

## *Note*

# **The California Supreme Court Framework for Mandatory Arbitration Agreements: *Armendariz v. Foundation Health Psychcare Services, Inc.***

By BERNARD FINNEGAN\*

**T**HE SITUATION IS familiar to every human resource employee in the country and repeated daily in all types of industries. An employer has decided to hire a new employee and wishes to avoid a costly jury trial should the employment relationship go sour. The general counsel's office offers the perfect solution: Before he is employed, have the employee sign an agreement requiring any dispute be submitted to binding arbitration. Costs are reduced and the dispute will be resolved more quickly. Once the interview and application process is over, the employee is trotted down to the human resources department to fill out the paperwork before he starts the job.

In addition to the usual payroll paperwork, a strange piece of paper is placed before the prospective employee entitled "Pre-Employment Contract." The employee is told that this document must be signed or the offer of employment will be withdrawn. Amongst the trade secret and the drug screening clauses is a clause that requires the employee to submit any employment dispute to binding arbitration.<sup>1</sup> The employee signs, and begins working for the employer, but later, the employment relationship sours—either the employee per-

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\* Class of 2002. The author would like to dedicate this article to his mother Merrily Helaine Finnegan for her years of support, encouragement, and love. The author would also like to thank B. James Finnegan for his support and inspiration; Molly Finnegan for leading the way; and Lynn Alsbaugh for her patience and understanding.

1. BLACK'S LAW DICTIONARY 100 (7th ed. 1999) (defining arbitration as "A method of dispute resolution involving one or more neutral third parties who are [usually] agreed to by the disputing parties and whose decision is binding.").

ceives harassment and brings suit, or he is terminated. The employee consults an attorney regarding filing suit. Perhaps unaware of the arbitration provision, the attorney files suit in state or federal court seeking relief. The employer moves to dismiss, based on the existence of the signed agreement requiring arbitration; the judge must then decide whether to enforce the agreement.

Much has been written recently regarding the use of mandatory arbitration clauses in collective bargaining agreements and pre-employment contracts. The plaintiff's bar seeks to invalidate the clauses, while employers seek enforcement. Until recently, the Ninth Circuit Court of Appeals sided with plaintiffs, holding that the Federal Arbitration Act ("FAA") does not apply to employment contracts.<sup>2</sup> The Ninth Circuit had also held that civil rights claims brought under Title VII<sup>3</sup> for discrimination in employment cannot be subject to mandatory arbitration.<sup>4</sup>

The validity of mandatory arbitration clauses, where the dispute involves state and federal civil rights, as well as any legal rights under the pre-employment contract, has been extensively litigated.<sup>5</sup> The result is a split in authority, with the majority of federal circuit courts of appeal<sup>6</sup> and the California Supreme Court holding that they are enforceable.<sup>7</sup> The Ninth Circuit has held that Congress did not intend that Title VII<sup>8</sup> claims be subject to compulsory arbitration.<sup>9</sup> As the history of arbitration agreements has been extensively covered, this Note examines recent changes in the law and elaborates on the California Supreme Court's position on arbitration agreements.<sup>10</sup>

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2. See *Craft v. Campbell Soup Co.*, 177 F.3d 1083, 1094 (9th Cir. 1999) (holding that the FAA does not apply to labor or employment contracts).

3. See 42 U.S.C. § 2000(a) (1994) (prohibiting discrimination on the basis of race, color, religion, or national origin).

4. See *Duffield v. Robertson Stephens & Co.*, 144 F.3d 1182, 1185 (9th Cir. 1998).

5. See, e.g., *Armendariz v. Foundation Health Psychcare Servs., Inc.*, 6 P.3d 669 (Cal. 2000).

6. See *Koveleskie v. SBC Capital Mkts., Inc.*, 167 F.3d 361 (7th Cir. 1999); *Rosenberg v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 170 F.3d 1 (1st Cir. 1999); *Seus v. John Nuveen & Co.*, 146 F.3d 175 (3d Cir. 1998); *Cole v. Burns Int'l Sec. Servs.*, 105 F.3d 1465 (D.C. Cir. 1997); *Bender v. A.G. Edwards & Sons, Inc.*, 971 F.2d 698 (11th Cir. 1992) (holding that arbitration agreements are enforceable).

7. See *Armendariz*, 6 P.3d 669, 699 (Cal. 2000).

8. See *Craft v. Campbell Soup Co.*, 177 F.3d 1083, 1083 (9th Cir. 2000).

9. See *Duffield v. Robertson Stephens & Co.*, 144 F.3d 1182, 1185 (9th Cir. 1998).

10. See, e.g., Shane Anderies, Note, *Mandatory Arbitration Clauses in Individual Employment Contracts After Duffield v. Robertson Stephens & Co.: A Note on Armendariz v. Foundation Health Psychcare Services, Inc.*, 34 U.S.F. L. REV. 765 (2000) (extensively covering the history of mandatory arbitration in California leading up to the present decision).

This Note examines both the minimum requirements for drafting and enforcing mandatory arbitration agreements and the arguments for and against each of these requirements. Part I of this Note gives a brief background of the issues involved and the cases leading up to the California Supreme Court's decision in *Armendariz*. Part II addresses the *Armendariz* case in detail and examines the requirements that the court has set forth. Part III deals with the effects of this decision on employers who have existing agreements and on plaintiffs who choose to bring actions against their employers. This Note concludes that the California Supreme Court was correct in upholding these provisions, but proposes that the court, by sidestepping too many important issues, did not go far enough.

## I. Background

The first United States Supreme Court case to examine the enforceability of arbitration agreements was *Alexander v. Gardner-Denver*<sup>11</sup> in which the Court rejected a mandatory arbitration clause contained in a collective bargaining agreement and allowed the plaintiff to pursue judicial relief.<sup>12</sup> The Court subsequently altered the employment arbitration landscape in *Gilmer v. Interstate/Johnson Lane Corp.*<sup>13</sup> holding that a claim brought under the Age Discrimination in Employment Act<sup>14</sup> was subject to mandatory arbitration.<sup>15</sup> There the issue was not one of collective bargaining, but instead involved an individual pre-employment contract signed as a condition of employment in the securities industry.<sup>16</sup>

### A. *Duffield v. Robertson Stephens, Co.*: The Civil Rights Act of 1991 Precludes the Enforcement of Mandatory Arbitration in Title VII Claims

Recently, the Ninth Circuit Court of Appeals overturned the district court's decision compelling arbitration in a Title VII and Fair Employment and Housing Act ("FEHA") claim in *Duffield*.<sup>17</sup> *Duffield*, interpreting *Gilmer*, had created a circuit split with the majority of

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11. 415 U.S. 36 (1974).

12. *See id.* at 59–60.

13. 500 U.S. 20 (1991).

14. 29 U.S.C. § 621 (1994).

15. *See Gilmer*, 500 U.S. at 23.

16. *See id.*

17. *See Duffield v. Robertson Stephens & Co.*, 144 F.3d 1182, 1185 (9th Cir. 1998).

courts aligned against the Ninth Circuit.<sup>18</sup> Tonya Duffield was a broker-dealer in the securities industry who was required to sign a pre-employment arbitration agreement which included an arbitration clause.<sup>19</sup> In a groundbreaking decision, the Ninth Circuit held that the Civil Rights Act of 1991<sup>20</sup> precludes the mandatory arbitration of Title VII claims.<sup>21</sup>

While this decision has not been expressly overturned, the United States Supreme Court in *Circuit City Stores, Inc. v. Saint Clair Adams*<sup>22</sup> has certainly fired a warning shot across the bow.<sup>23</sup> In *Circuit City Stores, Inc.*, the Court felt that the intent of Congress was that employment agreements are to be covered under the Federal Arbitration Act.<sup>24</sup> By overturning the Ninth Circuit's earlier holding that the FAA does not apply to employment contracts,<sup>25</sup> the Court appears to have made its position known.

### **B. *Cole v. Burns International Security Services*: Factors Required in Mandatory Arbitration Agreements**

The Court of Appeals for the District of Columbia issued an opinion which helped form the basis for the California Supreme Court's holding in *Armendariz*. In *Cole v. Burns International Security Services*,<sup>26</sup> The court of appeals created a framework for evaluating arbitration agreements. The court read *Gilmer* as "requiring the enforcement of arbitration agreements that do not undermine the relevant statutory scheme."<sup>27</sup> The court in *Cole* first determined that the only agreements that fall outside of the FAA are those that cover workers involved directly in the movement of goods in interstate commerce.<sup>28</sup> The court then expounded on five factors necessarily present before a clause is deemed valid:

[T]he arbitration arrangement (1) provides for neutral arbitrators, (2) provides for more than minimal discovery, (3) requires a written award, (4) provides for all of the types of relief that would oth-

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18. See *supra* note 6 discussing the majority view.

19. See *Duffield*, 144 F.3d at 1185.

20. 42 U.S.C. § 2000 (1996).

21. See *Duffield*, 144 F.3d. at 1190 n.7.

22. No. 99-1379, 2001 U.S. Lexis 2459 (Mar. 21, 2001).

23. See *id.* (holding that the FAA applies to all employment contracts including collective bargaining agreements).

24. See *id.*

25. See *Craft v. Campbell Soup Co.*, 177 F.3d 1083, 1094 (9th Cir. 1999).

26. 105 F.3d 1465 (D.C. Cir. 1997).

27. *Id.* at 1468.

28. See *id.* at 1472.

erwise be available in court, and (5) does not require employees to pay either unreasonable costs *or* any arbitrators' fees or expenses as a condition of access to the arbitration forum.<sup>29</sup>

Prior to *Armendariz*, the state courts had to review conflicting federal and state law to determine whether to uphold arbitration clauses in employment contracts. The California Supreme Court provided some guidelines for the lower courts to follow.

## II. The Case

### A. Parties

Marybeth Armendariz and Dolores Olague-Rodgers ("Plaintiffs") were formerly employed as supervisors in the Provider Relations Group at Foundation Health Psychcare Services, Inc. ("Defendant").<sup>30</sup> On June 20, 1996, Plaintiffs were informed that their positions were being eliminated and that they were being terminated.<sup>31</sup> They subsequently filed a complaint for wrongful termination against Defendant in a superior court.<sup>32</sup> The Plaintiffs alleged that they had been terminated after a year of sexual harassment by their same sex coworkers and supervisor.<sup>33</sup> The basis of their complaint was that they were terminated in violation of the FEHA for being heterosexual.<sup>34</sup> Both Plaintiffs had filled out and signed employment application forms which included a clause requiring arbitration of all wrongful termination claims.<sup>35</sup> The agreement also limited damages to wages which would have been earned from the date of the termination until the date of the arbitration award and denied any other remedy at law or in equity.<sup>36</sup>

### B. Procedural Posture

After receiving the initial complaint, Defendant responded by filing a motion to compel arbitration.<sup>37</sup> The trial court denied the mo-

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29. *Id.* at 1482.

30. *See Armendariz v. Found. Health Psychcare Servs., Inc.*, 6 P.3d 669, 674 (Cal. 2000).

31. *See id.* at 675.

32. *See id.* at 674.

33. *See id.* at 675.

34. *See id.*; *see also* Fair Employment and Housing Act (codified as CAL. GOV. CODE § 12920) (West 1992) (listing among the characteristics singled out for protection: "sexual orientation").

35. *See Armendariz*, 6 P.3d at 675.

36. *See id.*

37. *See id.*

tion on the grounds that the arbitration provision was an “adhesion contract”<sup>38</sup> and that the provisions were such that they shocked the conscience.<sup>39</sup> The court focused specifically on the requirement that the employees arbitrate their claims, but not the employer; it also focused on the limitation of damages and remedies.<sup>40</sup> The Defendant appealed the decision.<sup>41</sup>

The court of appeal reversed the lower court decision,<sup>42</sup> determining that the contract was one of adhesion and the damages provision was unconscionable and contrary to public policy.<sup>43</sup> The court of appeal did hold that the arbitration agreement itself was valid and severed the offending damages provision.<sup>44</sup> Subsequently, the California Supreme Court granted review to address the issue of whether employers may enforce mandatory arbitration agreements.<sup>45</sup>

### C. The California Supreme Court Decision

The California Supreme Court first found the agreement between Foundation and the employees to be unconscionable, allowing the employees to bring their claim before a jury.<sup>46</sup> The court proceeded to address the issue of mandatory arbitration and implicitly held that such agreements are nevertheless enforceable if they meet the criteria established in *Cole*.<sup>47</sup> As a result, the court’s opinion has served as a road map of rules for employers to follow in creating valid arbitration clauses. At the time, the California Supreme Court, in rejecting *Duffield*, also created incentives for employees to engage in forum shopping when bringing Title VII and corresponding FEHA claims.

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38. See *Neal v. State Farm Ins. Cos.*, 10 Cal. Rptr. 781, 785 (1961) (defining a contract of adhesion as “a standardized contract, which, imposed and drafted by the party of superior bargaining strength, relegates to the subscribing party only the opportunity to adhere to the contract or reject it.”).

39. See *Armendariz*, 6 P.3d at 675.

40. See *id.*

41. See *id.*

42. See *Armendariz*, 80 Cal. Rptr. 2d 255, 258 (Cal. Ct. App. 1998).

43. See *id.* at 263.

44. See *id.* at 268.

45. See *Armendariz*, 6 P.3d at 676.

46. See *id.*

47. See *id.* (discussing *Cole v. Burns Int’l Sec. Servs.*, 105 F.3d 1465 (D.C. Cir. 1997)).

## 1. Majority Opinion

### a. Applicability of the FAA to Employment Contracts

The first issue before the California Supreme Court was whether the FAA would apply to employment contracts.<sup>48</sup> Rather than resolve the issue, the court chose not to decide the matter.<sup>49</sup> Instead, the court decided to distinguish *Duffield* based on differences between the Federal Arbitration Act and the California Arbitration Act<sup>50</sup> (“CAA”). Noting that the FEHA contains no prohibition against the use of mandatory arbitration, the court turned to whether the contract was unconscionable or against public policy.<sup>51</sup> This issue, however, was recently resolved. The United States Supreme Court in *Circuit City Stores*<sup>52</sup> recently held that employment contracts are covered under the FAA unless they involve the specific exemptions contained therein.<sup>53</sup>

### b. Notice

The second issue argued by the Plaintiffs and passed on by the court, was the level of notice required in an arbitration agreement to waive civil rights claims.<sup>54</sup> Plaintiffs contended that the clause only applied to contractual rights and that they had not been given clear notice that their rights under FEHA, or any other statutory framework, were also subject to compulsory arbitration.<sup>55</sup> The court noted that the Ninth Circuit had held mandatory arbitration clauses to be unenforceable unless the clause expressly put the employees on notice that their statutory claims are included.<sup>56</sup> The court declined to decide this issue because the employees failed to petition for review on this issue.<sup>57</sup>

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48. See *id.* at 678.

49. See *id.*

50. See CAL. CIV. PROC. CODE § 1280(a) (West 1982) (defining “Agreement” under the CAA as “[including] but is not limited to agreements providing for valuations, appraisals and similar proceedings and agreements between employers and employees.”). But see 9 U.S.C. § 1 (1997) (stating, “but nothing herein contained shall apply to contracts of employment of seamen, railroad employees, or any other class of workers engaged in foreign or interstate commerce”).

51. See *Armendariz*, 6 P.3d at 680.

52. No. 99-1379, 2001 U.S. Lexis 2459.

53. See *id.*

54. See *Armendariz*, 6 P.3d at 680 n.7.

55. See *id.*

56. See *Renteria v. Prudential Ins. Co. of Am.*, 113 F.3d 1104 (9th Cir. 1997).

57. See *Armendariz*, 6 P.3d at 680 n.7.

## 2. Requirements for a Valid Agreement

Next the court used contract principles to decide whether the arbitration agreement was unconscionable.<sup>58</sup> The court began: “assuming an adequate arbitral forum, we agree with the Supreme Court a party does not forgo the substantive rights afforded by the statute.”<sup>59</sup>

### a. Limitation of Remedies

Among the first issues addressed by the California Supreme Court in *Armendariz* was the principle that an arbitration agreement cannot contain a limitation of remedies,<sup>60</sup> noting that the purpose of the FEHA was to address discrimination.<sup>61</sup> Elaborating on its reasoning, the court stated: “It is indisputable that an employment contract that required employees to waive their rights under the FEHA to redress sexual harassment or discrimination would be contrary to public policy and unlawful.”<sup>62</sup> Thus, “[i]n light of these principles, it is evident that an arbitration agreement cannot be made to serve as a vehicle for the waiver of statutory rights.”<sup>63</sup>

The court based its finding, that the limitation of damages provision unconscionable, in part on its prior decision in *Broughton v. CIGNA Health Plans of California*.<sup>64</sup> In *Broughton*, the court examined a claim brought under the Consumer Legal Remedies Act,<sup>65</sup> which includes a provision for “permanent injunctive relief to enjoin deceptive business practices.”<sup>66</sup> The court concluded “such a remedy is beyond the scope of an arbitrator to grant or properly enforce.”<sup>67</sup> Thus, an agreement to arbitrate cannot contain a provision that would limit statutory remedies. The *Broughton* court also noted that where an agreement contained limitations on punitive damages and attorneys’ fees, that agreement is also unlawful.<sup>68</sup> So, under *Armendariz* there is a

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58. See *A&M Produce Co. v. FMC Corp.*, 135 Cal. Rptr. 114, 122 (1982) (finding that there are two different elements of unconscionability: the first element is procedural and focuses on whether there was oppression or surprise; the second element is substantive and focuses on the terms of the agreement. Both need to be satisfied, though not equally.).

59. *Armendariz*, 6 P.3d at 679 (quoting *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*, 473 U.S. 614, 628 (1985)).

60. See *id.*

61. See *Rojo v. Kliger*, 801 P.2d 373, 380 (Cal. 1990).

62. *Armendariz*, 6 P.3d at 681.

63. *Id.*

64. 988 P.2d 67 (Cal. 1999).

65. CAL. CIV. CODE § 1750 (West 1998).

66. *Broughton*, 988 P.2d at 71.

67. *Id.*

68. See *Graham Oil Co. v. Arco Prods. Co.*, 43 F.3d 1244 (9th Cir. 1994).

requirement that any agreement cannot limit an employee's statutory damages<sup>69</sup>—this includes punitive damages.<sup>70</sup> The court also found that the contract provision limiting damages to salary up to the time of arbitration and denying equitable relief was unconscionable.<sup>71</sup>

### b. Adequate Discovery

The court next looked at how the employee's rights may be safeguarded where the employer is often in control of the necessary documents.<sup>72</sup> The Defendants argued that their agreement was valid because it had incorporated all of the rules of the CAA.<sup>73</sup> The CAA contains a provision allowing for depositions and discovery for civil cases as if the claim was brought before a court.<sup>74</sup> The court did note that parties could agree to something less than the full range of discovery, but such an agreement must be express.<sup>75</sup> Otherwise, "when parties agree to arbitrate statutory claims, they also implicitly agree, absent express language to the contrary, to such procedures as are necessary to vindicate that claim."<sup>76</sup> Even if the parties are not entitled to the full range of discovery under the CAA, "they are at least entitled to discovery sufficient to adequately arbitrate their statutory claim, including access to essential documents and witnesses."<sup>77</sup>

### c. Written Arbitration Award to Allow Judicial Review

The court next addressed the requirement that the arbitrator issue an award in writing that "will reveal, however briefly, the essential findings and conclusions on which the award is based."<sup>78</sup> The Plaintiffs argued that the court's decision in *Moncharsh v. Heily & Blase*<sup>79</sup>

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69. This Note does not address whether an employer can limit contract damages.

70. See *Commodore Home Sys., Inc. v. San Bernardino County*, 649 P.2d 912, 918 (Cal. 1982).

71. See *Armendariz v. Found. Health Psychcare Servs., Inc.* 6 P.3d 669, 683 (Cal. 2000).

72. See *id.*

73. See *id.*

74. See CAL. CIV. PROC. CODE § 1283.05(a) (West Supp. 2000) (allowing for such discovery unless the dispute is a "limited civil case").

75. See *Armendariz*, 6 P.3d at 684.

76. *Id.*

77. *Id.*

78. *Id.* at 685.

79. 832 P.2d 899 (Cal. 1992). In *Moncharsh*, the California Supreme Court overturned the common law rule that an arbitrator's award could be vacated if there was an error on the face of the award and it would cause substantial injustice. See *id.* The court determined that this was contrary to public policy, but in dicta said that an award could be subject to judicial review if it was inconsistent with a party's statutory rights. See *id.*

rendered this point moot, as review would provide plaintiffs with no protection.<sup>80</sup> In *Moncharsh*, the California Supreme Court held that even an award that is "erroneous on its face and will cause substantial injustice" is not subject to judicial review.<sup>81</sup> Plaintiffs contended that even if an award contained a significant error of law that would cause substantial injustice, there was nothing the court could do.<sup>82</sup> The court even admits that mistakes will happen, but accepts that the benefit of allowing parties to bypass the judicial system and obtain a speedy decision outweighs the potential harm.<sup>83</sup> The *Armendariz* court did not address what standard of review was necessary to comply with the statute and avoided the issue as the court was not faced with a petition to confirm an award.<sup>84</sup> The court chose instead to rely on the United States Supreme Court decision in *Shearson/American Express, Inc. v. McMahon*,<sup>85</sup> in which the Court held that judicial scrutiny of arbitration awards was proper to ensure that arbitrators comply with the statute.<sup>86</sup> Thus, the court merely held that an arbitrator in a FEHA claim must issue a written arbitration decision to allow for judicial review.<sup>87</sup>

#### d. Neutral Arbitrator

Plaintiffs did not contest the neutrality of the arbitrator involved in their case.<sup>88</sup> However, this is an issue that requires the attention of any attorney drafting such an agreement. The California Supreme Court stated, prior to the *Armendariz* case, that the use of a neutral arbitrator is essential to the integrity of the arbitration process.<sup>89</sup> There are remedies where an arbitration agreement contains a provision which allows for the use of a biased or pre-selected arbitrator.<sup>90</sup> The court would likely sever that portion of the agreement.<sup>91</sup> A good example of a well written arbitration clause can be found in *Little v.*

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80. *Armendariz*, 6 P.3d at 684–85.

81. *Moncharsh*, 832 P.2d at 919 (Kennard, J., dissenting).

82. *See id.*

83. *See id.* at 904.

84. *Armendariz*, 6 P.3d at 684–85.

85. 482 U.S. 220 (1987).

86. *See id.* at 232.

87. *Armendariz*, 6 P.3d at 685.

88. *See id.* at 682.

89. *See Graham v. Scissor-Tail, Inc.*, 623 P.2d 165, 167 (Cal. 1981).

90. Examples of biased or pre-selected arbitrators include: when the employer forces the employee to arbitrate the dispute with a law firm it has on retainer; the human resources director of an affiliate; or even a single arbitrator known for a defensive bias.

91. *See id.*

*Auto Steigler, Inc.*,<sup>92</sup> a recent case upholding a mandatory arbitration clause.<sup>93</sup>

### e. Costs Must Be Paid by the Employer

The next argument addressed by the *Armendariz* court involved the apportioning of the costs of arbitration in FEHA cases.<sup>94</sup> The Plaintiffs argued that the requirement that they share the costs of arbitration,<sup>95</sup> which are often substantial,<sup>96</sup> posed an undue burden on their ability to seek redress of their claims.<sup>97</sup> The court determined that “when an employer imposes mandatory arbitration as a condition of employment, the arbitration agreement . . . 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.”<sup>98</sup> The court rested its decision on the potentially chilling effect large costs would have on plaintiffs’ exercise of their constitutional rights<sup>99</sup>—an employee who is unable or unwilling to foot the high forum costs would be precluded from obtaining relief.<sup>100</sup> The *Armendariz* court felt that requiring the employer to bear the costs was fair, as the party requiring mandatory arbitration is the one who bears the costs of such arbitration.<sup>101</sup> The court specifically stated that in order for arbitration to be compelled “[there must be] specific provisions on arbitration costs.”<sup>102</sup> Forcing employees to pay arbitration costs was also disfavored, even when the employer prevails.<sup>103</sup> Thus, the *Armendariz* court felt that the risk that an employee would not

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92. 92 Cal. Rptr. 2d 56, 58 (2001) (providing that the arbitrator was to be a retired superior court judge and would be subject to disqualification for the same reasons as a judge of that court).

93. See *id.* at 58.

94. *Armendariz v. Found. Health Psychcare Servs., Inc.*, 6 P.3d 669, 684–85 (Cal. 2000).

95. See CAL. CIV. PROC. CODE § 1284.2 (West 1982) (providing that “each party to the arbitration shall pay his pro rata share of the expenses and fees of the neutral arbitrator.”).

96. See *Armendariz*, 6 P.3d at 685.

97. See *id.* at 685.

98. *Id.* at 687.

99. See *id.*

100. See *Shankle v. B-G Maint. Mgmt. of Colo., Inc.*, 163 F.3d 1230 (10th Cir. 1999).

101. See *Armendariz*, 6 P.3d 669, 686 (Cal. 2000) (citing *Cole v. Burns Int’l Sec. Servs.*, 105 F.3d 1465 (D.C. Cir. 1997)).

102. *Id.* at 679.

103. See generally *Cal. Teachers Ass’n v. California*, 975 P.2d 622 (Cal. 1999) (holding it is not constitutionally permissible to require a teacher who lost an administrative procedure to pay one half of the Administrative Law Judge fees).

bring a claim to vindicate his statutory rights for fear of a substantial costs would chill those rights.<sup>104</sup>

#### f. Agreements Must Require That Both Parties Submit to Arbitration

The court next looked at the contract to determine if the contract, or any part of it, was unconscionable.<sup>105</sup> The court did not restrict this particular ruling to the arbitration of statutory claims, but held that it applies to all claims where mandatory arbitration is required as a condition of employment.<sup>106</sup> The first part of the analysis used by the court was to determine whether the contract was one of adhesion.<sup>107</sup> After determining that the agreement was a contract of adhesion, the court looked at whether it should be enforced against the employees.<sup>108</sup>

The Plaintiffs argued, relying on *Stirlen v. Supercuts, Inc.*,<sup>109</sup> that because the contract required only the employees to submit to arbitration, it should be held unconscionable. The court upheld the court of appeals decision in *Stirlen* requiring that an arbitration agreement must provide a “modicum of bilaterality,”<sup>110</sup> reasoning that “[if] the arbitration system established by the employer is indeed fair, the employer . . . should be willing to submit claims to arbitration.”<sup>111</sup> The exception is if the employer has “at least some reasonable justification for such one-sidedness based on business realities.”<sup>112</sup> The court concluded, “the doctrine of unconscionability limits the extent to which a stronger party may, through a contract of adhesion, impose the arbitration forum on the weaker party without accepting that forum for itself.”<sup>113</sup>

### 3. Severability of Provisions

Defendant argued that even if some of the provisions of its contract were unconscionable, the court should sever those provisions,

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104. See *Armendariz*, 6 P.3d at 687.

105. See *id.* at 688.

106. See *id.*

107. See *id.*

108. See *id.* at 690–91.

109. 60 Cal. Rptr. 2d 138 (1st Dist. 1997).

110. *Armendariz*, 6 P.3d at 679.

111. *Id.*

112. *Id.*

113. *Id.* at 699.

but leave the agreement intact.<sup>114</sup> The court first examined the California Civil Code to determine the available options. Section 1670.5(a)<sup>115</sup> allows the court to either sever the offending provision or refuse to enforce the contract<sup>116</sup> and section 1598<sup>117</sup> allows for the voiding of an entire contract if its purpose is unlawful.<sup>118</sup> The court concluded that because the contract contained both an unlawful unilateral arbitration agreement and an unlawful limitation of damages provision, the contract was permeated by an unlawful purpose.<sup>119</sup> The *Armendariz* court concluded that, unlike a potentially severable clause limiting damages, a contract that has a lack of mutuality cannot be cured by severance; instead, it can only be cured by reformation<sup>120</sup> and there is no statute contained in the CAA that would allow the reformation of the contract at issue.<sup>121</sup>

#### 4. Justice Brown's Concurring Opinion

Justice Brown wrote separately to disagree with the majority solely on the issue of apportioning the costs of arbitration.<sup>122</sup> Justice Brown felt the most equitable way to apportion these costs was to allow the arbitrator to apportion the costs among the parties.<sup>123</sup> Her plan would neither require the employee to pay any of the costs up front nor pay a certain share.<sup>124</sup> Instead, "the arbitrator should consider the magnitude of the costs unique to arbitration, the ability of the employee to pay a share of these costs, and the overall expense of the arbitration as compared to a court proceeding."<sup>125</sup>

### III. Analysis and Criticism

The court in *Armendariz* attempted to placate both sides of the mandatory arbitration debate. On one hand, the court has allowed employers to continue to use these agreements to protect themselves. On the other hand, the court has subjected such agreements to in-

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114. *See id.* at 695.

115. CAL. CIV. CODE § 1670.5(a) (West 1985).

116. *See id.*

117. CAL. CIV. CODE § 1598 (West 1982).

118. *See id.*

119. *See Armendariz*, 6 P.3d at 684.

120. *See id.*

121. *See id.*

122. *See id.* at 699 (Brown, J., concurring).

123. *See id.*

124. *See id.*

125. *Id.*

tense scrutiny. Certain portions of the opinion do not require further comment, such as the requirement that a neutral arbitrator be used.<sup>126</sup> Furthermore, many commentators would be in agreement that allowing an employer to limit employees' statutory rights via a contract of adhesion likely runs against public policy.<sup>127</sup>

### A. The Decision

The court's rejection of the Ninth Circuit's decision in *Duffield*<sup>128</sup> was necessary to protect employers and uphold the intent of the legislature in drafting the CAA.<sup>129</sup> In doing so, the California Supreme Court has followed most other jurisdictions that have addressed the issue.<sup>130</sup> By distinguishing the *Gardner-Denver* line of cases, which involved the collective bargaining arena, the court in *Armendariz* correctly noted a difference where an individual voluntarily enters into an agreement.

In *Armendariz*, the employees cited the Dunlop Commission Report<sup>131</sup> to support their point that discovery is necessary in order to bring a FEHA claim. The court agreed "that adequate discovery is indispensable for the vindication of FEHA claims"<sup>132</sup> and held "[a]dequate provisions for discovery are set forth in the CAA at Code of Civil Procedure section 1283.05, subdivision (a)."<sup>133</sup> The difficulty

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126. See discussion *supra* Part II.C.2.d (discussing neutral arbitrators).

127. See *Armendariz*, 6 P.3d at 682 ("The principle that an arbitration agreement may not limit statutorily imposed remedies such as punitive damages and attorneys fees appears to be undisputed.").

128. See *supra* note 9.

129. See generally CAL. CIV. PROC. CODE §§ 1280–89 (West 1987).

130. See discussion *supra* Part I.A.

131. Commission on the Future of Worker-Management Relations, Reported Recommendations (1994) available at [http://www.ilr.cornell.edu/library/e\\_archive/gov\\_reports/default.html?page=dunlop%2Fdunlop](http://www.ilr.cornell.edu/library/e_archive/gov_reports/default.html?page=dunlop%2Fdunlop).

132. *Armendariz*, 6 P.3d at 683.

133. *Id.* See also CAL. CIV. PROC. CODE § 1283.05(a) (West 2001). To the extent provided in section 1283.1 depositions may be taken and discovery obtained in arbitration proceedings as follows:

- (a) After the appointment of the arbitrator or arbitrators, the parties to the arbitration shall have the right to take depositions and to obtain discovery regarding the subject matter of the arbitration, and, to that end, to use and exercise all of the same rights, remedies, and procedures, and be subject to all of the same duties, liabilities, and obligations in the arbitration with respect to the subject matter thereof, as provided in Chapter 2 (commencing with Section 1985) of, and Article 3 (commencing with Section 2016) of Chapter 3 of, Title 3 of Part 4 of this code, as if the subject matter of the arbitration were pending before a superior court of this state in a civil action other than a limited civil case.

*Id.*

is in attempting to reconcile the “desirable simplicity with the requirements of the FEHA in determining the appropriate discovery.”<sup>134</sup> While the court does provide employers with an opportunity to tailor the agreements to limit discovery,<sup>135</sup> it still provides adequate protection for employees seeking information, and allows for judicial review.<sup>136</sup> While there exists the potential for abuse on both sides, this portion of the decision comports with general notions of fairness.

By forcing employers to bear the costs of arbitration, the court has both placated plaintiffs’ attorneys, and placed the burden squarely on those most able to afford it. Employees will not be dissuaded from bringing discrimination claims by high costs and smaller awards.<sup>137</sup> Both sides of the debate win on this issue—the employer gets a quick resolution of the claim in arbitration, and the employee suffers no greater cost than litigation in a courtroom. Furthermore, the plaintiff benefits from quick resolution. The requirement of neutral arbitrators, coupled with efforts from the plaintiffs’ bar should be sufficient to avoid any bias by companies seeking repeat defense business.<sup>138</sup>

The requirement of a written award, which can be subject to judicial review, will ensure that a plaintiff’s rights are vindicated. This requirement protects the employer as well. By outlining the basis for its decision, the employer is provided with information that should help prevent problems in the future. Furthermore, in backing off from the overall tone in *Moncharsh*<sup>139</sup> and sanctioning some judicial review of arbitration awards, the court has provided ample protection against unlawful awards.

Finally, by essentially declaring that all agreements that are not binding on both parties are unlawful<sup>140</sup> and not subject to severance,<sup>141</sup> the court has laid down a fairly bright line test by which employers may review their existing agreements. Employers will know the court has the option of either severing the unconscionable terms or invalidating the agreement.<sup>142</sup> If the arbitration agreement does not contain the “modicum of bilaterality” then any motion to compel arbi-

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134. *Id.* at 684 n.11.

135. *See Armendariz*, 6 P.3d at 684.

136. *See id.*

137. *See id.* at 686–87.

138. *See Cole v. Burns Int’l Sec. Servs.*, 105 F.3d 1465, 1485 (D.C. Cir. 1997).

139. *Moncharsh v. Heily & Blase*, 832 P.2d 899, 900 (Cal. 1992) (en banc) (holding that generally any substantive review, even where there was an error in law on the face of the award which resulted in substantial injustice, is barred).

140. *See supra* text accompanying note 119.

141. *See supra* text accompanying note 120.

142. *See Armendariz*, 6 P.3d at 680.

tration must fail. If, however, there are other clauses that could be severed, the contract must be analyzed to determine if the central purpose is "permeated by an unlawful purpose."<sup>143</sup> If it is not, it can be cured by "severance, restriction or duly authorized reformation."<sup>144</sup> This portion of the holding will keep many attorneys busy drafting subsequent arbitration agreements which bind employers wishing to arbitrate their disputes.

## B. What Needs to Be Done

The two issues the court declined to address, but which may threaten the validity of mandatory arbitration, are the requirement of express notice and the judicial standards of review for statutory claims leading to review of arbitration awards.

### 1. Review of the Arbitrator's Award

In *Moncharsh*, the California Supreme Court held that the only grounds for review of an arbitrator's award were those contained in the California Code of Civil Procedure section 1286.2<sup>145</sup> and thus severely limited the ability of a party to seek redress of an award issued in error.<sup>146</sup> While the *Armendariz* court does attempt to soften this stance, by quoting its earlier decision suggesting judicial review may be necessary when the arbitrator's award is inconsistent with a party's statutory rights,<sup>147</sup> the court conveniently ignores its own statement immediately following: "Without an explicit legislative expression of public policy, however, courts should be reluctant to invalidate an arbitrator's award on this ground. The reason is clear: the Legislature has already expressed its strong support for private arbitration and the finality of arbitral awards . . . ."<sup>148</sup> While this may seem harsh, the underlying truth is that arbitrators are not bound by the black letter of

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143. *Id.* at 684.

144. *Id.* at 685.

145. CAL. CIV. PROC. CODE § 1286.2 (West Supp. 2002). The five grounds for overturning an arbitration award are:

(a) The award was procured by corruption, fraud or other undue means; (b) there was corruption in any of the arbitrators; (c) the rights of such party were prejudiced by misconduct of the neutral arbitrator; (d) the arbitrator exceeded their powers . . . ; (e) the rights of the party were substantially prejudiced by the refusal to postpone . . . or by the refusal of the arbitrator to hear evidence material . . . or by other conduct . . . contrary to the provisions of this title. *Id.*

146. *See Moncharsh v. Heily & Blase*, 832 P.2d 899, 923 (Cal. 1992) (Kennard, J., dissenting).

147. *See Armendariz*, 6 P.3d at 685 (quoting *Moncharsh*, 832 P.2d at 918).

148. *Moncharsh*, 832 P.2d at 919.

the law, instead they decide the cases *ex aequo et bono*,<sup>149</sup> allowing them to take into account factors that a court may not.<sup>150</sup> Based on this premise, an arbitrator may be able to go outside of traditional evidentiary rules and consider all relevant information in making a decision. While there may be an occasional mistake, the cost savings by the avoidance of litigation should make up for such mistakes.

## 2. Notice of Mandatory Arbitration

The other issue that has yet to be resolved is the type of notice necessary prior to enforcement of an agreement to arbitrate disputes. In the case of voluntary arbitration, this is not an issue. However, in the pre-employment contract stage, this is an issue that could prohibit the enforcement of an agreement. The Ninth Circuit in *Renteria v. Prudential Insurance Company of America*,<sup>151</sup> held that the standard for compelling arbitration is whether the plaintiff made a “knowing waiver” of his rights to a judicial forum.<sup>152</sup> Furthermore, the provision must include a clause that the plaintiff is bound to arbitrate Title VII claims.<sup>153</sup> While this holding has been criticized by other courts,<sup>154</sup> the lesson to employers is to include a comprehensive list of all claims in the agreement.

While the level of notice required has not been expressly decided, the Supreme Court has provided some guidance as to the level of notice required. In *Doctor's Associates, Inc. v. Casaratto*,<sup>155</sup> the Court held that the FAA does not require a greater level of notice than any other provision in a contract. The Montana legislature enacted a statute which required that an agreement to arbitrate must be placed on the first page of the contract and the text be underlined.<sup>156</sup> The Montana Supreme Court held that the statute was not at odds with the FAA and therefore the agreement was invalid.<sup>157</sup> The United States Supreme Court reversed, stating:

[The Montana statute] directly conflicts with [section] 2 of the FAA because the State's law conditions the enforceability of arbitra-

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149. BLACK'S LAW DICTIONARY 581 (7th ed. 1999) (defining *ex aequo et bono* as according to what is just and good).

150. See *Moncharsh*, 832 P.2d. at 902.

151. 113 F.3d 1104 (9th Cir. 1997).

152. See *id.* at 1108.

153. See *id.*

154. See *Rosenberg v. Merrill Lynch, Pierce, Fenner & Smith*, 170 F.3d 1 (1st Cir. 1999) (holding that nowhere in the FAA does knowing waiver come up).

155. 517 U.S. 681, 686 (1996).

156. See MONT. CODE ANN. § 27-5-114(4).

157. See *Casarotto*, 517 U.S. at 684.

tion agreements on compliance with a special notice requirement not applicable to contracts generally. The FAA thus displaces the Montana statute with the respect to arbitration agreements covered by the Act.<sup>158</sup>

Employers should also be careful because some courts of appeal have followed a different standard for the enforceability of contracts of adhesion. In *Marin Storage & Trucking v. Benco Contracting & Engineering, Inc.*,<sup>159</sup> the court used the alternative set forth in *Graham v. Scissor-Tail*<sup>160</sup> where a contract may be denied enforceability if it "frustrates the reasonable expectations of the weaker party."<sup>161</sup> In that particular case, an indemnification clause was upheld as the party to be bound had entered into hundred of the contracts.<sup>162</sup> This same legal reasoning could be applied to invalidate an arbitration clause if the employee is not given adequate notice of the waiver.

The courts will, however, support an employer's decision to require mandatory arbitration. In *Lagatree v. Luce, Forward, Hamilton & Scripps*,<sup>163</sup> the California Court of Appeal for the second district held that a claim for wrongful termination must involve public policy violations and that requiring arbitration was not a public policy violation.<sup>164</sup> Lagatree was a legal secretary who was asked to sign a mandatory arbitration clause as a condition of continued employment.<sup>165</sup> Declining to do so, he found himself in search of a new job. When he did find subsequent employment, his new employer also required that he sign an arbitration agreement.<sup>166</sup> Again declining to do so, he found himself unemployed. He then brought suit alleging that his termination was against public policy.<sup>167</sup> The court of appeal strongly disagreed, stating "[h]ere, general social policies will be advanced by *not* allowing a wrongful termination claim. This is so because public policy favors the resolution of disputes through arbitration."<sup>168</sup> This holding will allow employers to revise their agreements to meet the standards set down in *Armendariz* and protect employers from lawsuits when employees refuse to sign.

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158. *Id.* at 687.

159. 107 Cal. Rptr. 645 (2001).

160. 65 P.2d 165 (1981).

161. *Id.* at 1057.

162. *See id.* at 1056.

163. 88 Cal. Rptr. 2d 664 (1999).

164. *See id.* at 681.

165. *See id.* at 667.

166. *See id.*

167. *See id.* at 668.

168. *Id.* at 681.

## Conclusion

Although the decision in *Armendariz* does provide some protection for employers, its failure to address the key issue of notice will leave many employers with existing agreements uncertain. The court does, however, set standards that employers in California can follow to evaluate their own agreements. A properly drafted agreement should defeat challenges and eliminate any potential advantage to be had by bringing suit in state court. However, with the *Moncharsh* decision limiting the review of these awards, the court may strictly scrutinize either the notice given to the employees or the neutrality of the arbitrator if it seeks a way around the award. Finally, the Ninth Circuit has shown an affinity for excusing these clauses. Therefore, one must be careful in drafting these agreements, or a defendant employer may find itself facing a federal jury trial.

Perhaps the best solution for dealing with existing agreements is to draft new clauses following the *Armendariz* formula, and require that employees read and sign the new agreements. As seen in *Lagatree*, the courts will protect employers from suits for wrongful discharge and any ability to circumvent arbitration can be foreclosed.

