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Santosh Narayan, Esq.

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The Potential Pitfalls of Arbitration Agreements

By Santosh Narayan

Because of crowded dockets and increased court and litigation costs, arbitration has become a popular method to resolve disputes. Arbitration offers the advantages of potentially lower costs, faster outcomes, and limited grounds for appeal. In employment cases, increasingly, employers are looking to arbitration as a way to resolve disputes with former employees. Arbitration can appear especially attractive for national employers because it allows the potential application of a single set of rules to almost all employment-related disputes. A pair of recent decisions by the California courts, however, demonstrates that multi-state employers with employees in California must exercise caution in drafting arbitration agreements, for California courts may be inclined to overturn arbitration agreements if the terms appear unfair to the employee.

As background, the primary California case regarding the enforceability of arbitration agreements is *Armendariz v. Foundation Healthcare Services, Inc.*, 24 Cal. 4th 83 (2000). *Armendariz* set forth the requirements for "essential fairness" in arbitration agreements, including: a neutral arbitrator, adequate discovery, all types of relief otherwise available in court, a written arbitration award that permits limited judicial review, and the employer must pay arbitrator's fees and all costs unique to arbitration. Generally, an employee arguing that an arbitration agreement is unenforceable must show that the agreement is both procedurally (*i.e.*, whether it was negotiated or presented on a take it or leave it basis) and substantively (*i.e.*, the terms of the agreement) "unconscionable."

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In a recent case, *Mayers v. Volt Management Corp.*, 23 Cal. App. 4th 1194 (2012), the California Court of Appeal found both procedural and substantive unfairness. In *Mayers*, the former employee sued his former employer, alleging several violations of the California Fair Employment and Housing Act ("FEHA"), including disability discrimination, failure to engage in the interactive process, and age discrimination. The employer moved to compel arbitration pursuant to a written arbitration agreement between the parties that covered "any and all employment related disputes."

The employee challenged the arbitration agreement, claiming it was unconscionable because it was drafted by the employer and because the employee had not been provided a copy of the particular rules of the American Arbitration Association that would govern the arbitration. The employee also argued that the arbitration agreement was unconscionable because it potentially exposed him to paying his employer's attorneys fees - something that could not occur under the FEHA in state court. The Court of Appeal agreed with the employee and found that these provisions rendered the agreement unconscionable, for the employee was at "greater risk" in the arbitration than he would have been in state court.

Two weeks later, in *Ajain v. CantorCO2e*, 203 Cal. App. 4th 771 (2012), the California Court of Appeal considered the issue of whether an arbitration agreement alleged to be unconscionable could be enforced when, among other factors, the employee challenging the arbitration agreement hired an attorney to review her employment agreement, which provided for arbitration, before signing it. The *Ajain* court first considered who determines if the arbitration agreement itself is unconscionable - the arbitrator or the court. The court determined that in the absence of "clear and unmistakable evidence" showing that the arbitrator could determine the validity of the arbitration agreement, the trial court and not the arbitrator determined whether or not the arbitration agreement itself was unconscionable. Moreover, the Court stated "the default expectancy is that the court would decide the matter."

The *Ajain* court found the agreement in question to be procedurally and substantively unconscionable and refused to enforce it. Procedurally, the court found that although the employee had six months to review the agreement, and even had the agreement reviewed by legal counsel, the employee still did not have equal bargaining power because the employee's promotion and raise was conditioned upon signing the agreement. Substantively, the court found the agreement unconscionable because, in part, it had the employee waive her rights to certain relief otherwise found under California law.

The *Mayers* and *Ajain* decisions demonstrate that including provisions to an arbitration agreement that appear to be beneficial to employers or that add risks for the employee not found under state law may lead to a court refusing to compel arbitration altogether. Particularly concerning is that provisions that are commonly found in other types of agreements - such as a prevailing party's attorney's fee clause - can be

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inconsistent with state law and thus render an entire arbitration agreement unconscionable.

Mayers and *Ajamin* are two examples of the California Court of Appeal carefully scrutinizing whether a particular arbitration provision is unconscionable under applicable state law. If a California employer does not carefully review state law before drafting their arbitration agreement, the employer runs the risk of the entire agreement being invalidated due to a single improper provision.

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