No. S275121

# In the Supreme Court of the State of California

PETER QUACH,

*Plaintiff-Appellant,*

v.

CALIFORNIA COMMERCE CLUB, INC.,

*Defendant-Appellee.*

Second Appellate District, Case No. B310458
Los Angeles County Superior Court, Case No. 19STCV42445
The Honorable Michael L. Stern, Judge

## APPELLANT'S REPLY BRIEF ON THE MERITS

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## INTRODUCTION

*Morgan v. Sundance, Inc.* (U.S. May 23, 2022) __ U.S. __ [142 S.Ct. 1708, 212 L.Ed.2d 753] corrected a fifty-four-year-old legal error in federal courts regarding the policy of the Federal Arbitration Act ("FAA") and the application of arbitration-specific rules, including particularly the imposition of a prejudice requirement for finding that a party has waived its contractual right to arbitration. In doing so, *Morgan* overturned a federal case that is at the origin of California's own use of an arbitration-specific prejudice requirement for waiver. (See *id.* at 1713 (overturning *Carcich v. Rederi A/B Nordie* (2d Cir. 1968) 389 F.2d 696).) Just as importantly, *Morgan* also clarified and reiterated that neither the text of the FAA nor the federal "policy favoring arbitration" authorize the creation of "novel rules to favor arbitration over litigation." (*Id.*) On the contrary, "[t]he policy is to make 'arbitration agreements as enforceable as other contracts, but not more so.'" (*Id.* (quoting *Prima Paint Corp. v. Flood & Conklin Mfg. Co.* (1967) 388 U.S. 395, 404 n.12).)

With its Answer, Defendant-Appellee California Commerce Club, Inc. ("Commerce") wants to pretend that *Morgan* has no bearing whatsoever on California courts. Commerce argues that California courts need not contend with *Morgan* and may continue imposing an arbitration-specific prejudice requirement for a finding of waiver in all cases because California is free to apply its own procedural rules in arbitration matters. There are, however, two fatal flaws with Commerce's argument: (i) California courts are not authorized by the statute of either the FAA or the

California Arbitration Act ("CAA") to fabricate arbitration-specific rules of waiver and (ii) no procedural rule can undermine the judicial policy embodied in a relevant statute.

As for the first flaw, Commerce simply ignores it and never even tries to find statutory support for the continued use of a prejudice requirement. Instead, Commerce proceeds as if the law regarding arbitration were a matter of common law, rather than being "wholly a creature of statute." (*Cable Connection, Inc. v. DIRECTV, Inc.* (2008) 44 Cal.4th 1334, 1375.) But without statutory authorization, courts are not at liberty to create and apply an arbitration-specific rule of waiver, regardless of whether that rule is classified as substantive or procedural.

As for the second flaw, Commerce attempts to avoid it by exploiting a purported distinction between federal policy regarding arbitration as expressed in *Morgan* and California's policy as expressed in *St. Agnes Medical Center v. PacifiCare of California* (2003) 31 Cal.4th 1187. Commerce suggests that, whatever the federal policy may be, California still has a "policy favoring arbitration" that authorizes the arbitration-specific prejudice requirement. But closer examination of the case law and history confirms that California's policy is the same as the federal policy and, as result, "*under both federal and California law*, arbitration agreements are valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract." (*Armendariz v. Found. Health Psychcare Servs., Inc.* (2000) 24 Cal.4th 83, 98 (emphasis added).)

California state courts are already grappling with the implications of *Morgan* for California's own use of a prejudice requirement and finding, at least in cases governed by the FAA, that the rule must be abandoned in favor of the ordinary contract rule. (See, e.g., *Davis v. Sheikh Shoes, LLC* (2022) 84 Cal.App.5th 956 [300 Cal.Rptr.3d 787, 795].) It is only a matter of time before California courts similarly contend with the implications of *Morgan* for arbitration agreements that either lack a clear FAA choice-of-law provision (as is the case here) or fall under the CAA. Such issues will be challenging and, if clear guidance is not provided now, likely throw California Courts of Appeal into conflict. Commerce would have this Court ignore this opportunity to correct a long-standing error and ward off the impending confusion. Instead, Mr. Quach asks that this Court reverse the judgment of the Court of Appeal and state clearly that, under both the FAA and the CAA, California courts are to apply ordinary contract principles, including those of waiver, when determining whether a party has relinquished a contractual right to arbitrate.

## ARGUMENT

### I. *Morgan*'s Bar on Bespoke Rules for Arbitration Requires California Courts to Cease Imposing a Prejudice Requirement for Waiver of the Contractual Right to Arbitrate under the FAA.

The central issue in *Morgan* was whether courts "may create arbitration-specific variants of federal procedural rules, like those concerning waiver, based on the FAA's 'policy favoring arbitration.'" (*Morgan*, *supra*, 142 S.Ct. at p. 1712.) In a

unanimous decision, the Court's answer to the question was "[t]hey cannot." (*Id.*) *Morgan*, therefore, set forth an interpretation of both the text of the FAA and federal policy regarding arbitration that California courts must follow when adjudicating cases arising under the FAA.

By using "the terminology of waiver" in framing the question before it, *Morgan* follows the lead of federal and state courts that have used the term "waiver" in the context of arbitration to mean the loss of the contractual right of arbitrate through any ordinary contract principle such as "waiver, forfeiture, estoppel, laches, or procedural timeliness." (*Id.* at p. 1713; *accord St. Agnes*, *supra*, 31 Cal. 4th at p. 1195 n.4 ("[t]he term 'waiver' has also been used as a shorthand statement for the conclusion that a contractual right to arbitration has been lost.") Appellant does the same here. So, while the arguments in this briefing, as in *Morgan*, have focused on the grafting of a prejudice requirement onto the ordinary contract principle of waiver, neither the holding in *Morgan* nor Appellant's argument is so limited. On the contrary, *Morgan* applies to any "ordinary procedural rule" which may provide a framework for determining whether a party has lost its contractual right to arbitrate. (*Morgan, supra*, 142 S.Ct. at p. 1713.) In short, *Morgan* concludes that neither the text of the FAA nor the federal policy on arbitration authorize courts "to invent special, arbitration-preferring procedural rules." (*Id.*)

Commerce, however, wishes to avoid the consequences of *Morgan* and simply pretends that *Morgan* has no relevance whatsoever for California courts under any circumstances. (See

Ans. at pp. 22–27.) Commerce defends this position by distinguishing between the substantive and procedural aspects of federal and state law on arbitration. Commerce asserts that, because California courts are free to apply their own procedural rules in cases arising under the FAA, *Morgan* does not disturb the use of a prejudice requirement in state courts adjudicating claims of waiver under the FAA. However, although California courts can apply California Code of Civil Procedure Section 1218.2 in cases governed by the FAA, they are not free to make up whatever procedural rules they wish.

On the contrary, "arbitration in this state has long ago ceased to be governed by common law and is now wholly a creature of statute." (*Cable Connection*, *supra*, 44 Cal.4th at p. 1375.) Accordingly, the fabrication and implementation of any procedural rule by California courts must be authorized by the relevant statute. Furthermore, California's procedural rules for arbitration may be applied only to the extent that the "California procedure for deciding motions to compel [arbitration] serves to further, rather than defeat, full and uniform effectuation of the federal law's objectives." (*Rosenthal v. Great W. Fin. Sec. Corp.* (1996) 14 Cal.4th 394, 410.)

According to *Morgan*, neither the text of the FAA nor the FAA's "policy favoring arbitration" provide courts, including California courts, with the authority to fabricate arbitration-specific rules, including specifically (but not exclusively) a rule that "condition[s] a waiver of the right to arbitrate on a showing of prejudice." (*Morgan*, *supra*, 142 S. Ct. at p. 1713.)

### A. The text of the FAA bars the creation of bespoke procedural rules for arbitration.

*Morgan* held that "the text of the FAA makes clear that courts are not to create arbitration-specific rules" like the requirement that a delay in seeking to compel arbitration results in prejudice to the opposing party before a finding of waiver can be made. (*Id.* at p. 1714.) The federal statute "is a bar on using custom-made rules, to tilt the playing field in favor of (or against) arbitration." (*Id.*)

Commerce attempts to avoid *Morgan* and the FAA by adopting a stance that directly contradicts its original position in the trial court below. The arbitration agreement at issue in this case does not have an express choice of law provision designating California law generally, nor does it specify whether the arbitration agreement is governed by the FAA or the CAA. (AA83–84.) Given these ambiguities, Commerce argued below that the agreement "is governed by the FAA" and that "Code of Civil Procedure section 1281.2 should not be applicable and federal law applies." (AA47–48.) Consistent with its original argument below, Commerce also argued for the application of the federal rule of waiver, including its requirement of prejudice, in this case. (See AA50 (citing *Newirth v. Aegis Senior Communities, LLC* (9th Cir. 2019) 931 F.3d 935, 944).) Now, however, Commerce argues that California procedures apply. (See Ans. at pp. 26–27.)

Commerce has changed its position in order to argue that California courts are free to apply their own procedural rules for enforcement of arbitration contracts and, because *Morgan* characterizes the bespoke rules regarding waiver as "procedural,"

California courts can, therefore, apply their own arbitration-specific rules for waiver, regardless of the holding in *Morgan*. (See Ans. at pp. 23–27.) But the application of California Code of Civil Procedure section 1281.2 does not shield Commerce or California courts deciding cases under the FAA from the legal consequences of *Morgan*.

California's procedural statute for arbitration provides that a court shall grant a petition to compel arbitration unless, among other things "the right to compel arbitration has been waived by the petitioner." (Code Civ. Proc. § 1281.2, subd. (a).) However, the California statute does not define "waiver." It has "long been the rule of California" that "when a word used in a statute has a well-established *legal* meaning, it will be given that meaning in construing the statute." (*Arnett v. Dal Cielo* (1996) 14 Cal.4th 4, 19 (citing *Harris v. Reynolds* (1859) 13 Cal. 514, 518) (emphasis in the original).) The statute, therefore, directs courts to apply the ordinary common law rule regarding waiver.

In cases governed by the FAA, this interpretation harmonizes with the text of the FAA itself. Section 2 of the FAA instructs that arbitration agreements shall be enforced "save upon such grounds as exist at law or in equity for the revocation of any contract." (9 U.S.C. § 2.) Under Section 2, therefore, "a state court may refuse to enforce an arbitration agreement based on 'generally applicable contract defenses.'" (*Little v. Auto Stiegler, Inc.* (2003) 29 Cal.4th 1064, 1079 (quoting *Doctor's Associates Inc. v. Casarotto* (1996) 517 U.S. 681, 687).) Given this plain directive of Section 2, the Supreme Courts of both the United States and California have

recognized, well before *Morgan*, that "state laws invalidating arbitration agreements on grounds applicable only to arbitration provisions contravene the policy of enforceability established by section 2 of the FAA, and are therefore preempted." (*Cable Connection, supra*, 44 Cal.4th at p. 1351 (citing *Doctor's Associates, supra*, 517 U.S. at pp. 686–88).) Following *Morgan*, the specific consequences of Section 2 for state courts deciding whether a party has waived the contractual right of arbitration under the FAA are clear: the text of the FAA bars California state courts from applying an arbitration-specific prejudice requirement for waiver in cases governed by the FAA.

### B. Federal policy regarding arbitration preempts the imposition of a prejudice requirement by California courts adjudicating motions to compel arbitration under the FAA.

*Morgan* further clarifies that "the FAA's 'policy favoring arbitration' does not authorize federal courts to invent special, arbitration-preferring procedural rules," either. (*Morgan, supra*, 142 S.Ct. at p. 1713.) While the holding in *Morgan* may technically be limited to federal courts, *Morgan*'s finding that the FAA's "policy favoring arbitration" does not authorize courts to impose "special arbitration-preferring procedural rules" remains relevant authority for California courts applying California's own procedures in cases arising under the FAA.

Both this Court and the U.S. Supreme Court have plainly stated that California may apply its own procedural rules in FAA cases only so long as doing so "would not undermine the goals and policies of, and is not preempted by, the FAA in a case where the

parties have agreed that their arbitration agreement will be governed by the law of California." (*Cronus Investments, Inc. v. Concierge Services* (2005) 35 Cal. 4th 376, 386 (*citing Volt Information Sciences, Inc. v. Board of Trustees of Leland Stanford Junior University* (1989) 489 U.S. 468, 477–479 (stating that the application of Code Civ. Proc. § 1281.2 must not "undermine the goals and policies of the FAA."); see also *Rosenthal*, *supra*, 14 Cal.4th at p. 410 ("Because the California procedure for deciding motions to compel serves to further, rather than defeat, full and uniform effectuation of the federal law's objectives, the California law, rather than section 4 of the USAA, is to be followed in California courts.").) Contrary to Commerce's suggestion otherwise, the relevant policy for cases under the FAA is the *federal* policy. (See Ans. at p. 35.) California's policy, whatever it might be, is irrelevant in such cases. For cases arising under the FAA, therefore, California's use of its own procedural rules remains constrained by the federal policy, and any state procedural rule that contravenes the federal policy embodied in the FAA is preempted. (*Id.*)

As *Morgan* reiterated, the federal policy "favoring" arbitration "is merely an acknowledgment of the FAA's commitment to overrule the judiciary's longstanding refusal to enforce agreements to arbitrate and to place such agreements upon the same footing as other contracts." (*Morgan*, *supra*, 142 S.Ct. at p. 1713 (quoting *Granite Rock Co. v. Teamsters* (2010) 561 U.S. 287, 302).) In *Morgan*'s words, "[t]he federal policy is about treating arbitration contracts like all others, not about fostering arbitration." (*Id.*)

Long before *Morgan*, this Court has recognized that the "FAA's purpose is not to provide special status for arbitration agreements, but only 'to make arbitration agreements as enforceable as other contracts, but not more so.'" (*Cronus*, *supra*, 35 Cal.4th at p. 384 (quoting *Prima Paint Corp.*, *supra*, 388 U.S. at 404 n.12).) Consequently, given the policy of the FAA, a California state court deciding whether a party has waived its contractual right to arbitrate runs afoul of this federal policy and triggers a preemption issue when the state court applies a standard for waiver that it would not apply to any other kind of contract. As interpreted by *Morgan* and other U.S. and California Supreme Court cases, the FAA preempts the application of a state procedural rule that treats arbitration agreements differently from any other contract, regardless of whether it treats arbitration more or less favorably. (See, e.g., *Rosenthal*, *supra*, 14 Cal. 4th at p. 408 ("[A] state procedural statute or rule that frustrated the effectuation of section 2's central policy would, where the federal law applied, be preempted by the USAA.").)

Implicitly recognizing that preemption would doom the prejudice requirement in cases under the FAA, Commerce simply denies the existence of any preemption problem. (Ans. at pp. 31–32.) Commerce asserts that "[t]he FAA only preempts contrary state laws that *disadvantage* the enforceability of arbitration agreements." (Ans. at p. 31 (Commerce's emphasis).) But this assertion relies on a one-sided reading of the federal policy that *Morgan* rejects when clarifying that the FAA prohibits "tilt[ing] the playing field in favor of (*or against*) arbitration." (*Morgan*,

*supra*, 142 S.Ct. at p. 1714 (emphasis added).) Moreover, in making its argument, Commerce tacitly admits that the prejudice requirement at issue here actually does favor arbitration and, therefore, contradicts the more balanced and historically accurate expression of federal policy endorsed by *Morgan*, *Granite Rock*, and other U.S. Supreme Court cases. (See *Morgan*, *supra*, 142 S.Ct. at pp. 1713–14 for citations.) The federal policy of the FAA, in short, preempts the use of an arbitration-specific prejudice requirement by California courts in cases arising under the FAA.

*Morgan*, therefore, sets forth an interpretation of the text of the FAA and federal policy regarding arbitration that prohibits courts, including California courts applying the FAA, from applying bespoke rules of waiver for arbitration, including specifically the imposition of a prejudice requirement that is not otherwise used for the waiver of any other contractual right.

### C. California Courts of Appeal are already deciding waiver arguments in FAA cases after *Morgan* and rejecting the prejudice requirement.

At least one California Court of Appeals has already decided this specific issue and has, in the process, rejected Commerce's argument that the application of California's procedural rules in FAA cases leaves California courts free to continue applying an arbitration-specific prejudice requirement. (See *Davis*, *supra*, 300 Cal.Rptr.3d 787.) In *Davis*, unlike the case here, the arbitration agreement had a choice-of-law provision that clearly specified that the FAA governed the contract. (See *id.* at p. 793.) Nevertheless, because the matter was being decided in state court, the court had to decide "whether the FAA or California law governs the inquiry

into whether Shiekh has waived its right to arbitration." (*Id.*) Both parties agreed and the Court of Appeal held that the FAA controlled the issue of waiver. (See *id.*)

Having decided that the federal rule of waiver governs, the court then considered what rule California courts should apply following the decision in *Morgan*. (See *id.*) The trial court below had relied on "the multi-factor test in *St. Agnes*." (*Id.* at p. 794.) The Court of Appeal found, and again the parties agreed, that "*Morgan* is controlling." (*Id.* at p. 795.) It concluded, therefore, *St. Agnes* notwithstanding, that "prejudice therefore is no longer required to demonstrate a waiver of one's right to arbitration, and the waiver inquiry should instead focus on the actions of the holder of that right." (*Id.*) The Court of Appeal found that the defendant had waived its contractual right to arbitrate because of its "lengthy delay in moving to compel arbitration." (*Id.* at p. 796.) Waiver was further supported, the Court of Appeal found, by the defendant's conduct, which was "inconsistent with its alleged intent to arbitrate," including, much like Commerce's conduct in this case, the defendant's participation in a case management conference, its demand for a trial, its estimate of the time of trial, and its participation in discovery after a trial date had been set. (*Id.* at p. 798.)

As *Davis* shows, California Courts of Appeal are already deciding whether a prejudice requirement for waiver still applies in FAA cases following *Morgan*. The decision in *Davis* was that it does not, which is in direct contrast with the position that Commerce takes here. This Court should affirm the approach in

*Davis* and reject Commerce's argument that California courts can still apply a prejudice requirement in cases controlled by the FAA. In doing so, this Court will provide much needed guidance to California's lower courts on a recurring issue that will otherwise be briefed repeatedly with possibly inconsistent results.

## II. Following *Morgan*, the Prejudice Requirement for Waiver of a Contractual Right to Arbitration Should be Overruled under both the FAA and the CAA.

Given the lack of authority under the FAA or the federal policy for the imposition of an arbitration-specific prejudice requirement for a finding of waiver arising from participation in litigation, this Court must overrule *Doers v. Golden Gate Bridge etc. Dist.* (1979) 23 Cal.3d 180, and its progeny, including *St. Agnes, supra*, 31 Cal. 4th 1187, and *Iskanian v. CLS Transportation Los Angeles, LLC* (2014) 59 Cal.4th 348, to the extent that these cases have established such a rule in California courts for cases arising under the FAA.

The question remains whether California courts should continue to apply an arbitration-specific requirement of prejudice for a finding of waiver from participation in litigation in cases arising under the CAA. While *Morgan*'s holding is not mandatory authority for California courts adjudicating cases under the CAA, the reasoning found in *Morgan* provides strong persuasive authority to California courts regarding the imposition of an arbitration-specific rule of waiver in CAA cases. In the same way that *Morgan* provided a much-needed corrective to courts regarding the import of the federal policy "favoring arbitration," a

similar reassessment of California's policy is required in this context. A review of the relevant statues and policy, particularly when considered in the appropriate historical context, establishes that there is no authority for courts to apply an arbitration-specific prejudice requirement for waiver in CAA cases. The articulation of such a rule in *Doers*, *St. Agnes*, and elsewhere should, therefore, be overruled.

### A. Neither the CAA nor California's policy authorizes the creation of an arbitration-specific rule of waiver.

As an initial matter, the text of the CAA does not provide the statutory authority to craft a rule of waiver unique to arbitration. As noted above, Section 1281.2 directs courts to enforce an arbitration agreement unless "the right to compel arbitration has been waived by the petitioner." (Code Civ. Proc. § 1281.2, subd. (a).) Since "waiver" is not defined, however, the term should be interpreted according to its "well-established legal meaning." (*Arnett*, *supra*, 14 Cal.4th at p. 19.) The statute, therefore, directs courts to apply the ordinary common law rules. This interpretation is consistent with the substantive provision of the CAA which, much like the FAA, states that written arbitration agreements are enforceable "save upon such grounds as exist for the revocation of any contract." (Code Civ. Proc. § 1281.) California courts have routinely noted the parallel language between 9 U.S.C. § 2 and Code Civ. Proc. § 1281 and have concluded therefrom that both statutes contain the same directive embodying the same policy. (See, e.g., *Armendariz*, *supra*, 24 Cal.4th at p. 97 ("[U]nder both federal and California law,

arbitration agreements are valid, irrevocable, and enforceable save upon such grounds as exist at law or in equity for revocation of any contract.").) Consequently, the statute itself only authorizes the enforcement of arbitration agreements on the same grounds as any other contractual agreement.

Presumably recognizing that the statutory text of the CAA provides no authority for creation of an arbitration-specific rule, Commerce argues that the prejudice requirement is justified by California's own policy "favoring arbitration." (Ans. at pp. 28–29.) In making this argument, Commerce ignores the fundamental fact that any policy must be rooted in the text of the statute itself because "arbitration in this state has long ago ceased to be governed by common law and is now wholly a creature of statute." (*Cable Connection*, *supra*, 44 Cal.4th at p. 1375.) Ignoring the statute altogether, Commerce relies upon the apparent difference between California and federal policy that has opened up in the wake of *Morgan*. This Court should now clarify that, as a careful review of the case law and history of the state and federal policy reveals, any purported distinction is, in fact, illusory.

As *Morgan* points out, the significance of the oft-repeated phrase "policy favoring arbitration" must be situated in the historical context of "the judiciary's longstanding refusal to enforce agreements to arbitrate." (*Morgan*, *supra*, 142 S.Ct. at p. 1713 (quoting *Granite Rock Co.*, *supra*, 561 U.S. at p. 302).) Indeed, "[a]rbitration has had a long and troubled history." (*Crofoot v. Blair Holdings Corp.* (1953) 119 Cal.App.2d 156, 183, disapproved of on another ground in *Posner v. Grunwald-Marx, Inc.* (1961) 56

Cal. 2d 169.) Since the eighteenth-century, English common law courts refused to enforce arbitration agreements under the so-called "ouster doctrine" under the theory that arbitrations "ousted" the jurisdiction of legally constituted courts. (See Richard C. Reuben, *Public Justice: Toward A State Action Theory of Alternative Dispute Resolution* (1997) 85 Cal. L. Rev. 577, 599–601.)

Judicial attitudes toward arbitration began to change, however, in the early twentieth century. (See *id.*) As early as 1917, in a case involving a motion to vacate and set aside an arbitration award, this Court stated that "it is the policy of the law to favor arbitration." (*Utah Const. Co. v. Western Pac. Ry. Co.* (1917) 174 Cal. 156, 159.) This change in attitude was codified and supported by federal and state legislation when the U.S. Congress enacted the FAA in 1925 and when California enacted its first modern arbitration statute two years later in 1927. (See generally *Keating v. Superior Court* (1982) 31 Cal.3d 584, 601.) From this point onwards, arbitration was "wholly a creature of statute," (*Cable Connection*, *supra*, 44 Cal.4th at p. 1375), and any "policy favoring arbitration" was rooted in the text of the relevant statute. (See, e.g., *Southland Corp. v. Keating* (1984) 465 U.S. 1, 10 ("In enacting § 2 of the federal Act, Congress declared a national policy favoring arbitration and withdrew the power of the states to require a judicial forum for the resolution of claims which the contracting parties agreed to resolve by arbitration.") As long as the historical context persisted in the active memory of the judiciary, the intent of the legislated policy remained clear. By

mid-century, this Court stated very clearly the original significance of the "policy favoring arbitration": "Once an award [of an arbitrator] regular on its face is established by satisfactory proof, a prima facie case is made, and every presumption is in favor of its validity." (*Franklin v. Nat C. Goldstone Agency* (1949) 33 Cal.2d 628, 630 (brackets in original).) In short, at its origin, the judicial policy favoring arbitration, marked a change in judicial policy towards enforcement arbitration awards.

Up through the 1960s, therefore, invocations of a "strong public policy" favoring arbitration appear primarily, if not exclusively, in cases involving the enforcement of arbitration awards. (See, e.g., *Hudson Lumber Co. v. U. S. Plywood Corp.* (1954) 124 Cal. App. 2d 527, 530 ("There is a strong public policy in favor of arbitration, of settling arbitrations speedily and with a minimum of court interference and of making the awards of arbitrators final and conclusive."); *Government Emp. Ins. Co. v. Brunner* (1961) 191 Cal.App.2d 334, 340 (same); *Lesser Towers, Inc. v. Roscoe-Ajax Const. Co.* (1969) 271 Cal.App.2d 675, 702 (same); see also *Federico v. Frick* (1970) 3 Cal.App.3d 872, 875–876; *Horn v. Gurewitz* (1968) 261 Cal.App.2d 255, 261.) As courts became several generations removed from the demise of the ouster doctrine, courts began to invoke the judicial policy favoring arbitration more loosely and often in the context of motions to compel arbitration. Most importantly, courts began invoking this "policy favoring arbitration" to justify the imposition of a prejudice requirement before finding that a party had waived a contractual

right to arbitration by participating in litigation. (See, e.g., *Carcich*, *supra*, 389 F.2d at p. 696.)

In California, the pivotal case in this respect is *Doers*, *supra*, 23 Cal.3d 180. In *Doers*, this Court took the unusual approach of adopting and issuing with slight modifications the opinion of the Court of Appeal as its own opinion. (See *id.* at pp. 182–83.) The Court had to decide if a party's contractual right to arbitration had been waived by initiating related litigation in federal court, where the merits had not been decided. (*Id.* at pp. 184–185.) The *Doers* court decided that no waiver had occurred and added in a footnote that it did not "preclude the possibility that a waiver could occur prior to a judgment on the merits if prejudice could be demonstrated." (*Id.* at p. 188 n.3.) In making its ruling, *Doers* expressly analogized its finding to the federal rule requiring prejudice in this context and cited *Carcich* for support, mentioning specifically *Carcich*'s invocation of a "national policy favoring arbitration." (*Id.* at pp. 188–89.)

As detailed in Quach's opening brief, and contrary to Commerce's assertion that Quach ignores this history, *Doers* is the origin of the prejudice requirement in California courts. (Compare Br. at p. 31 with Ans. at p. 33.) Prior to *Doers*, California courts did not impose the prejudice requirement when deciding if a party had waived its contractual right to arbitrate through delay and participation in litigation. (See, e.g., *Gunderson v. Superior Court* (1975) 46 Cal.App.3d 138, 142–145.) *Doers* is also the origin of California courts grounding the prejudice requirement in a California policy favoring arbitration. (See *Doers*, *supra*, 23 Cal.3d

at p. 189.) Tellingly, after *Doers*, courts would routinely use phrases such as "[a]rbitration is strongly favored," when imposing the prejudice requirement for a finding of waiver of the contractual right to arbitrate based on participation in litigation. (*Christensen v. Dewor Developments* (1983) 33 Cal.3d 778, 782 (quoting *Keating*, *supra*, 31 Cal.3d at pp. 604–05).) In such cases, the "policy favoring arbitration" would be invoked without any further discussion of the meaning of the phrase, the significance of the policy, or its historical context. (See, e.g., *id. passim*.) In this context, it became a catchphrase divorced from its original meaning.

However, California's policy on arbitration has not prevented California courts from consistently applying ordinary contract principles in contexts other than waiver. (See Br. at pp. 38–40.) California courts have remained sensitive to the limits of California's policy favoring arbitration and treated arbitration agreements the same as other contracts. In *OTO LLC v. Kho* (2019) 8 Cal.5th 111, for example, an opinion that post-dates *St. Agnes*, this Court applied the ordinary standard of unconscionability to an arbitration agreement, observing that the doctrine's "application to arbitration agreements must rely on the same principles that govern all contracts." (*Id.* at p. 125.) In *Armendariz*, *supra*, 24 Cal.4th 83, when also considering a defense of unconscionability, this Court observed that, "although we have spoken of a 'strong public policy of this state in favor of resolving disputes by arbitration,' Code of Civil Procedure section 1281 makes clear that an arbitration agreement is to be rescinded on

the same grounds as other contracts or contract terms." (*Id.* at pp. 126–127 (citations omitted).)

This Court's sensitivity to the limits of California's policy favoring arbitration is not limited to the defense of unconscionability either. In *Engalla v. Permanente Med. Grp., Inc.* (1997) 15 Cal.4th 951, for instance, the Court "consider[ed] the circumstances under which a court may deny a petition to compel arbitration because of the petitioner's fraud in inducing the arbitration agreement or waiver of the arbitration agreement." (*Id.* at p. 960.) The Court observed that fraud in the inducement is one of the ordinary grounds on which a contract can be rescinded (*id.* at p. 973 (citing Civil Code § 1689, subd. (b)(1)) and remanded to the Superior Court for resolution under the ordinary statutory standard (*id.* at p. 982.) Similarly, in *Wagner Construction Co. v. Pac. Mech. Corp.* (2007) 41 Cal.4th 19, the Court observed that a motion to compel arbitration may be denied where a party has failed to "demand arbitration within a reasonable time" as required by "the general principle of contract law articulated in Civil Code section 1657." (*Id.* at p. 30.)

When considering any defense other than the waiver of the contractual right of arbitration from participation in litigation, therefore, California courts regularly recognize, as does *Morgan*, that under the applicable statutory schemes "arbitration agreements are neither favored nor disfavored, but simply placed on an equal footing with other contracts." (*Armendariz*, *supra*, 24 Cal.4th at p. 127.) Commerce has offered no argument, apart from its general reliance on California's "policy favoring arbitration," for

why the waiver context should be treated any differently from any other contractual defense. But, as a thorough examination of that policy shows, California's policy does not justify an arbitration-specific rule that would treat arbitration agreements more or less favorably than any other contract.

In sum, as with the federal statute and policy reviewed by *Morgan*, neither the text of the CAA nor California's policy regarding arbitration authorizes an arbitration-specific rule for waiver, including particularly the imposition of a prejudice requirement.

### B. Federal and California law on arbitration should remain harmonized, as they always have been.

In order to preserve the prejudice requirement, Commerce attempts to drive a wedge between federal and California law on arbitration. However, as demonstrated above (*supra* Section II.A), any apparent distinction arising from a comparison of *Morgan* and *St. Agnes* is illusory. As California courts have long recognized, "under California law, as under federal law, an arbitration agreement may only be invalidated for the same reasons as other contracts." (*Armendariz*, *supra*, 24 Cal.4th at p. 98.)

The practical consequences of this legal harmony are immense. In many cases, such as the one here, the arbitration agreement does not specify which statutory regime, the FAA or the CAA, governs the arbitration agreement. Courts frequently, avoid the difficult choice-of-law and preemption issues that would otherwise arise in such a situation on the basis that underlying rules and policy of the CAA and FAA are practically identical.

(See, e.g., *St. Agnes*, *supra*, 31 Cal.4th at p. 1194 ("Although the FAA generally preempts any contrary state law regarding the enforceability of arbitration agreements, the federal and state rules applicable in this case are very similar.") (citations omitted).) If, however, significant differences between the FAA and the CAA were to be found following *Morgan*, then serious preemption problems would emerge, and future Courts of Appeal would routinely be faced with a host of complex issues that would inevitably lead to inconsistent results and considerable appellate litigation. By clearly stating that there is no distinction between state and federal law regarding the use of ordinary contract principles when deciding whether a contractual right to arbitrate has been waived, this Court will not only remain on strong legal footing in adherence to a long-established policy, but it will also avoid a significant disruption in California law.

### C. At a minimum, this Court should clarify that *St. Agnes* does not articulate any test whatsoever for the relinquishment of the contractual right to arbitrate.

As set forth in Quach's opening brief and above, there is no authority under federal or state law for California courts to impose arbitration-specific rules regarding the relinquishment of a contractual right to arbitrate. Any prejudice requirement for waiver resulting from participation in litigation should, therefore, be generally overruled for both the FAA and the CAA. Instead, the ordinary standard for waiver of a contractual right, which does not include a prejudice inquiry, should be applied to all cases considering whether a party has waived its right to arbitrate

through participation in litigation or other conduct. (See Br. at pp. 32–34.) Furthermore, this Court should further clarify that the contractual right to arbitrate may be lost through any ordinary principle of California contract law, including, for example, forfeiture, estoppel, laches, bad faith, fraud, misconduct, or timeliness. (See *id.* at pp. 34–35.)

In doing so, this Court need not necessarily overrule *St. Agnes* in its entirety. But, at a minimum, this Court should clarify the scope and significance of *St. Agnes*, particularly in light of the way the *St. Agnes* opinion is used in the Court of Appeal opinion below and Commerce's Answer.

*St. Agnes* observed that the term "waiver" in the context of arbitration has served as "a shorthand statement for the conclusion that a contractual right to arbitration has been lost." (*St. Agnes*, *supra*, 31 Cal. 4th at p. 1195 n.4 (quotation omitted).)[1] For this reason, *St. Agnes* also correctly and clearly stated that "*no single test* delineates the nature of the conduct that will constitute a waiver of arbitration." (*Id.* at p. 1195 (emphasis added); see also *Davis v. Blue Cross of Northern California* (1979) 25 Cal.3d 418, 426 (same); *Engalla*, *supra*, 15 Cal.4th at p. 983 (same).) Nevertheless, despite this clear statement of legal fact in *St. Agnes*,

[1] Much like the use of phrase "strong policy favoring arbitration" discussed above, the use of "waiver" as a "shorthand" has caused substantial confusion in the case law for both courts and practitioners. While the use of shorthand is economical and unavoidable to a degree, it can, when left unchecked for too long, generate widespread legal error. This case presents one such instance, and this Court now has the opportunity to issue an opinion that can serve as a general corrective.

the Court of Appeal below was guided in its analysis by what it took to be "*St. Agnes*'s test." (*Quach v. California Commerce Club* (2022) 78 Cal.App.5th 470, 479.) The Court of Appeal here was not alone in doing so, as other Courts of Appeal have also begun applying a "*St. Agnes* test." (See, e.g., *Lewis v. Fletcher Jones Motor Cars, Inc.* (2012) 205 Cal.App.4th 436, 445 n.2 (referring to "the *St. Agnes* test"); *Brown v. Superior Court* (Ct. App. 2013) 157 Cal.Rptr.3d 779, 787, review granted and opinion superseded *sub nom Brown v. S.C.* (Cal. 2013) 161 Cal.Rptr.3d 699) (same).) Federal district courts have done so, too. (See, e.g., *Sequoia Benefits & Ins. Servs., LLC v. Constantini* (N.D. Cal. 2021) 553 F.Supp.3d 752, 758 (referring to "California's *St. Agnes* test.").) This Court should clarify that there is, in fact, "no single test," and *St. Agnes* did not create one.

*St. Agnes* does provide a list of six "factors" that it deems "relevant and properly considered in assessing waiver claims." (*St. Agnes*, *supra*, 31 Cal.4th at p. 1196.) But this list of factors, too, has often been misconstrued. This list of factors was taken from *Sobremonte v. Superior Court* (1998) 61 Cal.App.4th 980, 992, which in turn took them from an opinion issued by the U.S. Court of Appeals, *Peterson v. Shearson/American Exp., Inc.* (10th Cir. 1988) 849 F.2d 464, 467–68. Both *Sobremonte* and *Peterson* treated this list of factors as a multi-factor test. (See *Sobremonte*, *supra*, 61 Cal.App.4th at 992–998; *Peterson*, *supra*, 849 F.2d at 468.) In its Answer, Commerce, too, takes much the same approach and treats each of the *St. Agnes* factors as encapsulating the possible defenses to enforcing a contractual right to arbitrate,

such as forfeiture and estoppel. (See Ans. at pp. 36–37.) However, *St. Agnes*'s list of factors does not encompass every ordinary contract principle that might be applicable in a dispute over the enforcement of a contractual right to arbitration. Nevertheless, even if it was not *St. Agnes'*s intention to do so, courts and attorneys have taken to treating *St. Agnes*'s list of factors as a "test" for waiver. At a minimum, therefore, this Court should also clarify that the list of considerations in *St. Agnes* should not be taken as "factors" in a "multi-factor test," that the list is not an exhaustive list of the ordinary contract principles that may be available to litigants contesting a party's contractual right to arbitrate, and that the wording of the *St. Agnes* list does not articulate the actual standard for any such applicable contract principle.

*St. Agnes* further exacerbated the problems which this case now presents to this Court by referring to prejudice as the "critical" factor and the "determinative issue." (*St. Agnes*, *supra*, 31 Cal.4th at p. 1203.) As shown in Mr. Quach's opening brief and above, this declaration is without statutory justification and constitutes a legal error that must be corrected. Unfortunately, however, as both the Court of Appeal's opinion below and Commerce's Answer show, *St. Agnes*' emphasis on the prejudice "factor" has permeated all of the other "factors" to the point that considerations of prejudice can be difficult to eliminate from any of them when courts incorrectly chose to apply a "*St. Agnes* test." (See Ans. at pp. 38–39.) The Court must also clarify, therefore, that, in overruling the use of a prejudice requirement, this Court is also

barring the consideration of prejudice from any applicable contract principle, unless prejudice is otherwise an element of the standard for the generally applicable principle being applied.

### D. Stare decisis does not prevent this Court from overturning *St. Agnes*.

While overruling *St. Agnes* may not be required, the longevity of the arbitration-specific prejudice requirement for waiver is no impediment to this Court doing so. (See Ans. at p. 34.) The rule of stare decisis is "flexible," and it "should not shield court-created error from correction." (*Estate of Duke* (2015) 61 Cal.4th 871, 893 (citing *Freeman & Mills, Inc. v. Belcher Oil Co.* (1995) 11 Cal.4th 85, 93).) "[R]eexamination of precedent may become necessary when subsequent developments indicate an earlier decision was unsound." (*Moradi-Shalal v. Fireman's Fund Ins. Companies* (1988) 46 Cal.3d 287, 297.) Such reassessments are appropriate, for instance, when there has been "an intervening change[]" in federal law. (*Id.*) Moreover, the need for flexibility is particularly acute when "the error [in the prior opinion] is related to a matter of continuing concern to the community at large." (*Freeman*, *supra*, 11 Cal.4th at p. 93 (quotations and citations omitted, brackets in original).)

Here, *Morgan* constitutes a change in federal law overruling federal opinions starting with *Carcich* that impose "bespoke rule of waiver for arbitration" because those decisions were wrongly decided given the lack of authority for any such rule in the FAA. (*Morgan*, *supra*, 142 S.Ct. at p. 1713.) The *St. Agnes* decision follows a line of California state court opinions that impose the

same arbitration-specific prejudice requirement for waiver, based upon the same flawed legal reasoning corrected by *Morgan*, and in reliance on the same erroneous federal opinion already overruled by *Morgan*. (See Br. at p. 31.) *St. Agnes* has already generated unnecessary confusion in the trial and appellate courts and is likely to continue to do so without the intervention of this Court. Indeed, contrary to Commerce's position here, some California courts have already found that *Morgan* abrogates the application of a prejudice requirement. (See *Davis*, *supra*, 300 Cal.Rptr.3d at pp. 794-95.) Furthermore, no member of the public other than defendants who for tactical reasons seek to litigate for extended periods before invoking a known contractual right to arbitrate rely upon the *Doers* and *St. Agnes* prejudice requirement. On the contrary, it is a matter of "continuing concern" to all litigants that the error be corrected to prevent its tactical abuse. (*Freeman*, *supra*, 11 Cal.4th at p. 93.) Under these conditions, stare decisis does not prevent this Court from overturning the *Doers* line of cases.

## III. The Court of Appeal Decision Cannot Be Affirmed on Other Grounds.

Commerce argues that the decision from the Court of Appeal can be upheld, even without the prejudice requirement, because other grounds equally supported the decision. (Ans. at pp. 39–43.) This argument, however, fails to contend with the degree to which the prejudice requirement colored and informed every aspect of the Court of Appeal's findings below. There were, in fact, no grounds

supporting the Court of Appeal's decision which were not analyzed through the framework of prejudice.

Commerce carefully selects its quotations from the Court of Appeal in an effort to occlude the importance of prejudice to the court's analysis. For instance, Commerce asserts that the court held that Commerce Club's "litigation activities were insufficient to constitute waiver" and then proceeds to quote a passage wherein the court detailed its findings. (See Ans. at p. 40 (quoting *Quach*, *supra*, 78 Cal.App.5th at p. 479.) However, Commerce ends its quotation just before the next sentence in which the Court of Appeal concluded, based on the activities quoted by Commerce, that "Quach has not shown any prejudice apart from the expenditure of time and money on litigation." (*Quach*, *supra*, 78 Cal.App.5th at p. 479.) As this key omitted sentence shows, the Court of Appeal's entire analysis of Commerce's litigation conduct was motivated and determined by a search for factual support for a finding of prejudice.

Similarly, Commerce asserts that the Court of Appeal found its delay was not "unreasonable." (Ans. at p. 40.) However, the Court of Appeal reviewed the applicable case law and underlying facts surrounding the delay arguments for a "showing of *prejudice* and/or undue delay." (*Quach, supra*, 78 Cal.App.5th at p. 481 (emphasis added).) The centrality of prejudice to the Court of Appeal's analysis is set forth plainly and directly in the Court of Appeal's core holding where it stated, "we conclude Quach's showing of prejudice was inadequate as a matter of law, and he

therefore failed to meet his 'heavy burden' below." (*Id.* at p. 478 (quoting *Iskanian*, *supra*, 59 Cal.4th at p. 375.)

When the ordinary contract rule for waiver is applied to the facts of this case, there is more than sufficient factual support for a finding of waiver. (See Br. at pp. 41–46.) Under ordinary contract law, waiver requires "an existing right, the waiving party's knowledge of that right, and the party's 'actual intention to relinquish the right,'" which intention may be implied "based on conduct that is 'so inconsistent with an intent to enforce the right as to induce a reasonable belief that such right has been relinquished.'" (*Lynch v. California Coastal Com.* (2017) 3 Cal.5th 470, 475 (quoting *Savaglio v. Wal-Mart Stores, Inc.* (2007) 149 Cal.App.4th 588, 598).) Commerce undeniably knew of its right to arbitrate when it produced the signature page to Mr. Quach's arbitration agreement (AA112) and when it asserted arbitration as an affirmative defense in its answer (AA031).

Despite this clear knowledge, Commerce took multiple actions over the next thirteen months which were inconsistent with any intent to exercise that right and in direct conflict with its own adhesion contract. Three months after the complaint in this case was filed, Commerce filed a case management conference statement in which it (i) chose *not* to check the box for "[b]inding private arbitration," (ii) asked for a 7-14 day jury trial, and (iii) did not list a motion to compel arbitration among the motions it expected to file before trial. (AR012–13.) Commerce then proceeded to post its own jury fees (AR019) and engaged in extensive discovery under the California Code of Civil Procedure,

including a deposition of Mr. Quach (AA105–08). In seeking a jury trial, Commerce took concrete actions which directly contradict its own adhesion contract which expressly states that each party "hereby waives his/her/its right to a trial by jury." (AA083.)

With these actions, Commerce took multiple steps that demonstrate a conscious, deliberate, and sustained repudiation of the terms of its own adhesion contract. However, because of its focus on "prejudice," the Court of Appeal below did not take into account these highly relevant facts. (See *Quach*, *supra*, 78 Cal.App.5th 470, *passim*.) But under the ordinary rule of contractual waiver, Commerce's conduct is "so inconsistent with an intent to enforce the right as to induce a reasonable belief that such right has been relinquished." (*Lynch*, *supra*, 3 Cal.5th at p. 475.) These facts are sufficient, therefore, to support a finding of waiver under the ordinary rule. (See *Davis, supra*, 300 Cal.Rptr.3d at pp. 796–99.)

## IV. If Remanded, the Trial Court Should Also Consider Mr. Quach's Unconscionability Defense.

Contrary to Commerce's suggestion, Mr. Quach is not asking for a substantive review of the Court of Appeal's decision regarding Mr. Quach's unconscionability arguments. (See Ans. at p. 43.) Instead, Mr. Quach has requested that, if this Court declines to decide whether Commerce has, in fact, waived its contractual right to arbitration and instead remands the matter back to the trial court, this Court provide the Superior Court with the opportunity to decide the issue of unconscionability.

This Court "may consider all issues fairly embraced in the petition." (*People v. Perez* (2005) 35 Cal.4th 1219, 1228; see also Cal. Rules of Court, rules 8.516, subd. (a)(1) and 8.520, subd. (b)(3).) The Superior Court below did not reach the unconscionability argument raised by Mr. Quach against enforcement of the arbitration agreement in this case because the court found the agreement unenforceable due to Commerce's waiver of its contractual right to arbitrate. (AA158–59.) Nevertheless, in the unpublished portion of its opinion, the Court of Appeal proceeded to decide the unconscionability issue. (See *Quach*, *supra*, 78 Cal.App.5th at p. 485.) It was wrong to do so. (See *Sonic-Calabasas A, Inc. v Moreno* (2013) 57 Cal.4th 1109, 1171–72 (stating that an unconscionability defense should "be determined by the trial court in the first instance.").) This error is "fairly included" in the issue of what general rules or principles of contract law should be applied in the trial court and should be corrected upon any remand. (*Perez*, *supra*, 35 Cal.4th at p. 1228.)

## CONCLUSION

For the foregoing reasons, Mr. Quach respectfully requests that the Court reverse the judgment of the Court of Appeal, reinstate the judgment of the Superior Court denying Commerce's motion to compel arbitration, and remand to the Superior Court to proceed with Mr. Quach's lawsuit without further delay. Alternatively, Mr. Quach respectfully requests that the Court remand to the Superior Court for determination of each of Mr. Quach's defenses to enforcement of the arbitration agreement.

Dated: December 27, 2022

Respectfully submitted,

/s/ Nilay U. Vora

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CERTIFICATE OF COMPLIANCE

I certify that the foregoing APPELLANT'S REPLY BRIEF ON THE MERITS uses a 13-point Century Schoolbook font and contains 8,096 words.

Dated: December 27, 2022

Respectfully submitted,

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**CERTIFICATE OF SERVICE**

I certify that the foregoing APPELLANT'S OPENING BRIEF ON THE MERITS was electronically served on the following interested parties on December 27, 2022, in the manner described.

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**STATE OF CALIFORNIA**
Supreme Court of California

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