By Iris Weinmann

> ***"... rarely are these arbitration agreements voluntary. They are designed to create a slanted playing field – and they do."***

Mandatory arbitration: the wolf in sheep's clothing

Congress and President Bush recognize the unfairness of mandatory pre-dispute arbitration.

On November 2, 2002, President Bush signed into law a bill designed to protect the constitutional right to jury trial of certain persons recognized as needing special protections from pre- dispute arbitration provisions. Congress recognized, and the President apparently agreed, that mandatory pre-dispute arbitration provisions were not truly voluntary due to the inherent unequal bargaining power between the large companies desiring arbitration and those who had no choice but to accept arbitration if they wanted to maintain their livelihood. Under this new law, "arbitration may be used to settle [a] controversy only if after such controversy arises all parties to such controversy consent in writing to use arbitration to settle such controversy." 15 U.S.C. § 1226 (2003).

Who are these oppressed parties that need special protections to safeguard their constitutional right to jury trial? Automobile dealers.

Three months after the Motor Vehicle Franchise Contract Arbitration Fairness Act was enacted, the California Supreme Court issued its opinion in *Little v. Auto Stiegler, Inc*. dealing with the enforceability of mandatory arbitration provisions in the employment context. And therein lies the irony. Who was the employer in *Little* who took its fight to enforce a mandatory pre-dispute arbitration agreement all the way to the California Supreme Court? An automobile dealership.

The automobile dealers cried foul when auto manufacturers required pre-dispute arbitration agreements in their franchise agreements. Their voices (or those of their lobbyists) were heard, and a law was enacted requiring written, post-dispute consent before arbitration can be instituted. When the tables are turned, as in *Little*, and an automobile dealer imposes pre-dispute mandatory arbitration on its employees, arbitration is suddenly touted as the most efficient, fair and economical way to resolve disputes.

Until arbitration fairness laws are enacted to protect employees from a forced deprivation of their constitutional right to a jury trial, it is crucial for employment law practitioners to have at least a working knowledge of arbitration in order to effectively represent their clients.

This article will first discuss some of the recent developments in the field of arbitration, as it relates to employment issues. This overview will then be followed by a discussion of some practical issues to be aware of when representing an employee whom the employer claims is bound to mandatory binding arbitration.

Armendariz: **The California Supreme Court finds that FEHA claims may be subject to mandatory arbitration, but only if certain minimum requirements are satisfied.**

In August of 2000, the California Supreme Court issued its landmark decision regarding the enforceability of mandatory arbitration agreements in the employment context. *Armendariz v. Foundation Health Psychcare Services, Inc*., 24 Cal.4th 83, 99 Cal.Rptr.2d 745 (2000). In *Armendariz*, the Court was faced with the issue of whether an employee can be compelled to arbitrate discrimination claims brought under California's Fair Employment and Housing Act ("FEHA"). The Court found that such claims are subject to arbitration, but only if the employee's statutory rights can be vindicated in the arbitral forum. *Id.* at 90- 91, 99 Cal.Rptr.2d at 750. The Court reasoned that the rights created under FEHA are unwaivable, and that an arbitration agreement could not be enforced if such an agreement effectively waived the statutory rights created by FEHA. *Id.* at 101, 99 Cal.Rptr.2d at 758.

The Court delineated certain minimum requirements that must be met before an agreement to arbitrate FEHA claims will be upheld[1]: (1) There must be a neutral arbitrator. *Id.* at 103, 99 Cal.Rptr.2d at 759. (2) The remedies available under the statute may not be limited. Thus, an arbitration provision that precludes the recovery of punitive damages, attorney's fees, or other remedies otherwise available under FEHA, is unlawful. *Id.* at 103-104, 99 Cal.Rptr.2d at 759-760. (3) The parties must be given the opportunity to conduct adequate discovery, which includes access to essential documents and witnesses. *Id.* at 104, 99 Cal.Rptr.2d at 760. (4) The arbitrator must be required to issue a written arbitration award setting forth the essential findings and conclusions on which the arbitrator based the award. *Id.* at 106-107, 99 Cal.Rptr.2d at 762-763. (5) The employee cannot be required to bear any type of expense the employee would not be required to bear if the action were brought in court. Thus, the costs of paying for the arbitrator's time and the administrative costs associated with commencing arbitration must be borne by the employer. *Id.* at 110-111, 99 Cal.Rptr.2d at 765.

Little: **The California Supreme Court extends the minimum requirements of *Armendariz* to claims other than those brought under FEHA.**

As several post-*Armendariz* decisions make clear, the minimum requirements set forth in *Armendariz* are not limited solely to claims brought under FEHA. In *Mercuro v. Superior Court*, 96 Cal.App.4th 167, 116 Cal.Rptr.2d 671 (2002), the Court of Appeal examined the Supreme Court's reasons for concluding that arbitration of

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FEHA claims was subject to "particular scrutiny," and reasoned that under the Supreme Court's analysis, such scrutiny should be applied to enforce rights under *any* statute enacted for a public reason. *Id.* at 180, 116 Cal.Rptr.2d at 680. Finding that the two Labor Code sections at issue have a public purpose, the court concluded that the minimum requirements set forth in *Armendariz* applied to the employee's claims in the case before it. *Id. Accord*, *Fittante v. Palm Springs Motors, Inc.*, 105 Cal.App.4th 708, 715-716, 129 Cal.Rptr.2d 659, 665-666 (2003) (concluding that because Labor Code section 970 was enacted for a public reason and to vindicate a public policy, an arbitration agreement purporting to encompass a claim for violation of Labor Code section 970 must meet the minimum requirements set forth in *Armendariz*.)

The California Supreme Court recently had the opportunity to re- examine the types of arbitration provisions that are subject to the minimum requirements set forth in *Armendariz*. In *Little v. Auto Stiegler, Inc.*, 29 Cal.4th 1064, 130 Cal.Rptr.2d 892 (2003), the California Supreme Court was asked to consider, among other issues, whether *Armendariz*'s minimum requirements for arbitration of unwaivable statutory claims also apply to an employee's claim that he or she was terminated in violation of a fundamental public policy. The Court answered that question in the affirmative. It concluded that because a *Tameny* claim – named for the case that established the tort of wrongful termination in violation of public policy – necessarily involves a fundamental public policy, such a claim is unwaivable. Thus, the Court determined that "the *Armendariz* requirements are as appropriate to the arbitration of *Tameny* claims as to unwaivable statutory claims." *Id.* at 1076-1077, 130 Cal.Rptr.2d at 901- 902.[2]

Thus, when faced with a mandatory arbitration provision in a lawsuit involving statutory claims such as FEHA (or other unwaivable statutes) or involving claims arguably affecting fundamental public policy, the arbitration agreement should be carefully examined to determine whether it meets the minimum requirements set forth in *Armendariz*. If it does not, the employee should have grounds to invalidate the arbitration provision.

Additional issues to examine when an employer asserts that the employee is bound to arbitrate his or her claims.

•*Is there a written agreement to arbitrate, and did the employee sign it?*

Federal and state law governing the enforceability of arbitration agreements both specifically require that such agreements be in writing to be enforceable by a court. (9 U.S.C. § 2; Code Civ. Proc. § 1281.) Thus, oral agreements to arbitrate are clearly not enforceable.

It is less clear, however, whether an arbitration agreement imposed by the employer in writing but not signed by the employee is enforceable. In *Craig v. Brown & Root, Inc.*, 84 Cal.App.4th 416, 100 Cal.Rptr.2d 818 (2000), the employer instituted a mandatory, binding arbitration policy and mailed that policy to the employee's residence. Even though the employee did not sign a written agreement to arbitrate, and even though the employee disputed ever receiving the arbitration policy, the Court of Appeal nevertheless found that by continuing employment, the employee had manifested an intent to be bound by the arbitration provision. *Id.* at 420, 100 Cal.Rptr.2d at 820.

In reaching its decision that the employee had entered into an implied in fact agreement to arbitrate through her continued employment, the *Craig* court relied on *Asmus v. Pacific Bell*, 23 Cal.4th 1, 96 Cal.Rptr.2d 179 (2000), a California Supreme Court case dealing with an employer's right to unilaterally discontinue or modify an employment policy governing job security. In *Asmus,* the employer had instituted a policy guaranteeing job security to its management level employees. The employer chose to discontinue that policy. Thus, the issue before the California Supreme Court was whether an employer could unilaterally terminate a policy which requires employees to be retained so long as a specified condition does not occur, even though the specified condition has not occurred. The Court answered in the affirmative. *Asmus, supra*, at 5-6, 96 Cal.Rptr.2d at 181. The *Craig* court reasoned that if an employer could unilaterally terminate a policy despite an earlier promise not to do so absent the existence of a specified condition, it could likewise unilaterally implement an arbitration provision.

There is a big fallacy in the *Craig* court's reasoning: *Asmus* did not deal with the issue of whether an employer may unilaterally deprive an employee of a *constitutional right* simply by informing the employee that his or her constitutional rights will be waived if the employee maintains his or her employment, without the provision of any additional consideration and without the employee's written assent or at least written acknowledgment of receipt of such a term of employment. The *Asmus* court had been faced only with the issue of an employer's right to terminate a policy guaranteeing job security. Moreover, there was evidence in *Asmus* that the employees affected by the policy change had been given additional consideration in the form of expanded pension benefits if they chose to remain with the company despite the termination of the job security provision in their employment agreements.

Other courts have concluded that an employee must sign an arbitration agreement to be bound by it. In *Romo v. Y-3 Holdings, Inc.*, 87 Cal.App.4th 1153, 105 Cal.Rptr.2d 208 (2001), the Court of Appeal was faced with the issue of whether an employee who did not sign an arbitration agreement contained in an employee handbook was bound to that agreement. The employee handbook contained two areas for the employee to sign: one under the section labeled "Mutual Agreement to Arbitrate Claims" and one at the end of the handbook, labeled "Employee Acknowledgment." The acknowledgment at the end of the handbook made no mention of arbitration. The employee signed the employee acknowledgment, but not the agreement to arbitrate. Reasoning that the agreement to arbitrate was a separate and severable agreement which had not been signed by the employee, the court found that no agreement to arbitrate existed between the parties. *Id.* at 1159- 1160, 105 Cal.Rptr.2d at 212.

Cases outside the employment context may also be helpful to an employee who wished to dispute that he or she is

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bound by an arbitration provision that was never signed. For example, arbitration provisions contained in supplements to customer agreements which were not signed by the customer have been found to be unenforceable. *See, e.g., Badie v. Bank of America*, 67 Cal.App.4th 779, 79 Cal.Rptr.2d 273 (1998).

Employees who have not signed agreements to arbitrate should, as a preliminary matter, determine whether they have a viable argument under existing case law that the unsigned agreements are unenforceable.

•*If there is a written agreement to arbitrate, do general contract defenses such as unconscionability apply to render it unenforceable?*

Under both federal and state law, a written agreement to arbitrate an existing controversy is valid and enforceable, "save upon such grounds as exist for the revocation of any contract." (9 U.S.C. § 2; Code Civ. Proc. § 1281.) State law applicable to contracts in general determines whether a valid agreement to arbitrate exists. *Ferguson v. Countrywide Credit Industries, Inc*., 298 F.3d 778, 782 (9th Cir. 2002); *First Options of Chicago, Inc. v. Kaplan*, 514 U.S. 938, 944, 131 L.Ed.2d 985, 115 S.Ct. 1920 (1995).

Thus, "general contract defenses such as fraud, duress, or unconscionability, grounded in state contract law, may operate to invalidate arbitration agreements." *Doctor's Associates Inc. v. Casarotto*, 517 U.S. 681, 687, 134 L.Ed.2d 902, 116 S.Ct. 1652 (1996). The most common contract defense used to invalidate arbitration provisions in the employment context is the doctrine of unconscionability. This defense was recognized by the California Supreme Court in *Armendariz*, and numerous published cases both before and after *Armendariz* have focused on the types of provisions in arbitration agreements that may render them unconscionable.

The analysis of whether a contract term is unconscionable begins with an inquiry into whether the contract is one of adhesion. *Armendariz, supra*, at 113, 99 Cal.Rptr.2d at 766-767. If the contract is one of adhesion, the court must then determine whether "other factors are present which under established legal rules – legislative or judicial – operate to render it [unenforceable]." *Id., citing Graham v. Scissor-Tail, Inc.*, 28 Cal.3d 807, 820, 171 Cal.Rptr. 604, 611 (1981).

•*Is the arbitration agreement a contract of adhesion?*

A contract of adhesion is "a standardized contract, imposed and drafted by the party of superior bargaining strength, which relegates to the subscribing party only the opportunity to adhere to the contract or reject it." *Neal v. State Farm Ins. Co.*, 188 Cal. App.2d 690, 694, 10 Cal.Rptr. 781, 784 (1961). Where an employer imposes an arbitration provision upon an employee as a condition of employment, and the employee has no alternative but to accept it to get or keep the job, the agreement to arbitrate is adhesive. *Little, supra*, at 1071, 130 Cal.Rptr.2d at 898; *Armendariz, supra*, at 114-115, 99 Cal.Rptr.2d at 768. Most mandatory arbitration provisions in the employment context are, by their nature, adhesive.

•*Is the arbitration agreement procedurally and substantively unconscionable?*

Unconscionability has both a "procedural" and a "substantive" element. *Armendariz, supra*, at 114, 99 Cal.Rptr.2d at 767. *Kinney v. United Healthcare Services, Inc.*, 70 Cal.App.4th 1322, 1329, 83 Cal.Rptr.2d 348, 352 (1999). Both procedural and substantive unconscionability must be present in order for a court to exercise its discretion to refuse to enforce a contract, or clause thereof, under the doctrine of unconscionability. *Stirlen v. Supercuts, Inc.*, 51 Cal.App.4th 1519, 1533, 60 Cal.Rptr.2d 138, 145 (1997). Essentially, a sliding scale is invoked: "the more substantively oppressive the contract term, the less evidence of procedural unconscionability is required to come to the conclusion that the term is unenforceable, and vice versa." *Armendariz, supra*, at 114, 99 Cal.Rptr.2d at 767-768.

The procedural element focuses on oppression or surprise, due to unequal bargaining power, which precludes the weaker party from negotiating the terms of the contract. This involves an analysis similar to the one used to determine whether the contract is one of adhesion. *Kinney, supra*, at 1329, 83 Cal.Rptr.2d at 353; *Stirlen, supra*, at 1532, 60 Cal.Rptr.2d at 145. Procedural unconscionability is often found where an agreement to arbitrate is contained in an employment agreement presented to the employee on a take it or leave it basis. *See, e.g., Stirlen, supra*, at 1534, 60 Cal.Rptr.2d at 146; *Ferguson, supra*, at 784, *Ingle v. Circuit City Stores, Inc.*, 328 F.3d 1165 (9th Cir. 2003).

Recently, the Second District Court of Appeal found procedural unconscionability where the employer exerted economic pressure on an employee who had refused to sign a mandatory arbitration provision. *Mercuro, supra*, at 174-175, 116 Cal.Rptr.2d at 676. Under the threat of having his employment conditions made so intolerable that he would be forced to resign, and under the threat of being blackballed from the industry so that he would have difficulty finding alternate employment, the employee reluctantly signed the arbitration provision. The provision was held procedurally unconscionable. *Id. Cf., Ellis v. McKinnon Broadcasting Co.*, 18 Cal.App.4th 1796, 1804, 23 Cal.Rptr.2d 80, 84 (1993) (finding procedural unconscionability where an employee was presented with an employment contract two weeks after he had moved from Salinas to San Diego to accept employment based on oral representations regarding the terms and conditions of his employment).

The substantive aspect of unconscionability focuses on overly harsh or one-sided results. *Kinney, supra*, at 1330, 83 Cal.Rptr.2d at 353; *Stirlen, supra*, at 1532, 60 Cal.Rptr.2d at 145. The following are some examples of the types of provisions that may render an arbitration provision substantively unconscionable:

•*Lack of Mutuality*. Arbitration provisions that compel the employee to arbitrate the claims the employee is most likely to bring against the employer, but do not compel arbitration of the claims most

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likely to be asserted by the employer against the employee lack mutuality and are substantively unconscionable. *See, e.g., Armendariz, supra,* at 118, 99 Cal.Rptr.2d at 770; *Stirlen, supra,* at 1541-1542, 60 Cal.Rptr.2d at 151-152; *Mercuro, supra,* at 176, 116 Cal.Rptr.2d at 677; *Ferguson, supra,* at 785.

•*Limitation of Remedies.* Limitations on the types of remedies that an employee may obtain or caps on the amount of recoverable damages may render the agreement substantively unconscionable. *See, e.g., Kinney, supra,* at 1332, 83 Cal.Rptr.2d at 355; *Stirlen, supra,* at 1539- 1540, 60 Cal.Rptr.2d at 150; *Ingle, supra*.

•*Limitations on discovery. See, e.g., Kinney, supra,* at 1332, 83 Cal.Rptr.2d at 355; *Ferguson, supra,* at 786-787.

•*Requiring the employee to shoulder significant costs. See, e.g., Ingle, supra; O'Hare v. Municipal Resource Consultants*, 107 Cal.App.4th 267, 279-280, 132 Cal.Rptr.2d 116, 125-126 (2003).

•*Requiring venue in a location disadvantageous to the plaintiff. See, e.g., Pinedo v. Premium Tobacco Stores, Inc.,* 85 Cal.App.4th 774, 781, 102 Cal.Rptr.2d 435, 440 (2000).

•*Limited Appeal Rights*. A provision in the arbitration agreement that allows the employer to appeal if the arbitration award exceeds a certain amount is unconscionable. *See, e.g., Little, supra,* at 1071, 29 Cal.Rptr.2d at 897; *Saika v. Gold*, 49 Cal.App.4th 1074, 56 Cal.Rptr.2d 922 (1996).

These are just a few examples of the types of provisions courts have found substantively unconscionable. The terms of each arbitration agreement should be carefully scrutinized to determine whether any of its provisions are unfairly one-sided.

Beware the trap: a repudiation of the abitration agreement

When an employee files a lawsuit in superior court notwithstanding the existence of an arbitration provision, the employer may try to argue that the filing of the lawsuit constitutes a repudiation of the arbitration agreement. If the employer's argument is successful, the employee may find himself or herself without a forum in which to have his or her claims heard. In court, the employer will move for summary judgment seeking dismissal of the lawsuit because of the agreement to arbitrate. In the arbitral forum, the employer will contend that the employee repudiated the arbitration agreement by filing a lawsuit in court, and that the employee has therefore waived its right to arbitrate.

As harsh as this may seem, there is legal precedent for such an outcome. In *Martinez v. Scott Specialty Gases, Inc.,* 83 Cal.App.4th 1236, 100 Cal.Rptr.2d 403 (2000) and *24 Hour Fitness, Inc. v. Superior Court,* 66 Cal.App.4th 1199, 78 Cal.Rptr.2d 533 (1998), employees who had signed arbitration agreements filed lawsuits in superior court. In both cases, the employers notified the employees or their counsel of the existence of the arbitration agreements and advised them to submit their disputes to arbitration. In both cases, the employees communicated a refusal to arbitrate. The courts in both *24 Hour Fitness* and *Martinez* found that the employees had waived their right to arbitrate, and dismissed the employees' cases.

More recently, in non-employment cases, several appellate courts have found that suing on an arbitrable claim does not necessarily constitute a wavier of the right to arbitrate. In *Simms v. NPCK Enterprises, Inc.,* 134 Cal.Rptr.2d 557 (2003), a lawsuit involving the alleged breach of a commercial lease, the trial court found that the plaintiffs had waived their right to arbitrate by filing a lawsuit in superior court. The Court of Appeal reversed, finding that even though the plaintiffs filed suit, the suit also requested arbitration, and the defendants were on notice that the plaintiffs sought to arbitrate if they could not litigate. Thus, there was no waiver of the plaintiffs' right to arbitrate.

Kalai v. Gray, 109 Cal.App.4th 768, 135 Cal.Rptr.2d 449 (2003) involved an arbitration provision in a construction contract. The plaintiff's lawsuit in superior court was dismissed on summary judgment. The plaintiff's subsequent attempts to arbitrate were then refused, based on the defendant's objections that the plaintiff's claims had been summarily adjudicated against him in superior court. In reversing the trial court's finding that the plaintiff had waived his right to arbitrate, the court distinguished *24 Hour Fitness* on the grounds that the plaintiff in that case had expressly repudiated the arbitration agreement. The court also found *Martinez* unpersuasive. The court recognized the importance of allowing a plaintiff to challenge the enforceability of an arbitration agreement in court, and refused to support a rule that would require a plaintiff to risk forfeiting his or her entire action by challenging the enforceability of an arbitration provision.

Although filing suit to determine the enforceability of an arbitration provision should not constitute a waiver of the employee's right to arbitrate the claim if the arbitration provision is upheld, counsel must be aware that the defendant may try to argue otherwise. Therefore, plaintiff's counsel should take preventive steps to ensure that such argument is unsuccessful. One possible avenue is for the employee to seek declaratory relief finding with respect to the enforceability of the arbitration agreement, making clear in the complaint that if the court finds the arbitration provision to be enforceable, the employee fully intends to proceed in the arbitral forum.

Conclusion

Mandatory employment arbitration is a critical issue facing employment law practitioners and their clients today. While the courts discuss and examine arbitration "agreements" between employers and employees, the practical truth is that rarely are these arbitration agreements voluntary. They are designed to create a slanted playing field – and they do. Rarely will an employee risk losing a job or an offer of employment to preserve his or her right to a constitutional right to a jury. Until lawmakers decide that employees are as entitled to a level playing field as auto dealers, it is up to employment law practitioners to fight in the courts, as well as in the halls of Congress, to ensure that the rights that

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have been afforded employees are not expropriated by the wolf in sheep's clothing – mandatory arbitration.

Endnotes:

[1]The *Armendariz* Court also discussed the types of issues that could invalidate an arbitration agreement in *all* types of cases, not just those asserting FEHA or other statutory claims. The Court explained that an arbitration agreement could be invalidated if it is found to be unconscionable. The doctrine of unconscionability as it relates to arbitration provisions is discussed elsewhere in this article.

[2]The *Little* Court also had occasion to consider whether the United States Supreme Court's decision in *Green Tree Financial Corp. v. Randolph*, 531 U.S. 79, 148 L.Ed.2d 373, 121 S.Ct. 513 (2000) affected the cost sharing requirements set forth in *Armendariz*. The Court found that *Green Tree* did not affect *Armendariz's* approach to the issue of arbitration costs in the context of mandatory employment arbitration. *Little, supra,* at 1085, 130 Cal.Rptr.2d at 909. The Court reconfirmed that when an employer seeks to impose mandatory binding arbitration in the employment context, and when unwaivable rights are at issue, the employer must pay any types of costs unique to arbitration. *Id.*

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