Arbitration Agreements in California: Where Are We Now?

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California employers considering whether they should require their employees to participate in a mandatory arbitration program do not have an easy task. They must consider the benefits and risks of the arbitration process and the effect arbitration agreements may have on employee morale. Additionally, employers must consider the enforceability of arbitration agreements. The law regarding mandatory arbitration agreements for the employment relationship is unclear in certain areas. But there are some general principles employers should consider before implementing a mandatory arbitration program.

The implementation of a valid arbitration agreement requires consideration of two components. First, the agreement must define what types of claims may be submitted to arbitration. Second, the agreement must comport with standard California contract laws governing formation of a valid and enforceable agreement.

What Types of Claims Are Subject to Arbitration?

Generally speaking, nearly any claim arising out of an employment relationship can be submitted to arbitration by agreement. The submission of a claim to arbitration must be decided according to the laws specifically governing arbitration agreements. In California, these laws include the California Arbitration Act ("CAA") (Code of Civil Procedure section 1280 et seq.) and the Federal Arbitration Act ("FAA") (9 U.S.C. sections 1-14). These laws are virtually indistinguishable in purpose; however, the FAA trumps any state law directed specifically at arbitration if the state law is in conflict with the federal policy favoring arbitration. For example, the FAA has been held to preempt California Labor Code section 229, which specifically excludes from arbitration claims for unpaid wages.

Interestingly, state and federal law differ in terms of what claims may be included in the arbitration process. In 2000, the California Supreme Court decided Armendariz v. Foundation Health Psychcare Services, Inc. In Armendariz, the Court held that discrimination claims asserted pursuant to California's Fair Employment and Housing Act ("FEHA") may be subject to binding arbitration. This remains the law in California state courts today.

Federal law, on the other hand, currently is unclear as to the enforceability of agreements requiring arbitration of Title VII discrimination claims. The source of the conflict within the Ninth Circuit Court of Appeals concerns the validity of the Court's 1998 decision in Duffield v. Robert Stephens & Co. In Duffield, the Court held the Civil Rights Act of 1991 precluded mandatory arbitration of Title VII claims.

Duffield is under attack. In 2002, the Ninth Circuit decided EEOC v. Luce, Forward, Hamilton & Scripps. In that case, the Court announced that Duffield had been impliedly overruled by the United States Supreme Court in Circuit City Stores v. Adams. However, the Ninth Circuit later vacated the decision in Luce Forward and the case is pending rehearing en banc. Until the Ninth Circuit issues a decision after rehearing, federal law in this area will remain in doubt.

What About Contractual Considerations?

Both the CAA and FAA require that arbitration agreements satisfy the requirements for a valid contract under state law. Under California law, contracts must be "conscionable," supported by consideration, and executed absent fraud, duress, mistake and lack of capacity. With respect to the enforcement of arbitration agreements, unconscionability and lack of consideration are the most common problems.

In California, a contract is unconscionable when the manner in which it was negotiated (referred to as "procedural unconscionability") and the terms of the agreement (referred to as "substantive unconscionability") unfairly favor the drafting party, who is presumed to be in a superior bargaining
A contract to arbitrate is unenforceable under the doctrine of unconscionability where there is both procedural and substantive elements of unconscionability. Thus, even an agreement with indicia of substantive unconscionability will be enforced if procedural unconscionability cannot be established.

For an arbitration agreement to be valid, the employer also must give the employee “consideration” in exchange for the employee’s agreement to waive access to the courts. If the employee is a new hire, the provision of employment likely will serve as adequate consideration. Similarly, for contractual employees, a renewal or extension of the contract would be sufficient. For current employees not covered by a contract, it is unclear whether continued employment is sufficient consideration for the agreement. Giving an employee a raise, a bonus, or additional vacation days likely would satisfy this requirement.

The “Armendariz Factors”
In addition to the basic principles of contract law discussed above, employers in California also must ensure their arbitration agreements satisfy the requirements set forth by the California Supreme Court in Armendariz. In that case, the Court held agreements to arbitrate employment discrimination and other statutory claims must meet the following requirements to be enforceable under California law: (1) require neutral arbitrators; (2) allow for more than minimal discovery; (3) require a written decision by the arbitrator; (4) allow for all types of relief otherwise available in court; and (5) not require employees to pay either unreasonable costs or any arbitrators’ fees or expenses as a condition of access to the arbitration process.

In a later decision, Little v. Auto Stiegler, the Supreme Court extended Armendariz to common law claims for wrongful termination in violation of public policy. It remains undecided whether an agreement to arbitrate other common law claims (such as breach of implied contract) must satisfy Armendariz’s requirements. Armendariz left other questions open as well, such as what is “adequate” discovery, what fees may an employer share with the employee, and may an employer reserve certain claims for adjudication by a court, such as trade secret violations. Several courts of appeal have issued opinions after Armendariz, answering a few of these questions. However, the courts have not answered these questions consistently, and more Supreme Court guidance may be necessary.

Will the Legislature Ban Mandatory Arbitration of Employment Disputes?
On July 27, 2003, the Legislature sent AB 1715 to Governor Davis for signature. The bill seeks to invalidate agreements to arbitrate FEHA claims if such agreements are required as a condition of employment or continued employment. The bill also places the burden on an employer seeking to compel arbitration to prove that the employee signed the agreement knowingly and voluntarily.

AB 1715, should the Governor sign it, likely will be struck down under the FAA and United States Supreme Court precedent. As discussed above, the FAA preempts any state laws that are incompatible with the FAA’s purpose-to encourage arbitration. In Doctor’s Associates, Inc. v. Casarotto and Circuit City Stores v. Adams, the United States Supreme Court held that state courts may not invalidate arbitration agreements under state laws applicable only to arbitration provisions. AB 1715 certainly is a state law aimed only at arbitration agreements (and not contracts in general) and therefore probably will not survive a legal challenge.

Other Recent Developments in the Law
The Ninth Circuit has been active in the arbitration arena of late. Interestingly, several of the Court’s decisions involve the arbitration agreements utilized by Circuit City Stores.

For instance, in March 2002, the Ninth Circuit ruled in Circuit City Stores, Inc. v. Ahmed that the company could compel arbitration under its agreement because the agreement was not procedurally unconscionable. The employee was provided with a “meaningful opportunity” to opt out of the arbitration program and the terms of the agreement were clearly spelled out in written materials and a videotape presentation. Moreover, the employee was encouraged to consult an attorney before signing the agreement, and given 30 days to decide whether to participate in the program.

Just a few months later, in June 2002, the Ninth Circuit reached the same conclusion in Circuit City Stores, Inc. v. Najd. In that case, the Court held the employee was required to arbitrate his FEHA claims because the agreement was a valid contract and the employee failed to establish both procedural and substantive unconscionability.

In Ingle v. Circuit City Stores, Inc., a May 2003 decision, the Court distinguished its prior decisions in Ahmed and Najd on the basis that the plaintiff in Ingle did not have a meaningful opportunity to opt out of the arbitration agreement or any power to negotiate the terms of the agreement. These facts established procedural unconscionability. The Court then examined whether the agreement was so “one-sided” as to establish substantive conscionability. Based on various terms contained in the agreement, such as a provision prohibiting arbitrators from hearing claims as a class action and a provision allowing only the employer to modify or terminate the agreement, the Court determined the
agreement was in fact substantively unconscionable and on that basis held the entire agreement was unenforceable.

Most recently, in July 2003, the Court issued its decision in *Circuit City Stores, Inc. v. Mantor*. In that case, the Court determined that, unlike the plaintiffs in *Najd and Ahmed*, Mantor did not have a meaningful opportunity to opt out of the arbitration program. Mantor presented evidence establishing he was threatened into assenting to the agreement and based on this, the Court found the agreement to be procedurally unconscionable. Because the agreement at issue was virtually the same agreement the Court had evaluated in *Ingle* (which the Court found to be substantively unconscionable), both elements of unconscionability were established and the Court invalidated the agreement in its entirety.

As discussed above, we are awaiting a decision from the Court in *Luce Forward*, which should resolve whether arbitration agreements may include Title VII discrimination claims within their scope.

**Practical Considerations for Employers**

In considering whether to require arbitration of employment disputes, employers should evaluate the benefits and risks of arbitration. The advantages of arbitration generally include:

- the possibility of quicker and more efficient dispute resolution;
- some argue awards by arbitrators are lower than jury awards for comparable claims;
- arbitration usually is more simple procedurally and less expensive than going to court;
- compared to jurors, arbitrators are believed by some to be “expert” decision-makers who bring specific knowledge and experience to the table;
- arbitrators are not as easily swayed as juries by passionate arguments and sympathy;
- employers believe they may benefit from being “repeat players” before arbitrators;
- lower costs of litigation may mean lower employment practices liability insurance premiums; and
- access to a dispute resolution procedure such as arbitration can lower the risks of unionization.

On the other hand, some of the potential concerns surrounding binding arbitration include the following:

- lack of clarity regarding various legal issues, including whether employers must comply with the Older Workers’ Benefit Protection Act in implementing a mandatory arbitration program, the scope of an employer’s ability to bind the Equal Employment Opportunity Commission by an arbitration agreement, and the effect of arbitration agreements on class actions;
- easier access to arbitration may mean a proliferation of employee disputes over relatively minor matters that would not be heard in court;
- courts have given arbitrators virtually unfettered discretion to decide issues of law, including evidentiary rulings, without interference by the courts, and there are limited grounds for appealing arbitrators’ decisions; arbitrators are known to “split the baby,” appeasing both sides of a dispute by awarding part of the relief requested;
- arbitrators generally are not accountable to the electorate, the press, or anyone else;
- arbitrators’ records often are unknown; and
- defense costs of litigation in arbitration, while generally lower, may still be significant.

Employers considering implementing an arbitration program should analyze their history of employment disputes over a three to five-year period to decide whether the benefits of requiring arbitration outweigh the disadvantages and risks. The review should include the following:

- defense costs;
- number of lawsuits;
- number of settlements and settlement value;
- the cost of implementing the program, including administering the agreement
and cost of consideration for current employees; and

- the effect of implementation of the program on employee morale and public relations.

Because of the complexity of the legal issues surrounding mandatory arbitration programs, employers should consult with experienced employment counsel before implementing such a program.

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