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Drafting Arbitration Agreements in the Employment Context

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Agenda

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Introduction: The Legal Backdrop for Arbitration Agreements

- The Federal Arbitration Act ("FAA"), 9 U.S.C. § 1, *et seq.*, provides strong federal policy in favor of enforcing private parties' arbitration agreements
  - FAA requires that courts "rigorously enforce" arbitration agreements according to their terms, including terms that specify with whom the parties choose to arbitrate their disputes, and the rules under which that arbitration will be conducted

Pros of Arbitration Agreements for Employers

- A streamlined system for the resolution of employment claims
- Lower insurance premiums for employers
- Potential reduction in litigation and discovery costs
- Preventing negative precedent and “runaway” jury verdicts
- Confidential dispute resolution
- Arbitration agreements with class action waivers can help to eliminate private employment class actions

Pros: The Class Action Waiver

- A class action waiver prevents employees from bringing their claims as a class action
- *AT&T mobility v. Concepcion*, 131 S.Ct. 1740 (2011)
  - The FAA preempts state laws that prohibit contracts from disallowing class-wide arbitration
- *American Express Co. v. Italian Colors*, 133 U.S. 2304 (2013)
  - Class action waivers in arbitration agreements are enforceable under the FAA, even if individual arbitration is economically infeasible

Potential Risks/Downside to Arbitration Agreements for Employers

- Potentially more expensive:
  - arbitrators may be less likely to grant dispositive relief
  - arbitrators may be paid by the hour or by the day
- Arbitrators may be more likely to “split the baby”/compromise
- Arbitrators may be less likely to accept procedural defenses
- Arbitrators may be more likely to allow hearsay and irrelevant witnesses

Enforceability of Employment Arbitration Agreements

- After *Concepcion*, the enforceability of arbitration agreements is governed by general contract principles
  - The FAA "permits agreements to be invalidated by generally applicable contract defense, such as fraud, duress, or unconscionability." *Concepcion*, 131 S.Ct. at 1746.
  - Any state-law rule that "stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress . . . is preempted by the FAA. . . . [Arbitration agreements may not be invalidated by] defenses that apply only to arbitration or that derive their meaning from the fact that an agreement to arbitrate is at issue." *Id*. at 1742-43.
- Unconscionability is the most common basis by which parties attempt to render an arbitration clause unenforceable in the employment context
- To prove unconscionability, both *substantive* and *procedural* unconscionability must be present

Unconscionability

- Substantive Unconscionability
  - Substantive unconscionability concerns the resulting terms of the agreement
  - An agreement to arbitrate may be deemed substantively unconscionable only if its terms are so one-sided as to "shock the conscious"
  - In California, arbitration agreements must also have "a modicum of bilaterality"
- Procedural Unconscionability
  - Procedural unconscionability concerns the manner in which the contract was negotiated and the circumstances of the parties at that time
  - "The procedural element focuses on 'oppression' or 'surprise.'" *Gutierrez v. Autowest, Inc*., 114 Cal. App. 4th 77, 87 (2003)
  - Oppression occurs where the parties to a contract have unequal bargaining power and the contract is not the result of real negotiation or meaningful choice.
    - Contracts of adhesion, i.e. "take it or leave it" agreements, are considered procedurally unconscionable to varying extents
  - Surprise involves the extent to which the supposedly agreed-upon terms are hidden in the agreement by the drafter

Crafting Enforceable Agreements

- To bolster arguments in support of enforceability employers should consider the following best practices:
  - Choose a proper arbitral forum and set of procedures
  - Specify the applicable rules
  - Ensure mutuality
  - Exclude non-arbitral claims
  - Include PAGA/representative claims (California employers)

Choosing the Arbitral Forum

- As a first step in drafting an arbitration agreement, chose a reasonable arbitral forum
- In choosing this forum employers should consider whether the forum provides for:
  - A neutral arbitrator
  - No Limitation on remedies
  - A means for adequate discovery
  - Written arbitration awards
  - Fees and costs to be born by the employer
- *Chavarria v. Ralphs Grocery Co.*, 733 F.3d 916 (9th Cir. 2013)
  - In *Chavarria*, the arbitration agreement failed to select an arbitral forum and prohibited the use of administrators from the American Arbitration Association ("AAA") or the Judicial Arbitration and Mediation Service ("JAMS")
  - The Court held that this provision added to the substantive unconscionability of the agreement and rendered the arbitration policy unenforceable

Specify the Rules that will Apply to the Agreement

- Along with the arbitral forum, employers should specify the rules that govern the arbitration
  - The agreement should clearly indicate what rules and procedures apply. For instance, the agreement may select the "Employment Arbitration Rules and Mediation Procedures" found on AAA's website
  - When selecting a set of rules, carefully consider whether it could be deemed unconscionable
- Employers may incorporate arbitral rules into the agreement by reference, as long as they are clearly identified and readily accessible
  - Employers should consider providing a link to online arbitral rules to bolster the argument that rules were properly incorporated or provide a copy of the rules themselves

Make the Terms of the Agreement Bilateral

- The California standard for arbitration agreements is that the agreement must have "a modicum of bilaterality"
  - The more mutual an arbitration agreement is, i.e., the more an employer must arbitrate its claims against the employee, the less likely it is that a court will find the agreement unenforceable
- To avoid accusations of unconscionability, arbitration agreements should not also create carve-outs or exceptions for claims that are likely to be brought only by one side or the other
  - For example, carve-outs for intellectual property actions may add to the unconscionability of the agreement because those are typically actions employers maintain against employees

Exclude Non-Arbitral Claims

- Employers should also consider including the following carve-outs and exclusions from the arbitration agreement:
  - The right to file a workers' compensation or unemployment compensation claim.
  - Carve-outs from the Department of Defense Appropriations Act of 2010
  - The right to file an administrative charge before a governmental agency, such as the Equal Employment Opportunity Commission, National Labor Relations Board, or Department of Labor
  - Under the Dodd-Frank Wall Street Reform and Consumer Protection Act, certain types of whistleblower claims may not be subject to mandatory pre-dispute arbitration.

CA: Include Waivers of PAGA/Representative Claims

- PAGA Actions Differ from Class Actions
  - Under California's Private Attorney General Act ("PAGA"), individuals may bring class or non-class representative actions to recover civil penalties and attorneys' fees on behalf of themselves and other "aggrieved employees" for certain violations of the California Labor Code.
  - Under this statute, 75% of any penalties recovered is distributed to the LWDA (the State), and the remaining 25% goes to the represented employees
- As with class actions, employment arbitration agreements should include waivers of an employee's right to bring representative actions, including claims under PAGA
- It is important to specify that the waiver covers "representative" suits, because courts have held that PAGA actions are different from class actions

Additional Considerations When Drafting Arbitration Agreements

- To bolster the enforceability of the agreement, it should:
  - Be signed by both the employer and the employee
  - Avoid language preserving the employer's right to amend, modify or cancel the agreement, in favor of language disallowing retroactive changes and providing notice periods before future changes are effective
  - Preserve all applicable statutes of limitations
  - Avoid confidentiality language that could be interpreted as restricting an employee's ability to build his or her case by talking with co-workers or seeking witness participation

Ongoing Issues

- *Gentry v. Superior Court*, 42 Cal. 4th 443 (2007)
- *Iskanian v. CLS Transp. of Los Angeles LLC*, 286 P.3d 147 (2012)
- *Brown v. Ralphs Grocery Co.*, 197 Cal. App. 4th 489 (2011)
- *In re D.R. Horton, Inc.,* 357 NLRB No. 184, 2012 WL 36274 (Jan. 3, 2012)

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Questions?

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