Employment Arbitration Agreements Are Legal Again - For Now At Least

09.26.2000

On August 25, 2000, the California Supreme Court issued a landmark decision in *Armendariz v. Foundation Health Psychcare Services, Inc.* upholding the right of employers to require employees to sign mandatory arbitration agreements as a condition of employment. Employers may now compel employees to agree to arbitrate all work-related disputes, including claims for discrimination and harassment, provided that the arbitration agreement meets certain tests of fairness and due process.

The Law Prior to *Armendariz*

Determining the legality of a mandatory pre-employment arbitration agreement in California has always been a rather tricky exercise, especially since 1998. That year, the Ninth Circuit Court of Appeals held in *Duffield v. Robertson Stephens & Co.* that a pre-employment agreement to arbitrate Title VII and FEHA claims was unenforceable. The *Duffield* court reasoned that the Civil Rights Act of 1991 was intended to preclude the compulsory arbitration of Title VII discrimination and harassment claims; accordingly, because California's FEHA was modeled after Title VII, California FEHA claims for discrimination and harassment similarly could not be subjected to compulsory arbitration.

Shortly after *Duffield*, the California Court of Appeal reached the opposite result in *24 Hour Fitness, Inc. v. Superior Court.* In *24 Hour Fitness*, the court upheld an arbitration agreement contained in an employee handbook. The *24 Hour Fitness* court specifically declined to follow *Duffield*, noting that (a) federal decisions are not binding in state courts, and (b) the anti-arbitration result mandated by *Duffield* was inconsistent with California's long-standing history in support of arbitration agreements.

Within days of the *24 Hour Fitness* decision, then-Governor Pete Wilson vetoed a proposed bill that would have banned mandatory arbitration of pre-employment disputes. Had it passed into law, Assembly Bill 574 would have made it an unlawful employment practice to request employees or potential employees to sign mandatory arbitration agreements. Violators of the law would have been liable for a civil penalty of $5,000 per violation.

Four months later, in February 1999, the California Court of Appeal changed course, and struck down an arbitration agreement in *Gonzalez v. Hughes Aircraft Employees Federal Credit Union*. The *Gonzalez* court ruled that the agreement, which imposed a 20-day statute of limitations and limited an aggrieved employee's discovery to 2 depositions, was an unconscionable contract of adhesion.

In March 1999, the California Supreme Court granted review in *Armendariz*, thus signaling the court's desire to clear-up the confusion among the lower courts, as well as the split between California state and federal courts.

The *Armendariz* Decision

In *Armendariz*, two employees filed a complaint for wrongful termination against their former employer. The employees alleged that they had been subjected to unlawful discrimination and harassment under California's FEHA. Both employees had previously signed a pre-employment agreement which compelled them to submit all employment-related disputes to arbitration. In response to the employees' lawsuit, the employer filed a motion to compel arbitration.

The trial court denied the employer's motion to compel arbitration, holding that the mandatory arbitration agreement was unconscionable and too one-sided. The agreement only required employees' claims to be arbitrated, not the employers' claims. In addition, the agreement required the employees to bear their *pro rata* costs associated with the arbitration. The agreement also limited damages, and denied any recovery of punitive damages or attorneys' fees. The California Court of Appeal reversed, concluding that, although certain provisions were unconscionable and void, the remainder of the agreement should be enforced.

Reiterating that California law "favors the enforcement of valid arbitration agreements," the California Supreme Court in *Armendariz* established a two-part framework:

With respect to *all* arbitration agreements, regardless of the types of claims being arbitrated, the agreement is valid and enforceable unless it is "unconscionable." An unconscionable pre-employment arbitration agreement is one that is (a) procedurally unfair due to unequal bargaining power, and (b) substantially unfair insofar as it results in overly harsh or one-sided results. The California Supreme Court gave little guidance on how to interpret this requirement, other than to say that a valid arbitration agreement must possess a "modicum of bilaterality." Presumably, that means if the employee is required to arbitrate her employment claims, so too is the employer. If the decision on the employee's claim is final and binding, so too must be the decision on the employer's claims. All pre-employment arbitration agreements must meet this test to be valid and enforceable.

In addition, if the pre-employment arbitration agreement seeks to compel arbitration of Title VII, FEHA or other statutory of civil rights claims, *Armendariz* requires that the agreement contain additional safeguards:

(1) *Does it provide for a neutral arbitrator? Armendariz* made clear that a neutral arbitrator is "essential to ensuring the integrity of the arbitration process."

(2) *Does it provide for more than minimal discovery? Armendariz* held that, to be valid, an arbitration agreement must provide employees with "discovery sufficient to adequately arbitrate their statutory claim, including access to essential documents and witnesses."

(3) *Does it require a written arbitration award?* According to *Armendariz*, an arbitrator in a FEHA case "must issue a written arbitration decision that will reveal, however briefly, the essential findings and conclusions on which the award is based."

(4) *Does it provide for all of the types of relief that would otherwise be available in court?* To be valid under *Armendariz*, the arbitration agreement cannot limit damages or preclude an award of punitive damages or attorneys' fees if the statute at issue explicitly authorizes such damages.

(5) *Does it require the employer to bear the expenses associated with access to the arbitration forum?* Where arbitration is being imposed by the employer, the *fees* associated with the arbitration must be borne 100% by the employer. The agreement can, however, require the employee to pay those costs that she would otherwise

have to incur if the case were pending in court (e.g., filing fees).

Considered against this framework, the California Supreme Court in *Armendariz* concluded that the employer's mandatory pre-employment arbitration agreement was unenforceable. The court concluded that it was unable to separate the valid provisions from the unconscionable ones without, in effect, re-writing the agreement. Accordingly, the motion to compel arbitration was denied, and the plaintiffs' FEHA and other claims were allowed to proceed in court.

Advice to Employers After *Armendariz*

While *Armendariz* leaves open many important questions, and raises still others, there are a few concrete guidelines employers can take from the decision.

First, recognize that *Armendariz* does not address arbitration agreements between employer and employee that arise *after* a dispute has arisen. Employers and employees are still free to decide between themselves, on whatever bases they choose, whether to submit a particular claim to arbitration after the dispute has arisen. *Armendariz* only applies to arbitration agreements which seek to compel arbitration before any dispute arises.

Second, if you do not currently have a mandatory arbitration policy, consider whether you should adopt one now. Numerous studies demonstrate that arbitration is advantageous to employers because it often reduces the costs of litigation, imposes some reasonable limitations on discovery, and, where awards are granted to plaintiffs, those awards are generally smaller than a court or jury verdict. This is especially true in counties such as San Francisco and Los Angeles where juries are generally more sympathetic to plaintiffs. In addition, arbitration generally achieves a resolution much faster than traditional litigation. For smaller disputes, however, arbitration can be relatively expensive, especially given that after *Armendariz* the employer is required to pay the arbitrator's hourly fees. A judge does not charge by the hour, whereas an arbitrator does. Moreover, some employers feel that, for political or moral reasons, it's not honorable to ask employees to give up their access to the court system. Other employers feel that the arbitration request offends some workers and destroys the "family atmosphere" some companies crave. Ultimately, this is a decision each employer must make, balancing the costs/benefits of either approach, the likely venue for a lawsuit against your company, and the impact, if any, on company culture. Consulting with experienced counsel can help you weigh these factors and determine whether an arbitration policy makes sense for your company.

Third, if you decide to adopt a pre-employment arbitration policy, make sure it complies with the requirements set forth in *Armendariz*. It must be balanced, and it must require the employer's and the employee's claims to be arbitrated. Choose JAMS, AAA or some other highly-regarded arbitration firm as your arbitrator. Do not artificially restrict the damages the arbitrator can award; in fact, state specifically that the remedies available in the arbitration shall be identical to those allowed at law. Make clear in your policy that discovery will be allowed consistent with, and on the same terms as, the specifications in the California Arbitration Act. All fees associated with the arbitration should be borne by the employer; however, your policy can require the aggrieved employee to pay reasonable filing and other administrative costs. In addition, your policy can remind employees that, at the conclusion of the arbitration, the arbitrator shall be entitled to award reasonable attorneys' fees to the prevailing party, consistent with applicable law. That should serve as a deterrent to the vexatious plaintiff who attempts to "run up" the arbitration bills, and hence the employer's expenses, by filing multiple discovery or other motions during the arbitration.

Fourth, if you decide to adopt an arbitration policy, and you plan to present it to current employees, you will need to give them some *new* consideration in exchange for their signature. We generally recommend that employers give some cash consideration to their employees for their signature. The courts generally do not question the amount of consideration, but they do look to see if some new consideration was exchanged.

Finally, regardless of what you decide, realize that you might have to re-visit your decision yet again. The legislature responded to the last court decision upholding arbitration (*24 Hour Fitness*) by passing a bill reversing the decision and outlawing pre-employment arbitration agreements (AB 574). That bill, which came from a Democratic legislature, was vetoed by our then-Republican Governor. Times have changed, and so too has the political landscape. Emboldened by a new Democratic Governor, our Democratic legislature may step forward with a new bill that seeks to erase, or at least modify, *Armendariz*. Stay tuned.

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