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PERSPECTIVE

Muddied waters on unconscionable arbitration agreements

By Timothy D. Reuben
and Michael N. Hirota

For many California employers and employees, a mandatory arbitration policy is part and parcel of the employment relationship. How such an arbitration clause must read to be enforceable and not unconscionable has been the subject of many appellate opinions. Unfortunately, the 1st District Court of Appeal has muddied the waters as to when such arbitration agreements are enforceable.

In *Serafin v. Balco Properties Ltd. LLC*, 2015 DJDAR 3048, Justice Ignazio Ruvolo with Justices Timothy Reardon and Maria Rivera concurring affirmed the Contra Costa County Superior Court's order enforcing an arbitration clause that unconscionably required both sides to bear their own attorney fees — that is, as long as that offending clause is severed.

Madeline Serafin began working for Balco Properties in June 2009. When Serafin was hired, she signed an arbitration agreement which provided that in the event of a dispute between Serafin and Balco, the matter shall be submitted to binding arbitration pursuant to the American Arbitration Association rules which were available "from the Human Resources department or directly from the American Arbitration Association."

The arbitration agreement also contained a provision that was blatantly inconsistent with the state Supreme Court's 15-year-old ruling in *Armendariz v. Foundation Health Psychcare Services Inc.*, 24 Cal. 4th 83 (2000), by requiring each party to bear its own attorney fees and costs. It has long been the law that "an arbitration agreement cannot be made to serve as a vehicle for the waiver of statutory rights created by" the Fair Employment and Housing Act (FEHA), which allows the employee (but not the employer) to recover attorneys fees if the employee is the prevailing party.

After about a year, Balco terminated Serafin and submitted a demand to the American Arbitration Association (AAA) to arbitrate a claim against her based on overpayment of wages. Serafin then sued Balco, claiming wrongful termination, harassment and defamation. She argued the arbitration clause was unconscionable, but the trial court granted Balco's motion to stay the litigation pending arbitration, severing the attorney fees and costs provision.

The arbitrator found in Balco's favor on all employment-related claims, and the trial court confirmed the arbitration decision. Serafin appealed, claiming she had not entered into a valid agreement to arbitrate her claims, and even if she had, such agreement was procedurally and substantively unconscionable.

Serafin argued the specific language of the agreement described the arbitration requirement only as an employer "policy," and that she merely signed stating: "I have read and understand this policy." She pointed out Balco expressly stated in the employee handbook that it retained the right to change its policies at any time, so there was really no agreement, and if there was, it was illusory.

The Court of Appeal rejected that there was no valid agreement, however, noting that Balco's arbitration agreement was a separate, two-page document specifically explained to Serafin by a human resources representative. It further rejected the argument that Balco's retention of the right to "modify, revoke, or change" its arbitration policy "at any time" rendered the agreement illusory. Pointing to *24 Hour Fitness, Inc. v. Superior Court*, 66 Cal. App. 4th 610 (1998), the court determined that because the implied covenant of good faith and fair dealing governed Balco's modification provision, this provision did not render the agreement illusory.

The court also rejected Serafin's claim that the arbitration agreement was unconscionable, which is somewhat problematic. As to procedural unconscionability, Serafin cited to *Trivedi v. Curexo Technology Corp.*, 189 Cal. App. 4th 387 (2010), which held that an arbitration agreement was procedurally unconscionable in part due to the employer's failure to provide the employee with a copy of the AAA rules. While the court acknowledged that failing to provide a copy of the rules could support a finding of procedural unconscionability, it distinguished *Trivedi* by pointing out that although the AAA rules were not affirmatively provided to Serafin, the arbitration agreement was explained by a human resources representative and the clause also identified where the AAA rules could be found. Since the arbitration agreement was drafted by Balco and was presented on a take-it-or-leave-it basis, the court concluded that Serafin had "shown a minimal degree of unconscionability arising from the adhesive nature of the agreement."

So the court turned to substantive unconscionability. Somehow, the court rejected this claim as well. Referencing "the sliding scale approach," because of the weaker procedural unconscionability, the court required a "strong showing of substantive unconscionability." The court acknowledged that requiring both parties to bear their own fees and costs was unconscionable, as it improperly sought a waiver of Serafin's ability to recover attorney fees and costs from her employer as a prevailing plaintiff in an action brought under the FEHA. But the court ruled that the unconscionability did not "permeate" the arbitration agreement. Thus, the trial court did not abuse its discretion in severing this portion of the agreement.

Serafin is perplexing as it offers little guidance as to when a clearly unconscionable provision may be severed from the underlying arbitration agreement, and when it is so unconscionable as to permeate the entire agreement. Indeed, *Armendariz*, the seminal case on unconscionability in arbitration agreements, provided that a single unconscionable term could justify a refusal to enforce an arbitration agreement if it were drafted in bad faith, as severing such a provision and enforcing the arbitration agreement would encourage the drafters of such agreements to overreach.

Although the *Serafin* court distinguished *Trivedi* by pointing to other instances where similar attorney fees provisions were severed, it offered no discussion as to why an apparent waiver of the right of a prevailing plaintiff under FEHA to recover fees and costs, identified in Trivedi as being "highly valued" by the Legislature, was not sufficiently unconscionable as to permeate the entire agreement. Likely, the one thing that makes *Serafin* distinguishable is that the arbitration agreement was a separate document and it was specifically explained to the employee by an employer representative at the beginning of employment.

Ultimately, *Serafin* creates more problems for employers and for courts than it solves by rewarding poor drafting and creating a fuzzy test for determining unconscionability. Parties to an arbitration agreement with clearly unconscionable terms are forced to roll the dice to determine whether it will actually be enforced, eliminating the sense of certainty that such agreements are aimed to promote, while trial courts have no clear guidance as to when to invalidate an arbitration clause as opposed to sever some portion of it. The silver lining may be that the decision will encourage smart employers to take a closer look at their arbitration agreements to avoid the ambiguity of this unconscionability analysis.

Timothy D. Reuben *is the founding principal of Reuben Raucher & Blum, a litigation boutique located in Westwood. He handles matters at both the trial and appellate level and in arbitration and specializes in complex matters including employment, real estate, intellectual property, unfair competition, and related business disputes. You can reach him at treuben@rrbattorneys.com.*

Michael N. Hirota *is an associate with Reuben Raucher & Blum. He practices in the area of employment law.*


TIMOTHY D. REUBEN
Reuben Raucher & Blum


MICHAEL N. HIROTA
Reuben Raucher & Blum

RRB
REUBEN RAUCHER & BLUM PC
ATTORNEYS AT LAW