ARBITRATING DISPUTES WITH EMPLOYEES:
Three 2011 Cases Refine Standards for Arbitration Agreements in California

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California may have more legal protections for employees than any other state. Many employers have decided that one of the ways to streamline the dispute resolution process and minimize possible legal exposure is to require all employees to arbitrate their disputes with them. The growing perception among employers is that experienced arbitrators can reach decisions more fairly and quickly than judges and juries, and that view may well be accurate.

Since 2000, when the California Supreme Court established the minimum requirements for predispute arbitration agreements with employees in the seminal case of *Armendariz v. Foundation Health Psych Care Services, Inc*., courts continue to define, and refine, the standards by which arbitration agreements can be enforceable in California. In *Armendariz*, the Supreme Court decided that, at a minimum, predispute employee arbitration agreements cannot limit the damages employees are otherwise entitled to receive, the arbitrator must be a neutral individual, the arbitration decision award must be set forth in writing and subject to minimal judicial review, and employees cannot be required to pay more in arbitration costs than they would incur if they file a complaint in court.

Like all contracts, the terms of an arbitration agreement cannot be *unconscionable*. An arbitration agreement is not enforceable if it is *both* procedurally and substantially unconscionable. A written agreement is *procedurally* unconscionable if it is "oppressive" or creates "surprise" due to unequal bargaining power, and is *substantively* unconscionable if it is "overly harsh" or "one-sided." Recent court decisions continue to explain how to know an unconscionable arbitration agreement "when one sees it!"

Zullo v. Superior Court – June 2011

A recent Court of Appeal decision entitled *Zullo v. Superior Court* reinforced the need to carefully follow the minimum arbitration requirements imposed by the Supreme Court in *Armendariz*. Ms. Zullo had worked as an account executive for Inland Valley Publishing Company and claimed that her direct supervisor discriminated against her because of her race and national origin and that she was fired because she complained about the discriminatory treatment. Zullo had signed an acknowledgement when she started to work at Inland that she received a copy of Inland's Employee Handbook. At page 54 of the 58-page Employee Handbook, an arbitration policy was stated that required arbitration of "any dispute arising out of the termination or alleged termination of any employee's employment . . . or any claim for discrimination or harassment arising out of any employee's employment . . . [which] shall be submitted to final and binding arbitration before a neutral arbitrator pursuant to the American Arbitration Association Employment Dispute Resolution

Rules, as may be amended from time to time (attached to this Handbook as Appendix A)." A procedure was described that mandated when and how an employee should make a request for arbitration and timely respond to the selection of the arbitrator and scheduling of the hearing.

Nevertheless, Zullo did not request arbitration, but filed a civil complaint in state court against her employer alleging wrongful termination. In turn, Inland filed a motion to compel arbitration pursuant to its policy in the Employee Handbook. The trial court granted the motion to compel arbitration, and Zullo appealed. But the Court of Appeal reversed and held Inland's arbitration policy was procedurally and substantively unconscionable. It was *procedurally* unconscionable because it imposed on employees, as a condition of employment, an arbitration policy without any opportunity to negotiate it. This conclusion is not unexpected as most employers institute such policies on a non-negotiable basis in order to require all employees to arbitrate their disputes. The Court also noted that the arbitration rules were not actually attached to the Employee Handbook and held that this "adds a bit to the procedural unconscionability" as it would be "oppressive" to require an employee to make an independent inquiry to locate the applicable rules in order to fully understand what the employee was about to sign. The Court also held despite the fact the AAA rules can easily be located on the AAA's website, few ever contend that the rules themselves are unfair.

The Court of Appeal also found that the arbitration policy was *substantively* unconscionable, that is, it was overly harsh or unjustifiably one-sided because it lacked "bilaterality." While employees had to arbitrate their claims against Inland, the policy did not expressly require Inland to also arbitrate its disputes with employees. The policy refers only to disputes "arising out of the termination," the very claims that are virtually certain to be filed against, but not by, the employer. Indeed, the language of the arbitration policy refers almost exclusively to what *employees* must do to maintain the right to pursue their claims without reference to what, if anything, employers are required to do. As the Supreme Court in *Armendariz* explained, arbitration agreements must contain a "modicum of bilaterality." Since the Court of Appeal determined that the arbitration policy lacked the required mutuality and it determined the policy was not enforceable.

AT&T Mobility – U.S. Supreme Court

The most significant recent arbitration decision came from the United States Supreme Court, which held that arbitration agreements subject to the Federal Arbitration Act ("FAA") could not be limited by state law. *AT&T Mobility, LLC v. Concepcion* in April 2011. AT&T's customer contracts required all disputes to be decided by arbitration and prevented pooling of claims either in a class action lawsuit or arbitration. The *AT&T* decision held that the FAA preempts California court decisions that banned class action waivers in arbitration agreements. Class actions have become increasingly common and have proved to be tremendously costly to businesses. Now, the United States Supreme Court has clearly established that businesses may require consumers to pursue claims against businesses only in an arbitration forum and without the right to pool claims with other similarly injured consumers in a class action.

While *AT&T* involved arbitration agreements with consumers, the decision nonetheless impacts arbitration agreements with employees. Employers should strongly consider incorporating class action waivers in arbitration policies and agreements with their employees. Despite the broad implications of the *AT&T* decision, a California Court of Appeal has since decided that not all employment claims are preempted by the FAA and, therefore, some claims can still be pursued in civil courts.

Brown v. Ralphs Grocery Company – July 2011

In *Brown v. Ralphs Grocery Company*, the Court of Appeal in Los Angeles determined that employment claims brought by employees under California's Private Attorney General Act ("PAGA") were different than private disputes and, therefore, could not be required to be arbitrated. Under PAGA, representative plaintiffs could file lawsuits for violations of various California labor laws, on their own behalf and for the State, and recover civil penalties for violations that otherwise could only be sought by State labor law enforcement agencies. The Court of Appeal held that since the purpose of PAGA is not to recover damages but, instead, provide a means of "deputizing" employees as private attorneys general to enforce the Labor Code, the representative actions under PAGA do *not* conflict with the purposes of the FAA. Since PAGA claims have become commonplace in lawsuits brought by employees, as it provides a means of expanding financial recovery as well as entitlement to attorneys' fees for prevailing employees, this decision may re-open the door that the *AT&T* case seemed to have firmly

closed. Thus, unless the California Supreme Court acts to review the *Ralphs Grocery* decision, employees will still be entitled to bring PAGA representative lawsuits in state courts even if they signed binding arbitration agreements.

Final Comments

In light of the recent United States Supreme Court's decision in *AT&T*, which reinforced the principle the FAA generally preempts state law, even those that ban the pooling of claims with others. Employers would be well-advised to revisit the issue of whether mandatory, arbitration agreements should be instituted as a means of resolving disputes with employees. Additionally, if an arbitration policy is to be adopted, or one already exists, it would be appropriate to ensure that class action waivers are included and re-examine whether their policy strictly follows the evolving guidelines established by the courts.

Arbitration agreements can be deemed unenforceable if they are "unconscionable." The arbitration policy or agreement must meet certain minimum legal requirements. In *Zullo*, the Court of Appeal found it significant that the arbitration policy did not clearly require the employer to arbitrate its own disputes with employees and, further, found it "oppressive" that the arbitration rules themselves were not included in the policy itself (apparently Inland forgot to attach them to the Employee Handbook).

In sum, the details and language of the arbitration policy do matter to the courts. One simple step to take is to ensure the arbitration policy or agreement obligates both parties to arbitrate disputes. This should not be a troublesome concept. If employers have already decided that arbitration is the most efficient and cost-effective means of resolving disputes, then they should be motivated to arbitrate their *own* disputes with employees. Of course, whether a predispute, mandatory arbitration policy or agreement is the best option for a particular business is a decision that should be made in consultation with legal counsel. And, if a mandatory arbitration policy is to be instituted, it is only prudent to consult with legal counsel to ensure that, in the end, the policy will in fact be enforceable under the law.