DRAFTING ENFORCEABLE CONSUMER AND EMPLOYMENT ARBITRATION AGREEMENTS IN 2017

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Introduction

- Corporations increasingly employ arbitration agreements in an effort to curtail litigation costs
- Goal is straight forward but drafting an arbitration agreement is not
- Legality of agreements – particularly those that waive rights to pursue class or other collective action – has been hotly litigated
- California courts particularly hostile to arbitration agreements in consumer and employee contexts
- We will review recent legal developments and key drafting tips

Assuring meaningful assent to arbitration terms

- **Arbitration agreements enforceable only if consumer or employee agrees or assents to contract terms**
  - **In e-commerce context, consumer consent typically is provided through "clickwrap" or "browsewrap" assent. *Nguyen v. Barnes & Noble*, 763 F.3d 1171, 1175-76 (9th Cir. 2014).**
    - "Clickwrap" requires that consumers "click" to agree. "Browsewrap" requires no affirmative manifestation of assent but seeks to bind website users to terms published on the site.
  - **Actual or constructive notice required**
    - A prominent notice that any use of site will bind user to the site's terms of use is sufficient to provide constructive notice.
    - Inconspicuous or "buried" terms are unlikely to be binding.

Assuring meaningful assent to arbitration terms from employees

- **Employers**
  - **Have employees review and sign arbitration agreement.**
  - **May establish consent through an employee signature acknowledging receipt of arbitration policy (even if policy is contained within employee handbook). *See McLaurin v. Russell Sigler, Inc.*, 155 F. Supp. 3d 1042, 1046 (C.D. Cal. 2016).**

Best practices to ensure meaningful consent

- **Ensure arbitration agreement is clearly disclosed in contract and that consumers take affirmative action to agree to contract (i.e. clickwrap or signed acknowledgment).**
- **Ensure consumers have an opportunity to cancel after they are provided the contract terms.**
- **Maintain records sufficient to identify specific terms that consumers or employees agreed to.**
- **Provide opt out for employees.**

Minimum requirements for mandatory employment arbitration agreements

- ***Armendariz v. Foundation Health Psyche Services, Inc.*, 24 Cal 4th 83, 102 (2000) held that any mandatory employment arbitration agreement must:**
  - **provide for a neutral arbitrator**
  - **provide for more than minimal discovery**
  - **require a written award**
  - **provide for all of the types of relief that would otherwise be available in court**
  - **not require employees to pay either unreasonable costs or any arbitrators' fees or expenses as a condition of access to the arbitration forum.**

Class action waivers: generally enforceable with some exceptions

- **State laws and judicial rules that prohibit class action waivers are preempted by the Federal Arbitration Act (FAA).**
  - **In 2005, CA Supreme Court ruled that mandatory arbitration agreements that include a class action waiver are unconscionable in many consumer contracts of adhesion. *Discover Bank v. Superior Court*, 36 Cal.4th 148 (2005).**
  - **U.S. Supreme Court overruled Ninth Circuit's application of this rule in *AT&T Mobility LLC v. Concepcion*, 563 U.S. 333 (2011).**

Class action waivers: *AT&T Mobility LLC v. Concepcion*

- ***Concepcion* facts: Plaintiffs sued AT&T for false advertising after being charged $30.22 in sales tax for a phone that was advertised as "free."**
  - **Their complaint was consolidated with a putative class action and AT&T moved to compel arbitration.**
  - **The Ninth Circuit relied on the *Discover Bank* rule in order to deny a motion to compel arbitration.**
  - **U.S. Supreme Court overturned holding that any state laws, including judicial rules, or policies that discriminate against arbitration contracts are preempted by the Federal Arbitration Act (FAA).**

Class action waivers: *AT&T Mobility LLC v. Concepcion*

- **Court reasoned:**
  - **Section 2 of the FAA permits that arbitration agreements may be declared unenforceable "upon such grounds as exist at law or equity for the revocation of any contract."**
  - **But, such rules may not discriminate against arbitration agreements (facially or in effect).**
  - ***Discover Bank* rule had the effect of allowing consumers to demand classwide arbitration and thus created a scheme inconsistent with the goals of the FAA to promote arbitration.**
    - "[T]he switch from bilateral to class arbitration," "sacrifices the principal advantage of arbitration—its informality—and makes the process slower, more costly, and more likely to generate procedural morass than final judgment."
    - Discover Bank Rule conflicts with FAA and is preempted.

Supreme Court has reaffirmed the key *Concepcion* rulings

- **Waiver of class arbitration is enforceable even if plaintiff's cost for individually arbitrating a federal statutory claim exceeds his or her potential recovery. *American Express v. Italian Colors Restaurant*, 133 S. Ct. 2304 (2013).**
  - **Recognized that arbitration agreements that create a "prospective waiver of a party's right to pursue statutory remedies" are not enforceable.**
  - **But, relatively minor size of a claim does not confer a right to class action to make the claim financially feasible.**
  - **Rule 23 does not create such a substantive right.**

Supreme Court has reaffirmed the key *Concepcion* rulings

- **U.S. Supreme Court disagrees with CA Court of Appeals in *Direct TV v. Imburgia*, 136 S.Ct 463 (2015).**
  - **Arbitration agreement at issue waived right to class arbitration but added that if the "law of your state" makes the waiver of class arbitration unenforceable, then the entire agreement "is unenforceable."**
    - CA Court of Appeals applied the *Discover Bank* rule as the "law of your state" because it was in effect at the time complaint filed.
    - Supreme Court overturned, reaffirmed that the FAA protects arbitration clauses, and held that California's interpretation of the phrase "law of your state" to include the *Discover Bank* rule discriminated against arbitration and was preempted by the FAA *Id.* at 471.

California courts continue to interpret *Concepcion*

- **California's Consumer Legal Remedies Act's anti-waiver provision is preempted by FAA insofar as it bars class waivers in arbitration agreements covered by the FAA. *Sanchez v. Valencia Holding Co*., 61 Cal.4th 899 (2015).**
  - **Plaintiffs argued that despite *Concepcion,* the FAA does not preempt CLRA, which expressly permits class actions and declares that any waiver of its provisions "is contrary to public policy and shall be unenforceable and void."**

California courts continue to interpret *Concepcion*

- **Judicial rule holding that Private Attorneys General Act (PAGA) rights to enforce labor practices on behalf of other "aggrieved employees" cannot be waived *is not* preempted by the FAA.**
  - **PAGA claims cannot be prospectively waived by an arbitration agreement. *Iskanian v. CLS Transp. Los Angeles, LLC,* 59 Cal. 4th 348 (2014).**
  - **The Ninth Circuit recently adopted the *Iskanian* court's reasoning, and concluded that the *Iskanian* holding did not conflict with the FAA and is therefore not preempted as the *Discover Bank* rule was. *Sakkab v. Luxottica Retail N. Am., Inc.*, 803 F.3d 425 (9th Cir. 2015).**

California courts continue to interpret *Concepcion*

- **California Court of Appeal recently held that a PAGA claim is an entirely representative action brought on behalf of the state. *Hernandez v. Ross Stores, Inc.* 2016 WL 7131652 (Dec. 7, 2016).**
  - **Employee must show she is an "aggrieved party" subject to a Labor Code violation to bring PAGA claim.**
  - **Employer claimed that an arbitration agreement required that all "disputes" (not "claims") between employer and employee be arbitrated. Thus, the "dispute" about whether plaintiff was an "aggrieved party" under PAGA had to be arbitrated.**
  - **Court rejected this argument, holding that a PAGA claim does not involve any individual dispute, claim or action brought by an employee.**

Class action waivers *may* be an unfair labor practice under NLRA

- ***D.R. Horton v. Cuda***
  - **Following *Concepcion*, the NLRB ruled that employment contracts that mandated individual arbitration violated the NLRA, which protects workers' rights to act collectively.**
  - **Overturned by the 5th Circuit in December 2013. *See D.R. Horton, Inc. v. N.L.R.B.*, 737 F.3d 344 (5th Cir. 2013).**
- **The 2nd and 8th circuits concur with the 5th Circuit.**
  - **These circuits have interpreted FAA to find that mandatory arbitration clauses that prevent employees from resolving workplace disputes by suing as a group are enforceable. *See Southerland v. Ernst & Young LLP*, 726 F.3d 290 (2d Cir. 2013); *Cellular Sales of Missouri v. NLRB*, 824 F.3d 772 (8th Cir. 2016).**

Class action waivers *may* be an unfair labor practice under NLRA

- **9th and 7th Circuits recently disagreed, creating a circuit split.**
  - ***Lewis v. Epic Systems*, 823 F.3d 1147 (7th Cir. 2016)**
    - Employer's arbitration provision that required employees to bring any wage-and-hour claims through individual arbitration and prevented them from seeking collective, representative, or class legal remedies, violated the NLRA and was thus unenforceable.
  - ***Morris v. Ernst & Young,* 834 F.3d 975 (9th Cir. 2016)**
    - Provision requiring employee claims be resolved on an individual basis in "separate proceedings" violated the NLRA because it precluded employees from exercising an "essential right" to initiate concerted legal action in any forum.

Class action waivers *may* be an unfair labor practice under NLRA

- **Supreme Court action on this issue possible: *Epic Systems* has petitioned for Supreme Court review. A decision in that matter could resolve this circuit split, and clarify the law for California courts.**

Other arbitration terms unenforceable if unconscionable

- **FAA allows that defenses such as fraud, duress, and unconscionability may still invalidate an arbitration agreement if they are enforced evenhandedly so as not to "interfere[] with fundamental attributes of arbitration."**
  - ***Concepcion* requires enforcement of class waivers but does not limit the unconscionability rules applicable to other provisions of arbitration agreements. *Sanchez v. Valencia Holding Co.*, 61 Cal. 4th 899, 906 (2015).**

Drafting arbitration clauses to avoid unconscionability

- **Unconscionability requires both procedural and substantive unconscionability but they need not be present in the same degree—a sliding scale is used.**
  - **Procedural unconscionabilty: requires showing of "oppression" and "surprise." *See e.g. Wayne v. Staples, Inc.*, 135 Cal. App. 4th 466, 480 (2006).**
    - Oppression is often found in consumer contracts that are contracts of adhesion.
    - Finding oppression is not alone sufficient to establish unconscionability. "Surprise" and some degree of substantive unconscionability are also needed.

Drafting arbitration clauses to avoid unconscionability

- **Avoid oppression**
  - **Consider including opt-out mechanism for consumers**
    - May reduce the risk that contract is a contract of adhesion. *Mohamed v. Uber Technologies*, No. 15-16178, 2016 WL 7470557 at *6 (9th Cir. Dec. 21, 2016); *Circuit City Stores, Inc. v. Ahmed*, 283 F.3d 1198, 1199 (9th Cir. 2002).
    - But opt-out provision does not guarantee a contract is not unconscionable. *Gentry v. Superior Court*, 42 Cal. 4th 443, 470-72 (2007).
  - **Allow employees to negotiate contract terms**
    - "Take it or leave it" arbitration clauses in employment contracts are procedurally unconscionable. *See Chavarria v. Ralphs Grocery Co.*, 733 F.3d 916 (9th Cir. 2013); *See also Carlson v. Home Team Pest Defense*, 239 Cal.App.4th 619 (2015).

Drafting arbitration clauses to avoid unconscionability

- **Avoid surprise**
  - **Provide brief and prominent notice of any arbitration agreement that makes the salient terms of the agreement hard for consumers to miss. *Kilgore v. Keybank Nat'l Ass'n*, 718 F3d 1052, 1058-59 (9th Cir. 2013).**
  - **Do not bury an employee arbitration agreement in an employment agreement or employee handbook, but provide it to employees as a stand-alone document. *Sanchez v. CarMax Auto Superstores of California, LLC* 224 Cal.App.4th 398, 403 (2014).**
  - **Ideally attach, but at least clearly reference, rules that will govern any arbitration.**

Drafting arbitration clauses to avoid unconscionability

- **Avoid substantive unconscionability:**
  - **standard has been given many labels ("overly harsh", "unduly oppressive", so one-sided as to "shock the conscience", or "unfairly one-sided.").**
  - **They all mean the same thing and require a substantial degree of unfairness *beyond 'a simple old-fashioned bad bargain.' Sanchez v. Valencia Holding Co.*, 61 Cal.4th 899, 911 (2015).**

Drafting arbitration clauses to avoid unconscionability

- **Avoiding substantive unconscionability**
  - **Mutuality: arbitration agreements should obligate both parties to the same degree.**
    - **Covered claims.** *See*, *Samaniego v. Empire Today LLC*, 205 Cal. App. 4th 1138, 1147-48.
    - **Award rejection clauses.** *See Saika v. Gold,* 49 Cal. App. 4th 1074, 1080 (1996).
    - **Appeal rights.** *Compare Little v. Auto Stiegler, Inc.*, 29 Cal. 4th 1064, 1072 (2003) *and Sanchez* 61 Cal. 4th at 916.
  - **Parties may be able to justify asymmetry based on a legitimate commercial need "other than the employer's desire to maximize its advantage" in the arbitration process. *See Armendariz v. Foundation Health Psyche Services, Inc.*, 24 Cal.4th 83, 117 (2000).**

Drafting arbitration clauses to avoid unconscionability

Avoiding substantive unconscionability

- **Arbitrator selection:** Arbitration agreements should provide a fair selection process that provides equal opportunity for both parties to reach agreement on a neutral arbitrator (e.g., by following the AAA or JAMS selection process). *See Graham v. Scissor-Tail, Inc.,* 28 Cal.3d 807, 827 (1981).
- **Location of arbitration:** Courts are reluctant to enforce arbitration agreements that require consumers or employees to travel far to arbitrate.
- **Arbitration fees:** consider offering to pay the full cost of arbitration for modest-size claims.
  - Employees and consumers seeking to remedy violations of unwaivable statutory rights or fundamental rights delineated in constitutional or statutory provisions may not be required to incur any costs they would not incur to litigate in court. *Samaniego*, 205 Cal. App. 4th at 1147-48.

Drafting arbitration clauses to avoid unconscionability

Avoiding substantive unconscionability

- **Confidentiality:** Confidentiality language that prevents even "mentioning" the fact of the arbitration was unconscionable because an employee who is unable to even mention the existence of a claim to others would be less able to engage in discovery and this would provide a clear advantage to the employer. *See Davis v. O'Melveny &Myers*, 485 F.3d 1066, 1078-79 (9thCir. 2007).

- Choice of law: Provisions contained in adhesion contracts are usually respected but choice-of-law provisions that would result in substantial injustice to the weaker party will not be enforced. *Samaniego v. Empire Today LLC*, 205 Cal. App. 4th at 1147-48 (2012).

On the Horizon: CFPB rules prohibiting class action waivers?

- On May 5, 2016, the CFPB proposed rules that would prohibit arbitration clauses in contracts for certain consumer financial products that disallow participating in class action lawsuits.
- News reports suggest the CFPB will issue the final rule before the change in administration, January 20, 2017.
- Current political climate makes future of this rule uncertain.

On the Horizon: CFPB rules prohibiting class action waivers?

- **Republican-led Congress could use its authority under the Congressional Review Act (CRA) to reject such a rule.**
  - **Under the CRA, an agency must submit a final rule to Congress and the Government Accountability Office before the rule can take effect.**
  - **Congress then has 60 "legislative days" to pass a joint resolution disapproving the rule (a vote on this joint resolution is not subject to filibuster in the Senate and can be passed by a simple majority).**
  - **If the resolution is passed by both the House and Senate, it is sent to the President for signature.**

On the Horizon: CFPB rules prohibiting class action waivers?

- **How likely is it that a final CFPB rule would be overturned by CRA action?**
  - **Historically, use of the CRA to overturn regulations has been rare because a president has veto power and most presidents are unlikely to overturn regulations that their own administrations have passed.**
  - **This year is unique because a presidential transition aligns with a White House and Congress controlled by the same party. Thus, the threat of CRA action is real.**

Significant Take-Away Points

- **Review contract formation practices and related recordkeeping practices to ensure you can document meaningful consent.**
- **Provide prominent notice to employees and consumers of arbitration terms.**
- **Ensure arbitration agreements obligate parties to the same degree creating "mutuality."**
- **If including a class action waiver in an employee arbitration clause, consider including an opt-out window to avoid unconscionability per *Morris v. Ernst & Young*.**

Significant Take-Away Points

- **Given uncertainty of whether a class action waivers for wage and labor claims will be enforced, consider adding a clause stating that if the class action waiver is deemed unlawful for any reason, any class, collective, or group action will be heard in court and not by an arbitrator, as most practitioners agree that class arbitration is unwieldy and undesirable.**
- **Monitor developments regarding CFPB rule prohibiting class action waivers.**

Sample mandatory arbitration clause

Any dispute or claim relating in any way to your use of any Amazon Service, or to any products or services sold or distributed by Amazon or through Amazon.com will be resolved by binding arbitration, rather than in court, except that you may assert claims in small claims court if your claims qualify. The Federal Arbitration Act and federal arbitration law apply to this agreement. . . The arbitration will be conducted by the American Arbitration Association (AAA) under its rules, including the AAA's Supplementary Procedures for Consumer-Related Disputes. The AAA's rules are available at www.adr.org or by calling 1-800-778-7879. Payment of all filing, administration and arbitrator fees will be governed by the AAA's rules. We will reimburse those fees for claims totaling less than $10,000 unless the arbitrator determines the claims are frivolous. Likewise, Amazon will not seek attorneys' fees and costs in arbitration unless the arbitrator determines the claims are frivolous. You may choose to have the arbitration conducted by telephone, based on written submissions, or in person in the county where you live or at another mutually agreed location. ***See Amazon's terms of use agreement.***

Sample class action waiver clauses

Ex. 1: "We each agree that any dispute resolution proceedings will be conducted only on an individual basis and not in a class, consolidated or representative action." ***See Amazon's terms of use agreement.***

Ex. 2: You and the Company each agree that, no matter in what capacity, neither you nor the Company will (1) file (or join, participate or intervene in) against the other party any lawsuit or court case that relates in any way to your employment with the Company or (2) file (or join, participate or intervene in) a class-based lawsuit, court case or arbitration (including any collective or representative arbitration claim.) ***See Sakkab v. Luxoittica Retail North America, Inc. 803 F.3d 425 (9th Cir. 2015).***

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