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Compliance Today - November 2023

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But we have an arbitration clause: Considerations when hiring Californians

by Chris Sabis

It's 4:45 p.m. on Friday. The human resources (HR) director calls and tells you that your company—or if you are outside counsel, your client—is finally expanding their sales operation to the West Coast. As part of that effort, the company is hiring a new employee, and the HR director needs a draft employment agreement by Monday morning. You ask for the particulars so you can assemble a standard agreement. Thirty minutes later, you receive the requested information and notice that, while your client is headquartered in, say, Nashville, Tennessee, the prospective employee lives and works in Sonoma County, California.

Saturday afternoon (while you could be at a barbecue), you are scrolling through the company's model employment agreement, adding information, and tweaking here and there. As you scroll faster through the standard legal provisions near the end, you note the arbitration clause and its Tennessee choice-of-law provision. You are not a California lawyer[1] and wonder if a California court will enforce the arbitration agreement and respect the Tennessee choice-of-law provision or a choice-of-law provision favoring any state's law other than California. The answer is more complex than you would hope.

California law on arbitration agreements

Your initial research tells you that California has a "strong public policy in favor of arbitration [and] any doubts regarding the validity of an arbitration agreement are resolved in favor of arbitration."[2] Even better, "California strongly favors enforcement of choice-of-law provisions . . . ."[3] But that is where the general policy statements end and the complications begin.

In California, an agreement presented to an employee "on a take-it-or-leave-it basis" is a contract of adhesion, and the employer is presumed to have had superior bargaining power.[4] Such agreements are particularly susceptible to California's unconscionability analysis. "Unconscionability refers to an absence of meaningful choice on the part of one of the parties together with contract terms which are unreasonably favorable to the other party."[5] "In deciding whether to enforce an arbitration agreement, California courts examine whether its terms are both procedurally and substantively unconscionable."[6] Unconscionability is a sliding scale: "The more procedural unconscionability is present, the less substantive unconscionability is required to justify a determination that a contract or clause is unenforceable. Conversely, the less procedural unconscionability is present, the more substantive unconscionability is required . . . ."[7] The ultimate question "is whether the terms of the contract are sufficiently unfair, in view of all relevant circumstances, that a court should withhold enforcement."[8]

What is and is not unconscionable in California

Unfortunately, common provisions found in arbitration clauses—more likely to be enforced in other state courts—render an arbitration agreement unconscionable and unenforceable in California.[9] Even a choice-of-law provision itself is unconscionable "[w]hen the weaker party to an adhesion contract can show the contract is unconscionable under California law," which includes when it deprives employees of their ability to assert protections or rights available under the California Labor Code.[10] This effectively nullifies choice-of-law provisions in employment agreements applying any other state's substantive law.

Other examples of procedurally or substantively unconscionable provisions in California include but are not limited to:

- Agreements that fail to provide sufficient information regarding the rules that would apply in an arbitration;[11]
- Clauses that make an employee responsible for the employer's attorneys' fees without a reciprocal provision or require employees to bear expenses they would not be required to pay in a California court;[12]
- Provisions that waive employees' California statutory rights to collect attorneys' fees and costs;[13]
- Prohibitions on prevailing employees recouping an arbitration filing fee;[14]
- Clauses that allow one party to obtain injunctive relief in court while limiting the other party to relief through arbitration;[15]
- Bilateral clauses requiring an appellant to pay the expenses of any appellate review;[16]
- Limitations on punitive damages;[17]
- Clauses that provide for insufficient discovery;[18] and
- Bars on tolling of the statute of limitations.[19]

In contrast, California courts have held that other provisions of arbitration agreements are not unconscionable, including:

- Pre-arbitration mediation clauses, so long as they are bilateral;[20]
- Clauses reasonably limiting the amount of discovery to be taken;[21]
- Provisions requiring an arbitrator to apply only "governing law" and not "informal principles of just cause;"[22] and
- Procedural provisions like optional findings of fact and conclusions of law, confidentiality, and a bar on consolidating claims.[23]

Although unconscionable provisions can sometimes be severed,

> [a]n arbitration agreement can be considered permeated by unconscionability if it 'contains more than one unlawful provision.' . . . Such multiple defects indicate

> a systematic effort to impose arbitration . . . not simply as an alternative to litigation, but as an inferior forum that works to the [stronger party's] advantage. The overarching inquiry is whether the interests of justice . . . would be furthered by severance.[24]

In most cases where more than one—maybe two—provisions of an arbitration agreement are found to be unconscionable, California courts disregard the arbitration agreement in its entirety.

The bottom line

However, drafting an enforceable arbitration agreement with a California employee is possible. The starting point should be the application of California law to arbitration. The agreement also should specify the rules under which the arbitration will take place and attach a copy of those rules as a precaution. The agreement should not shift fees or limit punitive damages in any way contrary to California law. But it can, among other things, (reasonably) limit discovery and require pre-arbitration mediation of all parties.

A fulsome analysis would require research tailored to the proposed arbitration clause. Generally, the more specific your client wants to be in the arbitration agreement, the more research you will be doing.

Takeaways

- As a business expands, employees who live and work in different states present complications for including enforceable arbitration clauses in employment agreements.
- California, in particular, presents challenges, including case law that renders choice-of-law provisions favoring other states' laws unconscionable and unenforceable.
- Common provisions found in arbitration clauses can render an arbitration agreement unconscionable and unenforceable in California.
- Although unconscionable provisions can sometimes be severed, even discrete provisions of a clause that run afoul of California law can render the entire clause unenforceable.
- Despite the unique aspects of California law, it is possible for an employer outside of California employing a California resident to draft an enforceable arbitration clause.

1 Neither am I, just to be clear.
2 Samaniego v. Empire Today LLC, 205 Cal. App. 4th 1138, 1144 (2012).
3 Harris v. Bingham McCutchen LLP, 214 Cal. App. 4th 1399, 1404 (2013) (internal citation omitted) (citing Nedlloyd Lines B.V. v. Superior Court, 3 Cal. 4th 459, 464, 834 P.2d 1148 (Cal. 1992)).
4 Mills v. Facility Solutions Group, Inc., 84 Cal. App. 5th 1035, 1050 (2022) ("An adhesive contract is standardized, generally on a preprinted form, and offered by the party with superior bargaining power on a take-it-or-leave-it basis.") (internal quotation marks omitted).
5 Nguyen v. Applied Medical Resources Corp., 4 Cal. App. 5th 232, 246 (2016) (internal quotation marks omitted).
6 Dotson v. Amgen, Inc., 181 Cal. App. 4th 975, 980 (2010).
7 Dotson v. Amgen, Inc., at 980 (quoting Armendariz v. Foundation Health Psychcare Servs., Inc., 24 Cal. 4th 83, 114, 6 P.3d 669 (Cal. 2000).
8 Nguyen, 4 Cal. App. 5th at 247 (quoting Sanchez v. Valencia Holding Co., LLC, 61 Cal. 4th 899, 911–12, 353 P.3d 741 (Cal. 2015)).

9 Using the above example of Tennessee, numerous cases indicate that certain arbitration agreement provisions are more likely to enforced in Tennessee than in California. See, e.g., Berent v. CMH Homes, Inc., 466 S.W.3d 740, 751 (Tenn. 2015) (nonmutuality of remedies does not *per se* invalidate an arbitration provision); Thomas v. Pediatrix Med. Grp. of Tennessee, P.C., No. E2009-01836-COA-R3-CV, 2010 WL 3564424, at *6 (Tenn. Ct. App. Sept. 14, 2010) (enforcing arbitration clause in employment agreement with non-reciprocal injunctive relief clause); Wright v. Rains, 106 S.W.3d 678, 681 (Tenn. Ct. App. 2003) ("Tennessee will honor a choice of law clause if the state whose law is chosen bears a reasonable relation to the transaction and absent a violation of the forum state's public policy."). See generally Pyburn v. Bill Heard Chevrolet, 63 S.W.3d 351, 359, 363 (Tenn. Ct. App. 2001) (an arbitration clause in a contract of adhesion is enforceable unless "the terms of the contract are beyond the reasonable expectations of an ordinary person, or oppressive or unconscionable" and the party challenging arbitration bears the burden of establishing prohibitive expense or improper cost shifting); Haun v. King, 690 S.W.2d 869, 872 (Tenn. Ct. App. 1984) ("when the inequality of the bargain is so manifest as to shock the judgment of a person of common sense, and where the terms are so oppressive that no reasonable person would make them on one hand, and no honest and fair person would accept them on the other").

10 See, e.g., Pinela v. Neiman Marcus Group, Inc., 238 Cal. App. 4th 227, 246–47 (2015); Samaniego, 205 Cal. App. 4th at 1147 ("Choice-of-law provisions contained in [adhesion] contracts are usually respected. Nevertheless, the forum will scrutinize such contracts with care and will refuse to apply any choice-of-law provision they may contain if to do so would result in substantial injustice to the adherent.") (quoting Washington Mutual Bank, FA v. Superior Court, 24 Cal. 4th 906, 918 n.6, 15 P.3d 1071 (Cal. 2001)).

11 Carbajal v. CWPSC, Inc., 245 Cal. App. 4th 227, 233 (2016) (arbitration clause that did not specify which American Arbitration Association (AAA) rules would apply was unconscionable); Samaniego, 205 Cal. App. 4th at 1146. See Nguyen, 4 Cal. App. 5th at 249 (failure to provide employee with AAA rules "did not increase the procedural unconscionability of the application or its arbitration provision").

12 Samaniego, 205 Cal. App. 4th at 1147; Nguyen, 4 Cal. App. 5th at 255.

13 D'Avella v. Overhill Farms, Inc., No. B303644, 2021 WL 4958910, at *4 (Cal. Ct. App. Oct. 26, 2021).

14 Mills, 84 Cal. App. 5th at 1052–53.

15 Carbajal, 245 Cal. App. 4th at 233.

16 Mills, 84 Cal. App. 5th at 1054–55 ("[employer] would have greater resources to pay the appellate and remand costs, thus encouraging an appeal by [employer] but discouraging one by [employee]").

17 Mills, 84 Cal. App. 5th at 1055.

18 Mills, 84 Cal. App. 5th ("The arbitration agreement allows each party to take depositions, designate expert witnesses, and subpoena witnesses, but it does not expressly allow for document requests, requests for admission, or interrogatories.").

19 Mills, 84 Cal. App. 5th at 1060.

20 Nguyen, 4 Cal. App. 5th at 254.

21 Dotson, 181 Cal. App. 4th at 982-83, 985 (reversing the trial court and enforcing the arbitration clause).

22 Sanchez v. Carmax Auto Superstores California, LLC, 224 Cal. App. 4th 398, 407 (2014).

23 Sanchez v. Carmax Auto Superstores California, LLC at 408.

24 Samaniego, 205 Cal. App. 4th at 1149 (internal quotation marks omitted) (quoting Lhotka v. Geographic Expeditions, Inc., 181 Cal. App. 4th 816, 826 (2010)).