

Enforcing Arbitration Agreements in California and Beyond

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A review of the impact of the US Supreme Court's 2011 decision in *AT&T Mobility LLC v. Concepcion* on employment arbitration agreements.



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Authors



JAMES A. GOODMAN
MEMBER
EPSTEIN BECKER &
GREEN, P.C.

Jim is a member of the firm's Labor and Employment and Litigation practices. He represents employers in state and federal courts in all aspects of labor and employment law litigation, including wage and hour, wrongful termination, harassment, discrimination and trade secrets.



AMY B. MESSIGIAN
ASSOCIATE
EPSTEIN BECKER &
GREEN, P.C.

Amy is an associate in the firm's Labor and Employment practice. She provides advice, counseling and litigation defense to employers in a diverse range of industries, including health care, hospitality, entertainment and retail. Amy speaks and writes frequently on employment law developments.

Courts around the country are invalidating employment arbitration agreements on various grounds and sending employers back to the drawing board to craft agreements that pass muster. One of the main battlegrounds relates to the ability of employers to include class action waivers in their employee arbitration agreements. Over the past five years, broad pronouncements by courts across the country have effectively prevented the enforcement of class action waivers in employment contracts.

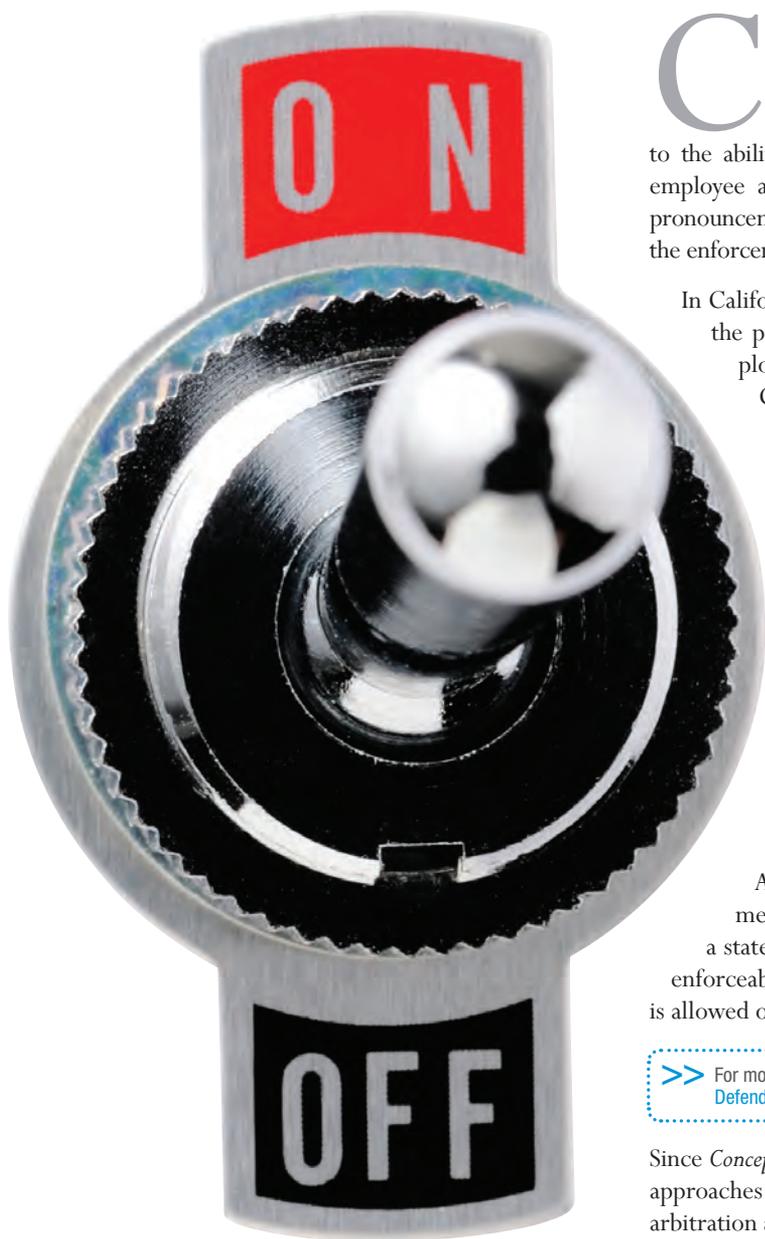
In California, the seminal 2007 case of *Gentry v. Superior Court* had the practical effect of invalidating class action waivers in employment arbitration agreements (42 Cal. 4th 443 (2007)). Class action waivers faced similar defeat in Florida, New York, New Jersey and Minnesota, among others.

The landscape changed drastically in 2011 when the US Supreme Court issued its decision in *AT&T Mobility LLC v. Concepcion*, 131 S. Ct. 1740 (2011). The *Concepcion* case held that the Federal Arbitration Act (FAA) preempts state laws or policies that deem arbitration agreements unconscionable and unenforceable on the basis that they preclude class actions, abrogating the California public policy established by *Discover Bank v. Superior Court* and potentially invalidating *Gentry* (see Box, *The Four California Kings: Armendariz, Discover Bank, Gentry and Concepcion*) (36 Cal. 4th 148 (2005)).

Although traditional contract-based defenses to enforcement of arbitration agreements still apply, under *Concepcion* a state cannot, by judicial or legislative mandate, condition the enforceability of an arbitration agreement on whether a class action is allowed or precluded by the terms of the agreement.

>> For more information on the US Supreme Court's decision in *Concepcion*, search [Defending Wage and Hour Collective Actions](#) on our website.

Since *Concepcion*, both state and federal courts have taken a variety of approaches to interpreting and applying its holding to employment arbitration agreements:





- Some courts have held that *Concepcion*, which involved a consumer arbitration agreement, applies equally to employment arbitration agreements and have enforced the underlying agreements.
- Other courts have applied *Concepcion*, but have invalidated the underlying arbitration agreements on other grounds.
- Yet other courts have held that *Concepcion* cannot prevent certain claims from being brought collectively under the National Labor Relations Act (NLRA) or on a representative basis under the California Private Attorney General Act (PAGA).

Against the background of the ever-growing, complex and as yet unsettled landscape of post-*Concepcion* case law, this article provides:

- An analysis of the state of the law in California and certain federal jurisdictions.
- A preview of what is to come in California and beyond.

Employers using arbitration agreements in the employment context should use this review of the relevant case law when drafting their agreements. As will become apparent, the position on enforceability varies from state to state, so employers need to understand the current position in each state in which they operate.

In summary, employers should ensure that each agreement is not unconscionable and provides for:

- Mutuality of the parties.
- Sufficient discovery available to both parties.
- Selecting a neutral arbitrator.
- The types of remedies that are available in court.
- An arbitrator's written decision that may be reviewed by a court.

>> For a sample arbitration agreement, search [Mutual Agreement to Arbitrate Employment-related Disputes \(California\)](#) on our website.

RECENT DECISIONS

Since *Concepcion*, there remains a tug-of-war in California and elsewhere regarding the effect of *Concepcion* on employment arbitration agreements. Recent decisions fall into four broad categories:

- Claims under the NLRA in light of the NLRB's decision in *D.R. Horton, Inc.*
- Claims under PAGA.
- Other federal appellate decisions.
- Other district court decisions.

NLRA CLAIMS

In January 2012, the NLRB held in *D.R. Horton* that a mandatory, employer-imposed agreement requiring all employment-related disputes to be resolved through individual arbitration

and disallowing class actions violated the NLRA. The NLRB found that employees who bring employment-related claims in court or before an arbitrator are exercising their rights under the NLRA to collective action and that such rights are not preempted by the FAA. (357 N.L.R.B. slip op. 184 (Jan. 3, 2012).)

Since January, numerous courts have distinguished or declined to follow *D.R. Horton*, including:

- The California Court of Appeal (*Truly Nolen of America v. Superior Court*, 208 Cal. App. 4th 487, 514 (Cal. Ct. App. 2012); *Nelsen v. Legacy Partners Residential, Inc.*, 207 Cal. App. 4th 1115, 1132-1135 (Cal. Ct. App. 2012)).
- The US District Court for the Southern District of New York (*LaVoice v. UBS Financial Servs., Inc.*, No. 11 Civ. 2308, 2012 WL 124590, at *6 (S.D.N.Y. Jan. 13, 2012)).
- The US District Court for the Middle District of Pennsylvania (*Brown v. Trueblue, Inc.*, No. 1:10-CV-0514, 2012 WL 1268644, at *4-6 (M.D. Pa. Apr. 16, 2012)).
- The US District Court for the Eastern District of Pennsylvania (*Tenet HealthSystem Philadelphia, Inc. v. Rooney*, No. 12-mc-58, 2012 WL 3550496, at *2-4 (E.D. Pa. Aug. 17, 2012)).
- The US District Court for the Northern District of California (*Sanders v. Swift Transp. Co. of Ariz., LLC*, 843 F. Supp. 2d 1033, 1036 (N.D. Cal. 2012)).
- The US District Court for the Middle District of Florida (*De Oliveira v. Citicorp North Am., Inc.*, No. 8:12-cv-251, 2012 WL 1831230, at *2 (M.D. Fla. May. 18, 2012)).

A few, however, have relied on *D.R. Horton* to limit the enforceability of arbitration agreements. See, for example, *Owen v. Bristol Care, Inc.*, No. 11-04258, 2012 WL 1192005, at *4 (W.D. Mo. Feb. 28, 2012) and *Herrington v. Waterstone Mortg. Corp.*, No. 11-cv-779, 2012 WL 1242318, at *4-6 (W.D. Wis. Mar. 16, 2012).

One of the cases declining to apply *D.R. Horton*, *Delock v. Securitas Security Services USA, Inc.*, noted it is “settled law that an employee’s statutory right to pursue a wage claim as part of a collective action ... [can] be waived in favor of individual arbitration.” There, the US District Court for the Eastern District of Arkansas compelled individual arbitration of an employee’s claims under the Fair Labor Standards Act (FLSA) and rejected the finding in *D.R. Horton* that collective action rights could not be waived. (No. 11-cv-520, 2012 WL 3150391, at *1 (E.D. Ark. Aug. 1, 2012).)

>> For more information on the FLSA, search [Wage and Hour Law: Overview](#) on our website.

D.R. Horton is currently on appeal to the US Court of Appeals for the Fifth Circuit. Although the Fifth Circuit has considered two arbitration agreements post-*Concepcion*, neither is telling as to how the court will rule. In *Reed v. Florida Metropolitan University, Inc.*, the Fifth Circuit held that the question of whether an arbitration agreement provided for class-wide arbitration was properly a question referred to the arbitrator.

However, in *Reed*, the agreement did not expressly provide for arbitration. Therefore the Fifth Circuit found it to be an excess of the arbitrator’s powers to read a class arbitration provision into the agreement. The court remanded the case with instructions to proceed in bilateral arbitration. (681 F.3d 630 (5th Cir. 2012)).

In *Carey v. 24 Hour Fitness, USA, Inc.*, the Fifth Circuit focused on the illusory nature of the agreement rather than its effect on the underlying FLSA cause of action. In *Carey*, the employer sought to compel arbitration under a provision contained in its employee handbook. Under Texas law, an agreement to arbitrate contained in an employee handbook is illusory, even if the employee signs an acknowledgement of receipt of the handbook. Finding the agreement illusory in this case, the court did not need to consider whether the employee’s collective action rights could properly be waived. (669 F.3d 202, 209 (5th Cir. 2012)).

Concepcion has begun to alter the employment arbitration landscape and whittle away at state-specific public policy limitations.

PAGA CLAIMS

Likewise, in California, at least one court of appeal has rejected individual arbitration where PAGA claims have been asserted. PAGA authorizes an aggrieved employee to bring a civil action to recover civil penalties “on behalf of himself or herself and other current or former employees” for violations of the Labor Code (*Cal. Lab. Code* § 2699 (2011)).

In *Brown v. Ralphs Grocery Co.*, a California Court of Appeal held that *Concepcion* does not apply to claims brought under PAGA (197 Cal. App. 4th 489 (Cal. Ct. App. 2011)). Other courts, however, have compelled individual plaintiffs to arbitration despite the existence of PAGA claims. See, for example, *Morvant v. P.F. Chang’s China Bistro, Inc.*, No. 11-cv-05405, 2012 WL 1604851, *12 (N.D. Cal. May 7, 2012) and *Iskanian v. CLS Transp. Los Angeles, LLC*, 206 Cal. App. 4th 949 (Cal. Ct. App. 2012), rev. granted, 147 Cal. Rptr. 3d 324 (Sept. 19, 2012).

Although these cases indicate there is still some resistance to class action waivers, *Concepcion* has begun to alter the employment arbitration landscape and whittle away at state-specific public policy limitations.

THE FOUR CALIFORNIA KINGS: ARMENDARIZ, DISCOVER BANK, GENTRY AND CONCEPCION

In California, four watershed decisions have set the landscape for employment arbitration agreements over the course of the last decade.

First, in *Armendariz v. Foundation Health Psychcare Services, Inc.*, the California Supreme Court addressed the standards for invalidating certain employment arbitration agreements under the doctrine of unconscionability, a contract law defense to the enforcement of a contract on the basis of extreme unfairness to one party (24 Cal. 4th 83 (2000)). To invalidate an arbitration agreement on the grounds of unconscionability, a party must show that the agreement is both substantively and procedurally unfair to one of the parties. Procedural unconscionability relates to the manner in which an agreement is negotiated and looks to whether the contract is the product of oppression or surprise. Employment arbitration agreements, which are often contracts of adhesion (one party presents the contract to the other on a take it or leave it basis), have been deemed procedurally unconscionable because there is effectively no choice but to sign the agreement to remain employed. Substantive unconscionability relates to mutuality of obligations and whether the agreement unreasonably favors the interests of one party over the other.

After *Armendariz* came *Discover Bank*. There, the California Supreme Court held in the context of a consumer contract of adhesion that a class action waiver was unconscionable and acted to invalidate the agreement. The *Discover Bank* court reasoned that given the relatively small amount of damages involved on a case by case basis, a class action waiver would have the effect of deterring vindication of consumer claims. Although *Discover Bank* involved a consumer contract, its holding represented a new argument to attack arbitration agreements in California.

It did not take long for the holding in *Discover Bank* to be tested against an employment arbitration agreement. Only two years later, the California Supreme Court did just that in *Gentry*. The *Gentry* case appeared to sound the death knell for class action waivers in employment arbitration agreements. In *Gentry*, the California Supreme Court held that a class action waiver of claims under the California Labor Code was unenforceable if the court determined that a class would be a “significantly more effective way of vindicating the rights of affected employees than individual arbitration.” *Gentry*’s adoption of the *Discover Bank* analysis presented a powerful judicial obstacle to enforcement of employment arbitration agreements. The practical effect of *Gentry*

is that arbitration agreements have been routinely invalidated in California from 2007 through the present due to a finding that the employees’ rights are better served with a vehicle for class claims.

Employers seeking to enforce their arbitration agreements took various approaches to the ruling in *Gentry*. Some removed express class action waivers from their agreements, while others gambled that their arbitration agreements would be enforced. In many cases, whether an arbitration agreement was enforced was due in large part to the parties’ luck of the judicial draw. Because an order compelling or denying arbitration is immediately appealable in California, many cases made their way out of the trial court system for months at a time in hopes for a better result on appeal.

On a parallel front, challenges were being made to the *Discover Bank* rule on federal preemption grounds. In March 2008, AT&T Mobility, the defendant in a lawsuit brought by Vincent and Liza Concepcion in the Southern District of California for purported overcharging of sales tax, moved to compel the Conceptions to arbitration (the Conceptions’ case had previously been consolidated with a putative class action). Relying on *Discover Bank*, the district court found the arbitration provision of the Conceptions’ contract with AT&T unconscionable. AT&T appealed and the US Court of Appeals for the Ninth Circuit affirmed, also finding the arbitration provision unconscionable under *Discover Bank*.

The US Supreme Court reversed the Ninth Circuit decision, finding that the *Discover Bank* rule was contrary to the purpose of the FAA, which makes arbitration agreements “valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract” (9 U.S.C. § 2 (2011)). *Concepcion* held that California law, as expressed in *Discover Bank*, is preempted by the FAA because it stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress. While the FAA provides that arbitration agreements may be invalidated on any grounds used to invalidate contracts generally, California law cannot impose special restrictions on arbitration agreements, such as a requirement that the parties agree not to waive the ability to bring class claims.

Concepcion represents a sea change to the enforcement of arbitration agreements in California and throughout the country and creates the possibility that *Gentry*, like *Discover Bank*, will be deemed preempted by federal law.

FEDERAL APPELLATE DECISIONS

Many of the federal appellate courts have considered the effect of *Concepcion* on arbitration agreements containing class action waivers. Most of these cases relate to consumer contracts of adhesion, which though not directly on-point, may signal how the courts will address class action waivers in employment arbitration agreements.

For example, in a relatively easy decision, the US Court of Appeals for the Eleventh Circuit found that Florida public policy did not prevent the defendant, Cingular Wireless, from compelling individual arbitration of plaintiffs’ claims in *Cruz v. Cingular Wireless, LLC*, a case involving an identical arbitration agreement to the one presented to the US Supreme Court in *Concepcion*. Based on *Concepcion*, the court held that any contrary public policy would be preempted by the FAA if it

did in fact exist. The court punted on the question of whether *Concepcion* leaves open the possibility that in some cases an arbitration agreement may be invalidated on public policy grounds if it prevents the claimant from vindicating a statutory cause of action. The court noted that unlike the California public policy preempted by *Concepcion*, Florida's public policy tests arbitration agreements on a case by case basis and does not apply a fixed rule prohibiting class action waivers. (648 F.3d 1205 (11th Cir. 2011).)

To date, the Eleventh Circuit has not considered the effect of *Concepcion* on Florida's public policy rule. However, in *In re Checking Account Overdraft Litigation MDL No. 2036*, the court affirmed the lower court's finding that the underlying arbitration clause was unconscionable under South Carolina law and that South Carolina's unconscionability doctrine was not preempted by the FAA. The court noted that "[a]lthough *Concepcion* held that the state law at issue was preempted, it made clear that there are instances wherein a state law may invalidate an arbitration agreement without being preempted by the FAA." Rather, in light of *Concepcion*, a court must determine whether a particular state law or policy is a "generally applicable contract defense[]" permitted by § 2 of the FAA ... or whether it necessarily 'interferes with fundamental attributes of arbitration' to the degree that it 'creates a scheme inconsistent with the FAA,' like the ban on collective-action waivers in *Concepcion*."

The Eleventh Circuit held that unlike the California rule, South Carolina's doctrine of unconscionability applies to arbitration and to other agreements according to the same basic criteria and does not disproportionately impact arbitration agreements. Particularly, the court noted that the South Carolina doctrine neither allows nor prohibits the aggregation of claims at all and simply focuses on the one-sidedness of the agreement. (685 F.3d 1269 (11th Cir. 2012).)

The US Court of Appeals for the Third Circuit is the first federal appellate court to expressly extend the *Concepcion* holding to employment arbitration agreements and enforce an arbitration agreement despite its potential preclusion of class arbitration.

In *Quilloin v. Tenet HealthSystem Philadelphia Inc.*, the plaintiff brought a collective action under the FLSA and her employer moved to compel arbitration. Reversing the lower court, the Third Circuit found that Tenet's motion to compel arbitration should have been granted, rejected the plaintiff's argument of unconscionability, and left for the arbitrator to decide whether the agreement contained an implied class action waiver by its silence as to this term. (673 F.3d 221 (3d Cir. 2012).)

Similarly, the US Court of Appeals for the Eighth Circuit affirmed an order compelling the arbitration of the plaintiff franchisees' misclassification claims, holding that under *Concepcion* the plaintiffs could not avoid arbitration under a Minnesota law preventing class action waivers. The plaintiffs in

that case, *Green v. SuperShuttle International, Inc.*, alleged that they had been misclassified as franchisees rather than employees and were owed wages and other damages. SuperShuttle successfully sought to enforce its arbitration agreements with its employees, which expressly precluded class-wide arbitration. Concluding that Minnesota's law "suffers from the same flaw as the state-law-based challenge in *Concepcion*," the Eighth Circuit affirmed the lower court's order compelling arbitration. (653 F.3d 766, 769 (8th Cir. 2011).)

DISTRICT COURT DECISIONS

Among the district courts, *Concepcion* has seen varying degrees of effect. In the Southern District of New York, for example, two judges have handed out seemingly contrary rulings. In *Sutherland v. Ernst & Young LLP*, the court refused to enforce an arbitration agreement due to its class action waiver, which it found prevented the plaintiff from "vindicating her statutory rights," notwithstanding *Concepcion* (847 F. Supp. 2d 528 (S.D.N.Y. 2012)). Meanwhile, in *LaVoice*, the court compelled arbitration despite a class arbitration waiver, which the court found could be waived in a contract of adhesion under *Concepcion*. These cases demonstrate the gamble employers continue to face in moving to compel individual arbitration where the plaintiff has asserted class claims.

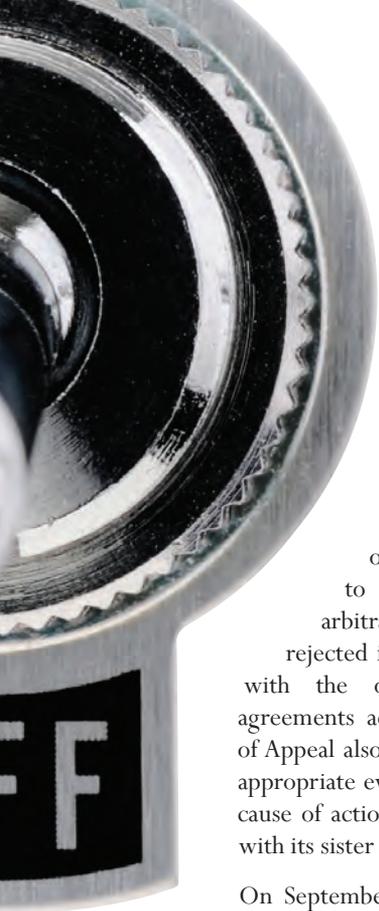
THE FUTURE

Although the tug-of-war continues, the bulk of case law post-*Concepcion* suggests that the *Gentry* rule will ultimately be deemed preempted in California. See *Truly Nolen of America*; *Lewis v. UBS Financial Services*, 818 F. Supp. 2d 1161, 1167 (N.D. Cal. 2011); *Morvant*. The case that will decide this issue is *Iskanian*.

Iskanian is on appeal for the second time. During the first appeal, the California Court of Appeal directed the trial court to reconsider its order to compel arbitration and dismiss the class wage and hour claims brought by Arshavir Iskanian against his former employer, CLS Transportation Los Angeles, in light of *Gentry*.

After *Concepcion* was decided, CLS renewed its motion to compel arbitration and dismiss *Iskanian*'s class claims. The trial court granted its motion and the plaintiff again appealed.





Considering the matter in light of *Concepcion*, the Court of Appeal affirmed the lower court's decision, finding that *Concepcion* "conclusively invalidates" *Gentry*. Particularly, the court stated that *Concepcion*'s "unequivocal rejection of court-imposed class arbitration applies just as squarely to the *Gentry* test as it did to the *Discover Bank* rule" and that "[a] rule like the one in *Gentry* — requiring courts to determine whether to impose class arbitration on parties who contractually rejected it — cannot be considered consistent with the objective of enforcing arbitration agreements according to their terms." The Court of Appeal also found that individual arbitration was appropriate even though the plaintiff had asserted a cause of action under PAGA, expressly disagreeing with its sister circuit's decision in *Brown*.

On September 19, 2012, the California Supreme Court accepted review of *Iskanian* to determine whether *Concepcion* impliedly overruled *Gentry* with respect to contractual class action waivers in the context of non-waivable labor law rights and whether *Concepcion* permits arbitration agreement to override the right to bring representative actions under PAGA.

Whether or to what extent arbitration agreements and arbitration waivers are effective in defending class and representative actions in California will remain unsettled until the California Supreme Court renders its decision. Moreover, although it appears unlikely, if the California Supreme Court declines to extend *Concepcion* to *Gentry* and affirm the Court of Appeal's decision in *Iskanian*, the case will very likely be appealed to the US Supreme Court.

The *Sutherland* case, accepted for review by the US Court of Appeals for the Second Circuit this spring, may similarly challenge the Second Circuit's decision in *In re American Express Merchants' Litigation*, which, like *Discover Bank* and *Gentry*, prevents the enforcement of class action waivers if it would not be "economically feasible" for plaintiffs to maintain an individual arbitration to vindicate their claims (634 F.3d 187 (2d Cir. 2011)).

TRADITIONAL CONTRACT DEFENSES

Even if *Gentry* is overturned, courts will still be able to prohibit enforcement of arbitration agreements due to traditional contract defenses, including unconscionability. In California, for example, that means that *Armendariz v. Foundation Health Psychcare Services, Inc.*, which provides a measuring stick for conscionability (see *Box, The Four California Kings: Armendariz,*

Discover Bank, Gentry and Concepcion), will continue to rule the day (24 Cal. 4th 83 (2000)). Likewise, courts in states such as South Carolina and Florida may continue to apply an even-handed approach to an unconscionability analysis, which may invalidate some arbitration agreements.

Post-*Concepcion*, several California courts have refused to enforce employment arbitration agreements due to the presence of substantive and procedural unconscionability. In *Wisdom v. AccentCare, Inc.*, for example, the California Court of Appeal held that an arbitration clause in an employment application was not enforceable under *Armendariz* without even mentioning *Concepcion* (202 Cal.App. 4th 591 (Cal. Ct.App. 2012)).

Likewise, *Mayers v. Volt Management Corp.*, another California Court of Appeal case, found that *Concepcion* does not prevent an unconscionability analysis. *Mayers*, like several other California cases, ultimately held that a failure to provide a copy of the American Arbitration Association rules made the agreement procedurally unconscionable. Taken together with a fee-shifting provision that was substantively unconscionable, the *Mayers* court refused to enforce the agreement under *Armendariz*. (203 Cal.App. 4th 1194 (Cal. Ct.App. 2012).)

Other courts have invalidated arbitration provisions contained in employee handbooks, finding that an employer's unilateral right to modify the agreement makes the agreement illusory under the state laws of Massachusetts and Texas. See, for example, *Carey, at 208* (interpreting Texas law) and *Douglas v. Johnson Real Estate Investors, LLC, 470 F.App'x 823, 826* (11th Cir. 2012) (interpreting Massachusetts law).

Until the US Supreme Court takes up an employment arbitration case, such as *Iskanian* or *Sutherland*, however, it would seem unlikely that there will be consistency in the enforcement of arbitration agreements according to their terms. Even within districts and state courts, luck of the draw on judicial assignments will continue to rule the day as interpretations of the underlying case law continues to vary.

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