

# The Legal Intelligencer

THE OLDEST LAW JOURNAL IN THE UNITED STATES 1843-2011

PHILADELPHIA, MONDAY, AUGUST 15, 2011

VOL 244 • NO. 31

An **ALM** Publication

## LITIGATION

### Res Judicata, Collateral Estoppel and Arbitration: Part II

#### ADR

*Editor's note: second in a series.*

**BY ABRAHAM J. GAFNI**

*Special to the Legal*

The first of these articles, which appeared in *The Legal* on April 18, relating to res judicata (claim preclusion) and collateral estoppel (issue preclusion) focused principally on difficulties presented when claim preclusion is sought following an award in arbitration. The article concluded that “similar but perhaps more confusing issues are presented when dealing with collateral estoppel [issue preclusion] following arbitration.”

As has been noted, claim preclusion generally bars the re-litigation of claims that produced a final decision on the merits in an earlier proceeding, and such preclusion has been given effect in arbitration awards.

Courts, however, have been less forthcoming in precluding issues earlier decided by arbitrators. The relative informality of arbitration proceedings, the general incompleteness of the record, and the absence of a reasoned opinion that would fully reflect the basis and scope of the arbitrator's decision have caused courts to exercise considerable discretion in deciding whether to apply issue preclusion to arbitration awards. This hesitancy has been particularly apparent when courts harbor doubts as to the fairness of the proceeding because the parties have not had the opportunity to engage in the full discovery available in court litigation.

Perhaps the greatest of such concerns has been expressed with respect to preclusion being applied to a non-party to the original litigation, often called “offensive preclusion.” As a result, some writers have argued that issue preclusion should never be allowed based upon an arbitration award, while others have contended that such preclusion should be applied on



**ABRAHAM J. GAFNI**

*is a mediator/arbitrator with ADR Options and a professor at Villanova University School of Law.*

a case-by-case basis.

Nonetheless, in Pennsylvania, the general rule has been that issue preclusion applies, even as to arbitration awards, if:

1. The issue decided in the prior case is identical to one presented in the later case;
2. There was a final judgment on the merits;
3. The party against whom the preclusion applies was a party or in privity with a party in the prior case;
4. The party or person privy to the party against whom the doctrine is asserted had a full and fair opportunity to litigate the issue in the prior proceeding; and
5. The determination in the prior proceeding was essential to the judgment. (This final factor is not mentioned in all Pennsylvania cases.)

The argument in favor of “offensive preclusion” in particular cases has been that the party against whom it is to be imposed stood in a legal relationship to the original litigant either as a party or in privity with the original litigant; therefore, its interests had an opportunity to be presented in the prior proceeding. Determining whether such privity existed, however, has not always been easy.

Consider how these factors played out in *Catropa v. Carlton*, a simple automobile accident case reported in a May 25, 2010, opinion of the Pennsylvania Superior Court. In *Catropa*, the plaintiff was suing the defendant in a case where liability was uncontested. The defendant

had a \$50,000 liability policy issued by an insurance company. In addition, the plaintiff had an underinsured motorist (UIM) policy in the amount of \$50,000 with the same company.

According to the court, the parties proceeded initially with the UIM arbitration. The arbitrators, who were essentially being called upon only to determine the plaintiff's damages, entered an award in the amount of \$100,000. Because there was an underlying third-party policy of \$50,000, the insurance company received a credit of \$50,000 and the plaintiff was entitled to a net award of \$50,000 from her UIM policy.

The plaintiff then proceeded on the third-party claim and demanded \$50,000, the full amount in the defendant's liability policy. The plaintiff filed a motion for summary judgment contending that the insurance company was precluded from contesting the amount of this recovery based on the arbitrators' \$100,000 award in the UIM proceeding because it was the insurer with respect to both the third-party coverage of the defendant and the plaintiff's UIM coverage. She argued that preclusion should apply because the defendant was in privity with the insurance company in the UIM arbitration as they both had the same interest in opposing the amount of damages claimed by the plaintiff.

The insurance company objected to any preclusion in the third-party action that would bar it from contesting the amount of damages found by the arbitrators in the UIM claim. It asserted that the defendant was not in privity with it in the UIM arbitration.

The Superior Court agreed that preclusion should not apply because the only privity between the defendant and insurance company arose by reason of the policy issued to the defendant. Privities, however, could not be found as to matters arising from other insurance contracts, such as the plaintiff's UIM policy, particularly as the

defendant would have lacked standing to intervene in the UIM proceeding.

Most importantly, the court noted that there was not the requisite identification of interest between the defendant and the insurance company to support a finding of privity.

While it was true that the insurance company had an interest in minimizing the amount of the award to be received by the plaintiff, its interest in this regard applied only to the limits of its coverage under the two policies, or \$100,000.

The court demonstrated that there was not a true identity of interests between the defendant and the insurance company, by positing what would have happened had the arbitrators entered an award in the amount of \$120,000. Assuming privity between the defendant and insurance company, the plaintiff, presumably, could have precluded defendant from denying that plaintiff's total damages were, in fact, \$120,000; accordingly, the plaintiff could have demanded payment of \$20,000. from the defendant, representing the difference between the gross award and the total amount payable by the insurance company under its two insurance policies.

In short, the court found no privity because of a divergence of interests between the defendant and insurance company, as it "had no interest if the damages awarded exceeded \$100,000 while defendant had an interest in ensuring that the damages did not exceed this amount."

Of course, one can envision other situations in which issue preclusion arising out of an arbitration proceeding would be of even greater concern for the courts.

Consider, for example, an auto accident in which multiple plaintiffs bring separate actions for damages against a single defendant who denies negligence. The smallest of the cases requiring little discovery and involving but a few thousand dollars proceeds to compulsory arbitration, the defendant is found to have been negligent and a minimal award is entered against him. Traditional rules of preclusion might suggest that the other plaintiffs, with claims in the many thousands of dollars, might assert that the defendant should be precluded from denying negligence because he had lost on this issue following a full and fair opportunity to defend. Preclusion would probably be rejected, however, because the defendant had little incentive to defend the first action vigorously or to expend

significant funds in seeking to prove that he was not negligent.

Similarly, it would be unfair to apply preclusion if procedural opportunities such as the opportunity for full discovery and the opponent's obligation to present live witnesses were denied to the defendant.

Faced with a concern that they may be subject to unwanted preclusion, parties may wish to consider stipulating that while they have agreed to arbitration, it should have no preclusive effect in subsequent proceedings.

In New York, for example, a party was not barred by issue preclusion from bringing a claim under New York's supplementary underinsurance motorist (SUM) policy even though she had been awarded only \$25,000 in the underlying third-party arbitration. The SUM carrier's claim that the prior small arbitration award col-

---

*Some writers have argued that issue preclusion should never be allowed based upon an arbitration award, while others have contended that such preclusion should be applied on a case-by-case basis.*

---

laterally estopped the policyholder from pursuing a larger SUM claim was rejected. Although recognizing that collateral estoppel would apply to arbitration awards, the court noted that the plaintiff and the defendant in the underlying third-party case had limited the scope of their arbitration by stipulating in their arbitration agreement that the decision rendered by the arbitrator was to be conclusive "only as to the matters being adjudicated in said arbitrations pertaining to the parties present" and was to have no "collateral effect as to the same or similar issues in companion claims or actions arising out of the incident which

is the subject of said arbitration." (See the New York Supreme Court, Appellate Division opinion in *Matter of State Farm Insurance Co. v. Smith.*)

The court's decision in this regard tracked Section 84 (4) of the *Restatement of Judgments, Second*, which provides: "If the terms of an agreement to arbitrate limit the binding effect of the award in another jurisdiction or arbitration proceeding, the extent to which the award has conclusive effect is determined in accordance with that limitation."

As the comment to that section notes, "Such a limitation should normally be given effect under principles of contract law, for the parties are under no obligation to submit themselves to arbitration with broader effects than may be agreed upon." (See the 2005 Pennsylvania Commonwealth Court case *Frog Switch and Manufacturing Co. v. Pennsylvania Human Relations Commission.*)

Accordingly, parties contemplating arbitration who fear that the results might preclude the assertion of a claim or defense in the future — particularly if there may be future proceedings related to the incident or their relationship — may wish to consider the use of such limiting language that will restrict the reach of the arbitration to the award of the arbitrators alone and not to any collateral matters associated with it. •