Judicial Hostility to Arbitration Provisions in Employment Agreements

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(As published in the Los Angeles Daily Journal April 26, 2012)

The central theme of the Supreme Court's decision in *AT&T Mobility v. Concepcion* was to end "judicial hostility" to arbitration. In the context of employment agreements with arbitration provisions – in which employees are asked to give up their rights to trial by jury and class actions – one could argue that this hostility has continued with vigor. The California courts' application of the doctrine of unconscionability to employment agreements to strike down arbitration provisions is somewhat well known. Less well known is that the courts are also finding surprising ways to strike down these arbitration provisions using contract interpretation principles.

A recent example of the California Court of Appeal striking down a seemingly well-crafted arbitration provision as unconscionable is *Mayers v. Volt Management Corp.* The arbitration agreement was contained in the employment application, the handbook, and the employment contract, all of which were signed by the employee. The agreements were on the front pages, in bold, and all capital letters. Arbitration would be through the American Arbitration Association (AAA) organization, and under AAA rules. The prevailing party would recover fees. Nothing in the provision prevented the employee from filing a claim with any governmental or administrative body.

Yet the provision was deemed so unfair that the court struck it down as unconscionable. The employer failed to specify which of the several AAA rules applied (e.g., the commercial or employment rules), failed to give any AAA rules to the employee, and failed to tell the employee where to find the rules. The court found these failures to mean that the actual terms of the arbitration were a "surprise" to the employee.

Next, the arbitration provision altered the risks faced by employees when it comes to fee awards. Under the discrimination law relied on by the employee (the Fair Employment and Housing Act), fees are rarely to be denied to the prevailing employee, but rarely awarded to the prevailing employer. By simply stating that the prevailing party shall obtain fees in the arbitration – without appropriate carve outs – the employee faced an undue risk of having a fee award against him.

Based on these factors, the court found that the provision had a "high degree" of unconscionability, and that the unconscionability so permeated the agreement, the offending portions could not be severed from the contract so that the principle of arbitration could be preserved.

To those in the employment law community, this kind of finding is not too surprising. But a couple of recent cases applying contract interpretation to strike down arbitration provisions has raised a few eyebrows.

In *Grey v. American Management Services*, the California Court of Appeal reversed an arbitration award in favor of an employer, finding that the parties never agreed to arbitrate their dispute, despite the fact that the employee signed not one but two agreements with arbitration provisions.

Indeed, that was the problem. The employer had a solid program in place to ensure that job applicants would be subject to arbitration. Each applicant signed a well-crafted Issue Resolution Agreement (IRA). The IRA attached a copy of the arbitration rules that would govern the arbitration. Both the prospective employee and employer signed the IRA. The arbitration provision was broadly written to encompass any claims "arising out of the application or eventual employment."

If hired, the employee was also required to sign an employment contract. The contract stated that it was the final expression of the parties' agreement on the terms of employment, except as may be amended by policies and procedures. The contract contained an arbitration provision that was written differently than the one in the IRA. This arbitration provision was limited to claims "arising out of a *breach* of the employment contract." These differing arbitration provisions would prove costly for the employer.

After being hired, the employee in this *Grey* case sued for discrimination on the basis of sexual orientation and a host of tort claims. The employer filed a motion with the court to compel arbitration. That motion was granted. The arbitration was conducted, and the arbitrator found in favor of the employer, which the court approved as a complete defense judgment.

The employee appealed that judgment, arguing that the arbitrator lacked authority. The Court of Appeal agreed, and reversed the judgment. The Court reasoned that: the contract, which contained an "integration clause," was the final expression of the parties' employment agreement; the IRA was a signed "agreement" that was superseded, and not a "policy or procedure" that might modify the contract; the arbitration provision in the employment contract was the only operative arbitration provision; that provision was limited to claims for breach of contract; and none of the employee's claims were for breach of contract -- they were all statutory and tort based.

Therefore, the arbitrator lacked authority to decide those claims, and the employer would have to defend the case again, this time in court.

The employer was tripped up by a seemingly trivial difference in language between the two agreements ("arising from employment" v. "arising from breach of the employment contract"), and by a failure to incorporate the IRA into the employment contract.

And in another recent case, *Peleg v. Neiman Marcus Group, Inc.*, an arbitration provision was struck down as being "illusory." Neiman Marcus provided its employees with a stand-alone mandatory arbitration agreement, and required its employees to sign an acknowledgment that they had read and understood it. The agreement required mandatory and binding arbitration for an exhaustive list of employment claims.

The plaintiff, who is gay, Jewish, and of Israeli origin, was terminated, and brought a host of employment claims, all of which were covered by the exhaustive list in the arbitration provision. He filed suit, the company filed a motion to compel arbitration, and that motion was granted. The

parties proceeded to arbitration, the company won, and was awarded over $40,000 in attorneys' fees and costs. The court confirmed the award.

The employee appealed, arguing that the arbitration provision was illusory and he never should have been subjected to arbitration in the first place. The Court of Appeal agreed, and directed the trial court to vacate the award, and to place the matter on the civil calendar.

The problem was that the agreement stated that the it could be amended, modified, or revoked in writing by the company at any time, upon 30 days' notice. This provision went on to specify that any such change shall have no effect on any arbitration that had been "filed" before the change.

However, these limitations on the employer's power to change the terms of the arbitration were inadequate. The court concluded that if the promisor retains the unlimited right to decide later the nature or extent of its performance, the promise is illusory.

And in a procedural twist, Texas law applied. The company, which has its principal place of business in Dallas, placed in the agreement a choice of law provision in favor of Texas. In this regard, Texas law is more stringent that California law. Texas law requires an express carve out, to the modification provision, of any claims that the employer knows about, or that have accrued. Failure to include that express carve out to the modification provision renders the arbitration provision illusory.

The Court was not required to specifically rule whether the result would be different under California law. The Court did, however, state that under California law, the failure to include an express carve out of known or accrued claims "may" render the provision illusory. That is, under California law, a failure to include the express carve out leaves the arbitration provision subject to uncertainty about enforceability.

Whatever the label, whether it be "judicial hostility" or something else, the California courts are taking a very careful look at arbitration provisions in employment agreements and giving no benefit of the doubt to employers.
