Arbitration Agreement in Employee Handbook Enforceable, California Court of Appeal Rules

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An arbitration agreement contained in an employee handbook was not invalid simply because the employer could change the handbook in its discretion, the California Court of Appeal has ruled. Serpa v. California Surety Investigations, Inc., No. B237363 (Cal. Ct. App. Apr. 19, 2013). Reversing an order denying the employer's motion to compel arbitration, the Court held that the implied covenant of good faith and fair dealing limited the employer's right to alter the agreement unilaterally; thus, the agreement was not illusory or unconscionable for lack of mutuality, as the plaintiff argued.

Background
Valerie Serpa was a bail bond investigator for California Surety Investigations, Inc. ("CSI"). Serpa signed an Agreement to Arbitrate and an Acknowledgement of Receipt of Employee Handbook, which also contained CSI’s arbitration policy. The arbitration agreement referenced the arbitration policy in the handbook. Among other things, the arbitration agreement and policy required the parties to submit all employment-related disputes to binding arbitration; required both parties to pay their own attorney’s fees and CSI to pay all other litigation costs; and included a severability provision. The employer retained the right to modify the handbook in its discretion.

Serpa sued CSI for sexual harassment and employment discrimination in violation of the California Fair Employment and Housing Act (“FEHA”), and wrongful termination in violation of state public policy. CSI asked the trial court to compel arbitration based on the arbitration agreement and policy. The trial court denied the request. It found the arbitration agreement was unconscionable and was illusory because CSI could change the policy in the handbook at its discretion. CSI appealed.

Applicable Law
“California law, like federal law, favors enforcement of valid arbitration agreements.” Armendariz v. Foundation Health Psychcare Services, Inc., 24 Cal. 4th 83, 97 (Cal. 2000). Under California law, an arbitration agreement must be both procedurally and substantively unconscionable for it to be found invalid. When examining for procedural unconscionability, a court looks at two factors: oppression and surprise. Substantive unconscionability focuses on the actual terms of the agreement and evaluates whether they create an “overly harsh” or “one-sided” result. Substantive unconscionability occurs when an arbitration agreement is “one-sided” in favor of the employer without sufficient justification, for example, when “the employee’s claims against the employer, but not the employer’s claims against the employee, are subject to arbitration.” Little v. Auto Stiegler, Inc., 29 Cal. 4th 1064, 1072 (Cal. Ct. App. 2003).

California courts have determined that contracts offered to employees on a take-it-or-leave-it basis typically contain some aspects of procedural unconscionability. However, this adhesive aspect is not dispositive. Roman v. Superior Court, 172 Cal. App. 4th 1462, 1471 (Cal. Ct. App. 2009). When there is no other indication of oppression or surprise, “the degree of procedural unconscionability of an adhesion agreement is low, and the agreement will be enforceable unless the degree of substantive unconscionability is high.” Ajamian v. CantorCO2e, 203 Cal. App. 4th 771, 796 (Cal. Ct. App. 2012).

Arbitration Agreement Upheld
Serpa first argued that the arbitration agreement was procedurally unconscionable because it was presented on a take-it-or-leave-it basis. While the appellate court agreed that the agreement was adhesive in that Serpa had no opportunity to negotiate any of its terms, the Court found this was not dispositive.
Serpa then argued the arbitration agreement was substantively unconscionable because it was one-sided and lacked mutuality. The Court noted that, standing alone, the arbitration agreement was one-sided because it required Serpa to submit her claims to arbitration, but not CSI. However, the arbitration agreement’s incorporation of the arbitration policy salvaged it because the policy imposed a mutual obligation on the company and Serpa to arbitrate any dispute arising from her employment.

Serpa next asserted that, although the arbitration policy imposed a mutual obligation, the promise was illusory because CSI could amend the handbook in its discretion. The Court disagreed, finding that the argument failed to “recognize the fundamental limit on CSI’s ability to alter the arbitration agreement imposed by the covenant of good faith and fair dealing implied in every contract.” The implied covenant of good faith and fair dealing prevents a contracting party from unfairly frustrating the other party’s rights under the agreement, the Court said. It concluded the implied covenant of good faith and fair dealing limited CSI’s “authority to unilaterally modify the arbitration agreement and save[ed] that agreement from being illusory and thus unconscionable.”

In addition, Serpa contended the arbitration agreement required her to submit her dispute informally to CSI before arbitration and thus unfairly gave the company a “free peek” at her case. Far from finding the arbitration agreement unfairly gave CSI an advantage, the Court concluded that requiring the exhaustion of internal grievance procedures before arbitration commenced was “both reasonable and laudable.” However, the Court struck the attorney’s fee provision as it was inconsistent with California’s FEHA. Accordingly, the Court reversed the order denying CSI’s motion to compel arbitration.

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While California employers will continue to face challenges to arbitration agreements, Serpa debunks many common arguments against such agreements. Please contact the Jackson Lewis attorney with whom you regularly work if you have any questions about this or other workplace developments.