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Employment Law Commentary

Collision Course: Conflict Between United States Supreme Court and California Judicial Interpretation of Arbitration Agreements Comes to a Head

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In our April 2009 Employment Law Commentary, entitled "Arbitration Agreements in Light of *114 Penn Plaza v. Pyett*," we contrasted the United States Supreme Court's and California courts' approaches to enforcement of arbitration agreements. We concluded that the federal high court has tended to enforce arbitration agreements in a manner that favors arbitration as an alternative to traditional adjudication, while California courts have generally viewed such agreements with skepticism.

These divergent approaches appear to be the result of a conflict between the U.S. Supreme Court's interpretation of the Federal Arbitration Act ("FAA") as it applies to arbitration agreements and the California judiciary's desire to enforce the state's substantive contract law—particularly with regard to the unconscionability defense to enforcement. In light of its grant of certiorari in *AT&T Mobility LLC v. Concepcion*, the Court may resolve this conflict by addressing whether and to what extent the FAA preempts California law.

(Continued on page 2)

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Recent U.S. Supreme Court Decisions

This year, the U.S. Supreme Court issued opinions in *Rent-A-Center*[2] and *Stolt-Nielsen*[3] that directly interpreted the FAA as it pertains to arbitration agreements.[4]

Rent-A-Center

In *Rent-A-Center*, the Court addressed whether a provision of an employment agreement that delegated exclusive authority to an arbitrator to resolve any dispute relating to the agreement's enforceability was a valid delegation under the FAA.

Rent-A-Center, West, Inc. ("Rent-A-Center") was sued by employee Antonio Jackson ("Jackson") for employment discrimination. Per an arbitration agreement between the parties, Rent-A-Center filed a motion under the FAA to dismiss or stay the proceedings and to compel arbitration. The arbitration agreement provided for arbitration of all "past, present or future" disputes arising out of Jackson's employment with Rent-A-Center, including "claims for discrimination" and "claims for violation of any federal… law." Further, the agreement provided that "[t]he arbitrator, and any federal, state, or local agency, shall have exclusive authority to resolve any dispute relating to the interpretation, applicability, enforceability or formation of this Agreement, including, but not limited to any claim that all or any part of this Agreement is void or voidable." The district court granted Rent-A-Center's motion despite Jackson's assertion that, under Nevada law, the arbitration agreement was "clearly unenforceable in that it [was] unconscionable." In doing so, the district court reasoned that the agreement "clearly and unmistakably" gave the arbitrator exclusive authority to decide whether the agreement was enforceable. The United States Ninth Circuit Court of Appeals reversed. The Ninth Circuit noted that where "a party challenges an arbitration agreement as unconscionable, and thus asserts that he could not meaningfully assent to the agreement, the threshold question of unconscionability is for the court." The United States Supreme Court granted certiorari.

The Court reversed the Ninth Circuit's holding that the threshold issue of unconscionability was within the district court's purview. The Court noted that the provision of the arbitration agreement giving the arbitrator the authority to decide enforceability issues—which was not specifically challenged by Jackson—was in and of itself an independent contractual "agreement to arbitrate threshold issues." As stated by the Court, "[a]n agreement to arbitrate a gateway issue is simply an additional, antecedent agreement the party seeking arbitration asks the federal court to enforce, and the FAA operates on this additional agreement just as it does on any other." Accordingly, based on precedent recognizing that parties can agree to arbitrate "gateway" questions of "arbitrability," the parties' agreement that the arbitrator determine the enforceability of the agreement as a whole was valid under the FAA.

Stolt-Nielsen

In *Stolt-Nielsen*, the Court addressed whether a class action may be arbitrated where an agreement is silent regarding that issue.

Stolt-Nielsen S.A. ("Stolt-Nielsen") was initially sued by AnimalFeeds International Corporation ("AnimalFeeds") based on alleged price-fixing. Stolt-Nielsen is a shipping company that provides parcel tankers—seagoing vessels with compartments that are separately chartered—to customers such as AnimalFeeds. AnimalFeeds engages in the business of shipping goods. These goods are shipped under a standard contract containing an arbitration clause, which is known within the maritime trade as a "charter party." Under the charter party, the parties proceeded with arbitration. They stipulated, however, that the arbitration clause was "silent" on the issue of class arbitration. The arbitration panel concluded that class arbitration was permitted under the charter party. The district court, however, vacated the arbitrators' award, holding that it was made in "manifest disregard" of the law. The district court reasoned that a proper choice-of-law analysis would have led the panel to properly apply federal maritime law, which mandates contracts to be interpreted in light of custom and usage. The United States Second Circuit Court of Appeals reversed the district court, reasoning that maritime law and New York state law were not manifestly disregarded since neither had an established rule against class arbitration. The United States Supreme Court granted certiorari.

The Supreme Court reversed the Court of Appeals. The Court held that imposing class arbitration on parties who have not agreed to authorize such action is inconsistent with the FAA. The Court reasoned that the arbitration panel did not consider whether the FAA, maritime law, or New York state law had a rule to apply in situations where a contract is silent regarding class arbitration. Rather, the panel "proceeded as if it had the authority of common-law court to develop what it viewed as the best rule to be applied in such a situation." Thus, "instead of identifying and applying a rule of decision derived from the FAA or either maritime or New York law, the arbitration panel imposed its own policy choice and thus exceeded its powers."

The Court also noted that the FAA's central purpose is to ensure that "private agreements to arbitrate are enforced according to their terms."[5] Accordingly, because such agreements are based on the "expectations of the parties," "it follows that a party may not be compelled under the FAA to submit to class arbitration unless there is a contractual basis for concluding that the party *agreed* to do so."

Recent California Court Decisions

Under California law, unconscionability has both a procedural and a substantive element, the former focusing on "oppression" or "surprise" due to unequal bargaining power, the latter on "overly harsh" or "one-sided" results.[6] Based on unconscionability, California courts have continued their trend of invalidating arbitration agreements within the context of employment disputes. They have been willing, however, to enforce agreements under circumstances where there was only a "low degree of procedural unconscionability."[7]

Most recently, in *Trivedi*,[8] plaintiff Ramesh Trivedi ("Trivedi") filed a complaint against his employer, defendant Curexo Technology Corporation ("Curexo"). Trivedi alleged several causes of action, including claims for age, race, and national origin discrimination under the California Fair Employment and Housing Act ("FEHA"). Curexo filed a motion to compel arbitration

(Continued on page 3)

and dismiss or stay the action. The trial court denied the motion, holding that the arbitration agreement between the parties was both procedurally and substantively unconscionable. Further, the trial court held that the "problematic provisions" in the agreement could not be severed. Curexo appealed to the First District Court of Appeal.

The Court of Appeal affirmed the trial court. In doing so, the Court of Appeal reasoned that the agreement was procedurally unconscionable because it was prepared by Curexo, it was mandatory, and Trivedi was not given a copy of the applicable American Arbitration Association ("AAA") rules. Further, the court reasoned that the agreement was substantively unconscionable because it allowed for the prevailing party to recover attorney's fees under any circumstances, ignoring case law holding that such fees should only be recovered by employers in FEHA cases where a plaintiff's claims are found to be "frivolous, unreasonable, without foundation, or brought in bad faith." Accordingly, "enforcing the arbitration clause and compelling Trivedi to arbitrate his FEHA claims lessen[ed] his incentive to pursue claims deemed important to the public interest, and weaken[ed] the legal protection provided to plaintiffs who bring non-frivolous actions from being assessed fees and costs." Further, the Court of Appeal held that the arbitration clause was procedurally unconscionable because it contained a provision that allowed the parties to access the courts only for injunctive relief, which Curexo was more likely to do as an employer. Finally, the Court of Appeal held that the trial court did not abuse its discretion in refusing to sever the arbitration clause's unconscionable provisions since "at least two provisions were properly found to be substantively unconscionable, a circumstance considered by [California's] Supreme Court to 'permeate' the agreement with unconscionability."

The court's holding in *Trivedi* is consistent with the conclusion reached by the Second District Court of Appeal in *Suh*.[9] In *Suh*, the court held that arbitration rules in the plaintiff anesthesiologists' contracts with a defendant hospital were substantively and procedurally unconscionable, and could not be severed. The court held that the contracts were substantively unconscionable because they prohibited an award of consequential, exemplary, incidental, punitive, or special damages. Further, the contracts were procedurally unconscionable because the arbitration clause was found on page 13 of the agreement in the same typeface as the agreement; as a condition of practicing anesthesiology at the hospital, the anesthesiologists were required to sign a two-page "Waiver and Agreement" binding them to the arbitration agreement with the hospital without having the opportunity to see that agreement; and the offending rules were not provided to them.

It should be noted however, that California courts do not always find that arbitration agreements are unconscionable in the employment context. In fact, California courts have held that where "the degree of procedural unconscionability is minimal, the agreement is only unenforceable if the degree of substantive unconscionability is high."[10] In *Dotson*, for example, the Second District Court of Appeal held that there was a minimum amount of procedural unconscionability where the arbitration provision was not overly long and was written in clear, unambiguous language; the fact that arbitration was a condition of employment was stated numerous times and was set forth in large, bold typeface; the employee was not rushed or coerced when he decided to assent to the arbitration provision; the employee was a highly-educated attorney; and the employee entered into the agreement containing the arbitration provision in exchange for a generous compensation and benefits package. The court noted that although agreeing to the arbitration provision was a mandatory condition of employment (and therefore an indication of procedural unconscionability), without a high degree of substantive unconscionability, the provision was enforceable. The court concluded that the agreement was enforceable because substantive unconscionability was not present.

AT&T Mobility LLC v. Concepcion

As the discussion above indicates, the U.S. Supreme Court has held that the FAA mandates that arbitration agreements be enforced according to the terms contained within their four corners. California courts, on the other hand, are more willing to look beyond the four corners of those documents and apply the unconscionability doctrine under circumstances in which there is purported unfairness. In deciding *Concepcion*, the Court has an opportunity to address whether the FAA preempts California law prohibiting the enforcement of unconscionable arbitration agreements. In other words, the Court will examine whether California's developing unconscionability doctrine is preempted by federal law and therefore unenforceable as to arbitration agreements.

In *Laster*,[11] the case from which *Concepcion* was appealed, plaintiff customers brought a putative class action alleging that defendant AT&T Mobility LLC ("AT&T") engaged in fraud by charging new subscribers sales tax for the retail value of free phones offered to anyone who signed up for telephone service. AT&T moved to compel plaintiffs to arbitrate their claims pursuant to an arbitration agreement that prohibited class arbitration. The district court denied AT&T's motion to compel. The district court held that the class action waiver was unconscionable under California law. Further, the district court held that California unconscionability law is not preempted by the FAA.

On appeal, the Ninth Circuit Court of Appeals affirmed the district court with respect to both holdings. The court applied the test for whether a class action wavier in a consumer contract is unconscionable as set forth by the California Supreme Court in *Discover Bank*,[12] and found: (1) that the wireless service agreement containing the arbitration clause was a contract of adhesion; (2) that the dispute between the plaintiffs and AT&T was likely to involve a small amount of damages; and (3) that AT&T—which had superior bargaining power—carried out a scheme to cheat large numbers of consumers out of small sums of money. With regard to the FAA expressly preempting California contract law, the court held that "because unconscionability is a generally applicable contract defense, it may be applied to invalidate an arbitration agreement without contravening… the FAA." Further, regarding implied preemption, the court held that California's

(Continued on page 4)

DHS Issues I-9 Electronic Filing Rule

In our April 2009 Employment Law Commentary entitled "New I-9 Forms in Effect," we noted that all employers are required to begin using the new version of the U.S. Citizenship and Immigration Service ("USCIS") Form I-9. On July 22, 2010, the United States Department of Homeland Security ("DHS") published a final rule amending its regulations to allow I-9 forms to be signed electronically and retained in electronic format.[13] The final rule, which took effect on August 23, 2010, applies to employers and recruiters, or those who refer employees for a fee and are required under the Immigration and Nationality Act to verify employment eligibility using I-9 forms. The final rule permits those persons and entities to complete, sign, scan, and store the I-9 forms electronically—including those already existing—as long as certain performance standards are met. The final rule makes minor changes to an interim rule that became effective in 2006.

The final rule, among other things, clarifies that:

- Employers must complete a Form I-9 within three business (not calendar) days;
- Employers may use paper or electronic systems, or a combination of paper and electronic systems;
- Employers may change electronic storage systems as long as the systems meet the performance requirements of the regulations;
- Employers need not retain audit trails of each time a Form I-9 is electronically viewed, but only when a Form I-9 is created, completed, updated, modified, altered, or corrected; and
- Employers may provide or transmit a confirmation of a Form I-9 transaction, but are not required to do so unless the employee requests a copy.

Additional information regarding the final rule can be found at the United States Department of Justice website at the following URL: http://www.justice.gov/eoir/vll/fedreg/2010_2011/fr22jul10.pdf.

unconscionability doctrine does not "stand as an obstacle to the FAA" with respect to the FAA's purposes: (1) to reverse judicial hostility to arbitration agreements by placing them on the same footing as any other contract and (2) to promote the efficient and expeditious resolution of claims.

While the outcome of *Concepcion* remains to be seen, the U.S. Supreme Court has an opportunity to limit state-law principles that prevent the enforcement of arbitration agreements based on their terms by holding that such principles are preempted by the FAA.

Implications for Employers

While it appears that the U.S. Supreme Court may offer some clarity with regard to the interplay between the FAA and state-law contract defenses, it remains important that employers work with counsel to make certain that arbitration agreements comply with all applicable laws. Employers should take all necessary steps to ensure that agreements are not drafted in such a manner that they might be declared unconscionable. Further, the risks associated with provisions such as class action waivers should be closely examined.

[1] *AT&T Mobility LLC v. Concepcion*, 130 S. Ct. 3322 (2010).

[2] *Rent-A-Center, W., Inc. v. Jackson*, 130 S. Ct. 2772 (2010).

[3] *Stolt-Nielsen S.A. v. AnimalFeeds Int'l Corp.*, 130 S. Ct. 1758 (2010).

[4] In a third case, *Granite Rock Co. v. Int'l Bhd. of Teamsters*, 130 S. Ct. 2847 (2010), the Court addressed issues concerning the ratification date of a collective bargaining agreement. Although the FAA was not directly implicated, the Court discussed "precedents applying the FAA because they employ the same rules of arbitrability that govern labor cases."

[5] *See Volt v. Bd. of Trs. of Leland Stanford Junior Univ.*, 489 U.S. 468 (1989).

[6] *See Armendariz v. Foundation Health Psychcare Servs.*, 24 Cal. 4th 83 (2000).

[7] *See Dotson v. Amgen, Inc.*, 181 Cal. App. 4th 975 (2010).

[8] *Trivedi v. Curexo Tech. Corp.*, __ Cal. App. __, 2010 WL 3760224 (Cal. App. 4 Dist. Sep. 28, 2010).

[9] *Suh v. Superior Court*, 181 Cal. App. 4th 1504 (2010).

[10] *See Dotson, supra note 7, citing Olvera v. El Pollo Loco, Inc.*, 173 Cal. App. 4th 447 (2009).

[11] *Laster v. AT&T Mobility LLC*, 584 F.3d 849 (9th Cir. 2010).

[12] Under the test set forth in *Discover Bank v. Superior Court*, 36 Cal. 4th 148 (2005), the presence of the following three factors is sufficient to establish that a class action waiver is unconscionable: (1) the contract at issue is one of adhesion; (2) the dispute involves a relatively small amount of damages; and (3) the dispute involves allegations that the defendant has carried out a scheme to deliberately cheat large numbers of consumers out of individually small sums of money. *See also Arguelles-Romero v. Superior Court*, 184 Cal. App. 4th 825 (2010) (holding that class action waivers can still be unconscionable in the absence of the Discover Bank elements).

[13] 75 Fed. Reg. 42575.

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