Client Alert

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CALIFORNIA SUPREME COURT RULING ON ARBITRATION AGREEMENTS MAY REQUIRE REVISION OF EXISTING AGREEMENTS USED IN CALIFORNIA

On August 24, 2000, the California Supreme Court issued its long-awaited decision on the legality of pre-dispute arbitration agreements between employers and employees. In *Armendariz v. Foundation Health Psychcare Services, Inc.*, 2000 Daily Journal D.A.R. 9401 (August 25, 2000), the Court defined parameters for enforceable pre-dispute arbitration programs.

Facts

The *Armendariz* plaintiff-employees claimed that as a condition of employment they were required to sign agreements to arbitrate wrongful termination and employment discrimination claims. The agreement they signed limited their recovery of damages to wages they would have earned from the date of their termination to the date of the arbitration. Only the employees, not their employer, were bound to arbitrate such disputes.

Elements of an Enforceable Arbitration Agreement

Although the Supreme Court struck down as unconscionable Foundation Health's agreement, its opinion makes clear that arbitration of claims under California law, including the California Fair Employment and Housing Act ("FEHA"), can be compelled if the pre-dispute arbitration agreement satisfies the following conditions:

1. A neutral arbitrator: Although the decision does not address arbitrator selection, pre-dispute arbitration agreements should provide that the parties will strike alternately from a panel provided by a reputable neutral organization.

2. Full remedies: The agreement "may not limit statutorily imposed remedies such as punitive damages and attorney fees."

3. Discovery: Although the full discovery permitted in civil litigation is not required, the employee is "entitled to discovery sufficient to adequately arbitrate [the] statutory claim, including access to essential documents and witnesses, as determined by the arbitrator(s)."

4. Written decision: The arbitrator "must issue a written arbitration decision that will reveal, however briefly, the essential findings and conclusions on which the award is based."

5. Arbitration costs: The employer typically should pay the arbitration costs. Specifically, the "process cannot generally require the employee to bear any *type* of expense that the employee would not be required to bear if he or she were free to bring the action in court."

6. Symmetrical arbitration scope: Although not all conceivable claims must be covered by the arbitration agreement, "all claims arising out of the same transaction or occurrence or series of transactions or occurrences" should be encompassed by the scope of the agreement. As a practical matter, the employer should exempt from coverage workers' compensation and unemployment claims, benefits claims that culminate in another arbitration process, and administrative charges alleging violations of federal and state laws prohibiting discrimination, harassment and retaliation, and the National Labor Relations Act, as amended. The Court explicitly noted that its opinion should not be interpreted to imply that an employee can be barred from pursuing an administrative complaint before the Department of Fair Employment and Housing or that the Department is prohibited from carrying out its functions.

Employers should evaluate carefully with their counsel whether they wish to allow both parties to seek temporary injunctive relief pending arbitration of any claim, including harassment, discrimination, unauthorized removal of company property or disclosure of confidential information, or unfair competition. Employers should weigh the benefits of such relief from a court of law against the detriment that public disclosure of the dispute will occur when the action is commenced in a court.

Employers are free to deviate from these requirements where they are negotiating arbitration provisions with a claimant after a dispute has arisen. The Court noted that these stringent "requirements would generally not apply in situations in which an employer and an employee knowingly and voluntarily enter into an arbitration agreement after a dispute has arisen."

Strategy for Curing Defective Agreements

The Court considered but rejected the employer's argument that the unconscionable provisions should be severed and the remainder of the agreement enforced. It noted that two factors

weighed against severance: (1) the agreement contained multiple unlawful provisions: "an unlawful damages provision and an unconscionably unilateral arbitration clause"; and (2) a court could cure the agreement's absence of a mutual scope clause only by "augmenting it with additional terms"; simply striking the offensive provision would not cure the defect.

The decision presents a dilemma for employers with non-compliant arbitration agreements. The Court noted that once the employment relationship has ended, the employer cannot cure a defective arbitration agreement simply by indicating a willingness to waive offending provisions. Such overtures are simply offers to modify an agreement that require acceptance to be binding.

Many existing pre-dispute arbitration agreements contain the following provisions that claimants may challenge: (1) the employer retains the right to litigate disputes for unauthorized disclosure of proprietary information and unfair competition; (2) the agreement specifies a shorter statute of limitations than the law for bringing a claim; (3) the employee must pay half of the arbitration fee – or at least more than the fee for filing a complaint in a court; and/or (4) discovery is prohibited. Employers who are using arbitration agreements with some or all of these provisions should immediately consider their options. Many employers whose agreements require revision will want to:

1. Present for signature to those who are parties to existing arbitration agreements a new agreement that complies with *Armendariz*, along with a letter setting forth the new "employer-will-pay" benefit that the employer is offering, the longer statute of limitations and the other pro-employee changes that should induce employees to sign. The cover letter should indicate that the employee has the free choice to continue to accept the existing agreement or accept these new, more employee-advantageous provisions. Employers should maintain an electronic or hard-copy record reflecting the persons to whom the offers were made and the date they receive the offer so that they cannot later claim they were "chilled" by the onerous provisions.

2. After a new agreement has been executed by those who are willing to do so, inform the remaining signatories to the former agreement that the employer will as a matter of course pay the full amount of the arbitrator's fee (perhaps minus the amount of the filing fee for commencing a lawsuit in a court of general jurisdiction), honor the longer limitations period and agree itself to arbitrate all claims the employee must arbitrate.

California Supreme Court's Commentary on Ninth Circuit's Contrary Holding

The California Supreme Court noted that the Ninth Circuit in *Duffield v. Robertson Stephens & Co.*, 144 F.3d 1182 (9th Cir. 1998), ruled that the Civil Rights Act of 1991 "prohibits the enforcement of mandatory employment agreements to arbitrate claims under Title VII of the Civil Rights Act of 1964, or equivalent state antidiscrimination statutes, such as the FEHA." But the California Justices deemed *Duffield* "a minority of one" whose "reasoning [is] unpersuasive."

Upcoming Supreme Court Argument

On May 22, 2000, the United States Supreme Court granted a writ of certiorari in *Circuit City Stores, Inc. v. Adams*, to determine whether arbitration provisions in employment agreements are enforceable under the Federal Arbitration Act.

Questions

We encourage you to contact the Paul, Hastings, Janofsky & Walker LLP attorney with whom you work to discuss this decision or:

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