

Legal Update - 1-26-2005

The Ninth Circuit and the Washington Supreme Court Provide Guidance on Arbitration Agreements

The Ninth Circuit and the Washington Supreme Court marked the holiday season and new year by issuing three decisions that provide guidance on when a pre-dispute employment arbitration agreement is unconscionable under Washington Law. Unconscionability is a doctrine under which courts may deny enforcement of all or part of an “unfair” or “oppressive” contract based on perceived abuses during the process of forming a contract (“procedural unconscionability”) or within the actual terms of the contract itself (“substantive unconscionability”). In Washington, in the employment context a contract may be invalid based on substantive unconscionability alone. The Washington Supreme Court has, however, declined to consider whether procedural unconscionability alone will invalidate an arbitration agreement. On December 24, 2004, in companion cases, *Zuver v. Airtouch Communications, Inc.* and *Adler v. Manor*, the Washington Supreme Court addressed employee claims of both procedural and substantive unconscionability. On January 14, 2005, the Ninth Circuit federal court - which covers Washington - addressed only the issue of substantive unconscionability in *Al-Safin v. Circuit City Stores, Inc.*

Procedural Unconscionability

In *Zuver* and *Adler*, the Washington Supreme Court defined procedural unconscionability as the lack of a meaningful choice considering all the circumstances surrounding the transaction including: (1) the manner in which the contract was entered, (2) whether each party had a reasonably opportunity to understand the terms of the contract, and (3) whether the important terms were hidden in a maze of fine print. Unequal bargaining power alone will not justify a finding of procedural unconscionability. At minimum, an employee who claims that an arbitration agreement is procedurally unconscionable must show some evidence that the employer refused to respond to her questions or concerns, placed undue pressure on her to sign the agreement without providing her with a reasonable opportunity to consider the terms, and/or that the terms of the agreement were set forth in such a way that an average person could not understand them. For example, in the *Alder* case, the Washington Supreme Court noted that if on remand the plaintiff could establish that his employer threatened to fire him for refusing to sign the arbitration agreement despite the fact that he had raised concerns with its terms or indicated that he had a lack of understanding due to a language barrier, the Court would likely find procedural unconscionability.

What does this mean for you? If you are requesting that employees sign arbitration agreements you should at the very least:

- (1) Provide the employee with an opportunity to review and ask questions about the agreement;
- (2) Ensure that any arbitration language is clearly set forth in an agreement - or if you are requesting the employee sign multiple agreements, ensure that the arbitration agreement language is clear in its terms and effects; AND
- (3) If you are aware of a language barrier, provide the employee with time to have the document reviewed in his/her native language.

In the event of a dispute with the employee down the road, careful attention to these issues may determine whether you can compel resolution of the dispute by an arbitrator, rather than in court.

Substantive Unconscionability

Substantive unconscionability involves those cases where a clause or term in the contract is alleged to be one-sided or overly harsh. 'Shocking to the conscience,' 'monstrously harsh' and 'exceedingly calloused' are terms sometimes used to define substantive unconscionability. Different contractual provisions were addressed in each of the three cases in the analysis of substantive unconscionability. Leaving the door open to deny enforcement of an entire arbitration agreement when unconscionable provisions 'pervade an agreement,' the Washington Supreme Court cases emphasized that when the parties agree to a severability clause, courts often strike offending provisions to preserve the contract's essential term of arbitration. Noting that only two provisions of the agreements were unconscionable in both Zuver and Adler, the Court severed the provisions from the remainder of the entire agreement. The Ninth Circuit, on the other hand, denied enforcement of the entire agreement stating that seven unconscionable provisions pervaded the entire agreement and any attempt to sever those provisions would render the procedure unworkable. (Of note, some of the seven provisions listed in the Al-Safin case, have been addressed by the Washington Supreme Court and were not automatically determined to be unconscionable).

A brief summary of the contractual provisions addressed and what employers should be aware of is set forth below:

* **Fee-Splitting Provisions:** An arbitration agreement's fee-splitting provision (a provision which provides that the employee and employer will split the cost of the arbitration) can be prohibitive for an employee who desires to bring a discrimination claim, and thus may be considered unconscionable. However, to invalidate an arbitration agreement on the ground that arbitration would be prohibitively expensive, an employee bears the burden of showing the likelihood of incurring such costs. Once the employee meets this burden, the employer must present contrary offsetting evidence to enforce arbitration. (Note: Without discussion, the Ninth Circuit held the cost-splitting and arbitration fee provisions in Al-Safin unconscionable)

To avoid this battle, employers often exclude these provisions, instead offering to offset or defray the cost of arbitration.

* **Attorneys' Fees Provisions - Arbitration:** An arbitration agreement that contains an attorneys' fees provision which requires each of the parties to bear their own respective costs and attorneys' fees will undermine an employee's rights under anti-discrimination laws, which allow successful plaintiffs to recover their attorneys' fees from the employer, and is unconscionable. If, however, an attorneys' fee provision states that a prevailing party may be entitled to receive reasonable attorneys' fee, the Washington Supreme Court has held that it is not unconscionable because it is solely speculation on whether an arbitrator will disregard case law in construing the attorneys' fee provision.

The safest measure is to state that each party will bear their own respective costs and attorneys' fees unless otherwise specified by statutory authority.

* **Confidentiality Provisions:** An arbitration provision that states that "all arbitration proceedings, including settlements and awards, under the Agreement will be confidential" hampers an employee's ability to prove a pattern of discrimination or to take advantage of findings in past arbitrations. Moreover, the Washington Supreme Court held that keeping past findings secret undermines an employee's confidence in the fairness and honesty of the arbitration process and potentially discourages that employee from pursuing a valid discrimination claim. Such a provision is therefore unconscionable. The Court, however, noted that a lack of public disclosure of arbitration awards is acceptable in the collective bargaining context, because both employers and unions monitor such decisions.

Employers should limit the use of such a provision to the collective bargaining context.

* **Remedies Limitation Provisions:** Any provision that waives or releases a right to recover certain remedies of an employee and is 'one-sided and harsh' will be held unconscionable pursuant to Washington law. For example, in Zuver, the agreement barred the employee from collecting any punitive or exemplary damages for her common law claims but permitted the employer to claim such damages for the only type of lawsuit that it would likely ever bring. The Court held that such an agreement blatantly and excessively favored the employer in that it allowed the employer alone access to a significant legal recourse.

If an employer is inclined to include a remedies limitation provision in its arbitration agreement, it should make certain that it generally applies to both parties. Both parties don't have to have identical requirements, but similar application of such a provision is good idea.

* Limitation on Actions Provisions: A provision that provides for a substantially shorter limitations period than an employee is entitled to pursuant to statutory authority will be deemed unconscionable. Some courts have held that six-month limitation provisions for Title VIII claims are reasonable and enforceable. The Ninth Circuit and the Washington Supreme Court, however, hold that if a provision deprives the plaintiff the benefit of the continuing violations and tolling doctrines, it will be deemed unconscionable - despite any specified stated time.

If an employer wishes to make a limitation period shorter than that provided by statute, it should make certain that (1) the limitation period is not substantially shorter (definitely not less than 6 months) and (2) ensure that the provision allows the employee to sue for continuing violations and tolling doctrines.

* Attorneys' Fees Provision - Non-arbitration: Some arbitration agreements contain a provision which allows attorneys' fees and costs to be awarded to a party who successfully stays such action and/or compels arbitration. Such a provision is okay so long as it permits either party to recover fees on a successful motion to stay an action and/or compel arbitration.

* Class - Action Provisions: In *Al-Safin*, the Ninth Circuit held that a provision which prevented class or consolidated arbitrations are unconscionable under Washington law. As the dissent points out, the majority did not cite to any Washington case law in support of its position and it is arguable that Washington law would not find such a provision unconscionable.

If an employer is inclined to include a class-action provision, it should be aware that the only case that currently addresses the issue is *Al-Safin* - which holds that it is unconscionable. It may be argued that this is wrongly decided pursuant to Washington law, but it is uncertain what a Washington Court would do if faced with the decision.

* Modification Provisions: The Ninth Circuit also held that a modification provision that allows an employer to alter the rules and procedures governing an arbitration almost at-will is unconscionable. The Court noted that in an employer's unilateral change in policy will not be effective until an employee receives reasonable notice of a change and accepts the change.

If an employer would like to include a modification provision, it should provide its employees with notice of any modification made in the future. Although Washington courts have not addressed this issue, an employer should also be careful to note that earlier arbitration agreements may be used for terminated employees when determining whether arbitration is mandatory.

Moving Forward

It is clear that the Ninth Circuit and Washington courts continue to uphold pre-dispute employment arbitration agreements. However, in drafting and presenting such agreements, employers need to be very careful in presenting the employee with a meaningful choice and ensuring the agreement presents relatively equal rights. As exemplified in each of these three cases, this can be a confusing maze that sometimes shifts in the sand given individual case facts.

Now is a good time to pull your arbitration agreements out to make sure they comply with the guidance provided in *Zuver v. Airtouch Communications, Inc.*, *Adler v. Manor* and *Al-Safin*. If in doing so you have any questions or thoughts, feel free to call any of the attorneys in Summit's Labor & Employment Group. We can also provide you a copy of the cases if you are interested.