

# California Supreme Court Clarifies Review Of Arbitration Agreement Public Policy Challenges

In *Sheppard, Mullin, Richter & Hampton, LLP v. J-M Manufacturing Co., Inc.*, No. S232946 (Cal. 8/30/18), the California Supreme Court clarified the important analytical distinction between two types of arbitration-related public policy challenges. Challenges to a single contract provision are for arbitrators to decide, reviewable only for violation of a statutory public policy. But challenges to the entire contract are for the courts and can be based on public policies found in non-statutory sources. The decision both clarifies a source of confusion and makes clear a departure from the Federal Arbitration Act.

A law firm undertook a representation of J-M, without disclosing that the firm had long represented one of the opposing parties and without obtaining either client's informed consent. After the firm was disqualified, it sought to arbitrate its dispute with J-M regarding the firm's right to fees. J-M opposed arbitration, arguing that the entire engagement agreement (which included an arbitration clause) was against public policy due to the firm's violation of attorney-conflict rules. The parties disputed how courts must decide such illegality challenges in cases that might be subject to arbitration: Whether the public policy must be expressed in a statute or whether the public policy can have its roots in other bodies of law, such as the Rules of Professional Conduct. The Supreme Court held that the type of review depends on the type of challenge:

**Entire illegality.** When a party argues an entire contract (containing an arbitration clause) violates public policy, California courts must decide the issue before compelling arbitration. The court's analysis is the same as when a party makes such a challenge in the non-arbitration context. That is, courts can look to any *legal source* to determine a public policy violation—not merely to statutory expressions of public policy.

**Provision illegality.** The arbitrator must decide a party's challenge to a single contractual provision that does not implicate the arbitration clause. Like any other arbitral decision, the arbitrator's determination is not subject to ordinary judicial review for legal or factual errors. But a narrow public-policy exception to limited judicial review still allows an award to be vacated for violation of *statutory rights*. Unlike California law, the FAA treats both entire-illegality and provision-illegality challenges this way.

The Supreme Court held that the former standard applied to the case before it. J-M did not challenge just a single contract provision, but rather argued that the entire engagement—the subject of the agreement—was prohibited since the firm had not obtained informed consent to its conflict of interest. (In a separate update, we address the important attorney-ethics issues addressed in other portions of the Supreme Court's opinion.)

J-M was successfully represented by Kent Richland and Jeffrey Raskin of Greines, Martin, Stein & Richland LLP, which specializes in appeals, writs, and trial court consulting.

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