

Are your Employment Arbitration Agreements Still Enforceable?

By Christopher W. Olmsted, Esq.

Employment arbitration agreements have been the subject of continuing refinement by California courts. As discussed below, recent case law should prompt employers to review their arbitration agreements to minimize the risk that a court will find the agreements unenforceable.

Background

In the last few decades, employee lawsuits have increased exponentially. In response to the expense and uncertainty of jury trials, employers have resorted to contractual arbitration as a less-expensive and timesaving alternative. Typically, employers have required new hires to sign arbitration contracts as a condition of employment. The parties agree to waive the right to a jury trial, and submit specified legal claims to an arbitrator, who is usually a retired judge.

State and federal courts have, for the most part, been willing to enforce employment arbitration agreements. For public policy reasons, arbitration is an accepted and favored alternative to the overburdened court system. As explained below, however, an increasing number of arbitration agreements have been found to be unenforceable in light of recent court decisions.

Basic Requirements For An Enforceable Employment Arbitration Agreement

In a year 2000 landmark California Supreme Court case, *Armendariz v. Foundation Health Psychare Services, Inc.*, the court upheld the enforceability of agreements requiring employees to arbitrate Fair Employment and Housing Act (FEHA) claims as long as the agreements are not “unconscionable.”

In a nutshell, the court set forth the following requirements:

- ◇ The agreement must be bilateral—employer must agree to submit its claims to arbitration, just as it requires employees to do so, absent a legitimate commercial need to exempt a particular right.
- ◇ Neutral arbitrator.
- ◇ Employer pays arbitrator’s fees and all costs unique to arbitration.
- ◇ Adequate discovery permitted.
- ◇ No limits on damages or other relief.
- ◇ Written award that permits limited judicial review.

Recent Developments

The court left several questions unanswered in *Armendariz*. Among them are: Do the requirements apply only to FEHA claims, or do other employee claims require the same protections? What kind of appellate review is acceptable? Under what circumstances can a defective agreement be “reformed?” Can an employer reserve the right to pursue injunctive relief in court, in order to enforce trade secret and other proprietary agreements? Two recent decisions have addressed these questions.

The Little Case

The California Supreme Court revisited *Armendariz* in February 2003 in a case titled *Little v. Auto Stiegler*.

The plaintiff was an automobile dealership’s service manager who was fired for reporting warranty fraud. His arbitration agreement contained a clause that permitted a party to appeal any result exceeding \$50,000 to a second arbitrator. The court enforced the agreement, but “severed” (deleted) the clause regarding appeals. The key holdings were:

- ◇ Provision allowing appeal of awards over \$50,000 is unconscionable (it is one-sided, benefiting only the employer).
- ◇ “Severing” unfair terms in agreements is possible where a *single* provision can simply be eliminated and *no redrafting* is necessary.

Armendariz protection extended from FEHA claims to now include terminations in violation of public policy (e.g. whistleblowing claims).

The O’Hare Case

In March 2003, the Court of Appeal, Second Appellate District of California issued its decision in *O’Hare v. Municipal Resource Consultants*.

When Nicholas O’Hare was hired by Municipal Resource Consultants (MRC) in 1991, his employment contract included an arbitration agreement.

The agreement required O’Hare to submit any claims against MRC to arbitration. For itself, MRC reserved the right to proceed in court for injunctive relief regarding misuse of trade secrets “in addition to any other rights.” (Example of injunctive relief: seeking a court order prohibiting a former employee from divulging trade secrets to a competitor.) The arbitration agreement prohibited discovery. It was silent as to allocation of arbitration costs, but incorporated American Arbitration Association (AAA) rules requiring an equal split of costs. The court refused to enforce the arbitration agreement and made the following key holdings:

- ◇ Prohibition of discovery was unconscionable.
- ◇ Incorporation of AAA rules requiring an equal fee split was unconscionable.
- ◇ Employer’s right to proceed in court for all injunctive relief was not supported by business justification (the arbitrator can provide injunctive relief).

- ◇ Unconscionable terms *could not be severed* (unlike *Little*) because there was more than one unfair provision, and the agreement would have to be redrafted to make it compliant with *Armendariz*.

Protecting Your Company In The Current Environment

Although arbitration agreements vary greatly, common problems seen in older agreements are as follows:

- ◇ Agreement does not specify all types of employee claims subject to arbitration (including statutory claims).
- ◇ Arbitration terms are found in the company handbook and are not properly incorporated into an employee contract.
- ◇ Employer is not required to arbitrate its claims against employee. For example, older agreements commonly reserve the right of the employer to seek injunctive relief against former employees to prevent misuse of trade secrets or customer lists. These provisions should be revised to carve out only temporary emergency relief rather than all injunctive relief.
- ◇ Arbitrators are pre-selected by the employer or selected from a trade group or other limited pool. These arbitrators may not be “neutral.”
- ◇ Parties split costs.
- ◇ No discovery permitted or unreasonable restrictions such as “one deposition per side.”
- ◇ Incorporation of arbitration rules from an outside source (such as AAA) that may or may not be compliant with recent case law.

If you have not updated your arbitration agreement in light of the recent cases, it is time to review it to determine whether it remains enforceable. Unless the agreement is carefully worded, your company may end up in front of a jury should an employee take legal action.

Christopher Olmsted is an attorney practicing in the areas of employment compliance, business litigation and insurance defense. He can be reached at (619) 682-4820 or cwo@barkerlawgroup.com



Christopher W. Olmsted, Esq.
Direct: (619) 682-4820
cwo@barkerlawgroup.com

Practice Area:
Civil Litigation

Areas of Emphasis:
Employment Litigation and Labor Law
Insurance Defense
Insurance Bad Faith
Construction Litigation
Business Litigation

Bar Admissions:
California, 1994
California District Court, Central District of California, 1994
U.S. Court of Appeals, Ninth Circuit, 1996

Education:
J.D., Loyola Law School, 1994
B.A., University of California, Berkeley, 1991

Summary:
Mr. Olmsted is an attorney practicing in the areas of employment litigation and compliance, business litigation, insurance defense, and insurance bad faith. His experience in insurance defense includes automobile, commercial, and homeowners claims, and encompasses personal injury, property damage, mold claims, and wrongful death matters. He has litigated bad faith cases including homeowners, mold, automobile, and disability insurance claims. Additionally, he has represented clients in the areas of business and commercial litigation, asbestos litigation, construction collection and construction defects.

Mr. Olmsted's employment litigation experience includes: FEHA claims regarding race, gender, age, religion, national origin, sexual orientation, disability, pregnancy and sexual harassment; California CFRA and federal FMLA; federal ADA and ADEA; False Claim and whistleblowing actions; public policy violations; ERISA; Labor Board and Unemployment Insurance claims. He has represented clients in state and federal jury and

bench trials, appeals before California and federal courts of appeal, judicial and contractual arbitrations, and administrative law hearings.

Mr. Olmsted is a member of: San Diego Risk and Insurance Management Society, Association of Business Trial Lawyers, California Bark Employment Law Section and San Diego County Bar Association Insurance Section.

Reported Cases:

- Wittkopf v. County of Los Angeles, 90 Cal.App. 4th 1205; Colmenares v. Braemar Country Club, 89 Cal.App. 4th 778.

Seminars presented include:

- Speaker on “The Nuts & Bolts of Prevailing Wage Law” for the Engineering General Contractor’s Society, San Diego, December 2, 2003.
- Speaker regarding California Leaves of Absences, Lorman Educational Services Seminar, San Diego, CA, October 15, 2003.
- Speaker on “How to Litigate Your First Civil Trial in California,” National Business Institute, San Diego, CA, 2003.
- Firm-sponsored seminar on Employment Law: Avoiding Liability in the Hiring Process, San Diego, CA, March 27, 2003.
- Speaker regarding Employment Issues for the Construction Trade, Lorman Educational Services Seminar, San Diego, CA July 20, 2002.

Pro-Bono Activities:

- San Diego Volunteer Lawyer Program, Domestic Violence Clinic
- San Diego Volunteer Lawyer Program – Disaster Relief Assistance

Articles:

- “Appellate Court Rejects Insured’s Expansive Definition of “Arising Out of the Use Clause,” by Christopher W. Olmsted
- “Legislature Doubles Labor Code Fine for Contracting with Unlicensed Contractor,” by Christopher W. Olmsted
- “Legislative Update: Labor Code Private Attorneys General Act,” by Christopher W. Olmsted
- “What to do in the First 30 Days After Being Sued,” by Christopher W. Olmsted