

# How Calif. Ruling Alters Worker Arb. Agreement Enforcement

By **Sander van der Heide** (July 26, 2024)

In a July 15 decision, the California Supreme Court held that courts cannot refuse to enforce arbitration agreements simply by finding that three or more provisions are unconscionable. Rather, courts must use a three-prong test to assess whether to remove or limit unconscionable terms and enforce the remainder of the agreement.

Ramirez v. Charter Communications Inc. is a reminder for employers to ensure their employment arbitration agreements are fair and balanced. The decision also clarifies the standard to determine whether courts can sever unconscionable terms, that is, those that are one-sided or illegal.



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## Background

Angelica Ramirez signed an arbitration agreement at the outset of her employment, but after she was terminated, she filed a lawsuit in court, rather than in arbitration.

Her employer, Charter Communications, filed a motion to compel the case to arbitration. The trial and appellate courts concluded the employer's motion should be denied because there were multiple unconscionable provisions in the employment arbitration agreement.

In particular, the employee challenged four provisions of the arbitration agreement.

First, she argued the agreement was one-sided because the claims it subjected to arbitration were primarily claims brought by employees, such as unlawful termination, discrimination, harassment, and wage and hour disputes.

Yet claims typically brought by employers were explicitly excluded from arbitration, including theft, embezzlement, noncompete agreements, unauthorized disclosure of trade secrets or confidential information, and intellectual property right claims.

Second, she challenged the agreement's requirement that claims subject to an administrative agency pre-filing must be filed in arbitration within the time period for submitting the claim to the administrative agency.

This provision effectively shortened the time to bring a claim for discrimination, harassment and/or retaliation under the Fair Employment and Housing Act.

Third, she asserted that the discovery permitted under the agreement, which was four depositions, 20 interrogatories and 15 document requests, was too limited.

Fourth, she disputed the enforceability of a provision that said if a lawsuit is filed in court, rather than in arbitration, and then compelled to arbitration, the party resisting arbitration must pay the other party's attorney fees and costs incurred in compelling arbitration.

The California Supreme Court affirmed the lower court's findings that the following provisions were unconscionable:

- The scope of claims included and excluded from arbitration;
- The shortening of time to submit claims; and
- The fee shifting provisions.

On the issue of limited discovery, the California Supreme Court held that the discovery provision was not unconscionable because arbitration agreements can limit discovery to less than what is permitted in court, and language in the discovery provision allowing the arbitrator to "decide all discovery disputes" included the ability to allow more discovery.

Despite affirming that the arbitration agreement contained unconscionable terms, the California Supreme Court's holding infers that the existence of unconscionable terms does not render the agreement per se unconscionable.

### **The Three-Prong Test**

On the issue of whether the agreement should be enforced, the California Supreme Court explained there is no bright-line rule regarding the number of unconscionable terms in a contract that mandates a court's refusal to enforce it. Instead, it set forth the following three-prong test.

A court may liberally sever any unconscionable provision of a contract and enforce the rest when:

- The unconscionable provision(s) are "collateral to the main purpose of the contract";
- It is possible to cure the unconscionability by removing or limiting the provision; and
- Enforcing the remainder of the contract would be in the "interests of justice."

Under the first prong, the court considers whether the main purpose of the contract is tainted by an unlawful purpose, e.g., creating a system that disfavors or disadvantages an employee's claims while favoring or advantaging an employer's claims. If not, the unconscionable provision(s) are collateral.

Under the second prong, the court considers whether striking or limiting existing terms removes the unconscionability, and whether the agreement contains a severance clause indicating the parties' intent to have the court do so. However, the court should not enforce the contract if terms must be added to it to remove the unconscionability.

Under the third prong, the court considers whether severance of unconscionable terms condones an illegal scheme. For example, severance could create an incentive for employers to draft one-sided agreements in the hopes that employees won't challenge them, and that the court would fix the problems for them if they do.

The second thing the court considers under the third prong is whether the agreement indicates a systematic effort to impose arbitration on an employee as an inferior forum that works to the employer's advantage.

If the answer to either question is yes, then in the interests of justice, the court should not enforce the agreement.

The case has been remanded for further consideration in light of the three-prong test laid out in the California Supreme Court's decision.

## **Lessons Learned**

Here are the key takeaways from the Ramirez v. Charter Communications decision.

If an employer's arbitration agreement is generally fair and balanced between the parties, having more than one or two provisions challenged will not necessarily invalidate the agreement. The assessment of whether a provision is unconscionable is based on the circumstances when the parties entered into the agreement, not on subsequent developments.

If the terms of the arbitration agreement indicate a systematic effort to impose arbitration on employees not simply as an alternative to litigation, but as a system to disadvantage employees, courts should refuse to enforce the agreement in the interests of justice.

Employers should ensure the provision defining which claims are subject to arbitration includes claims typically made by employees, e.g., breach of fiduciary duty, misappropriation, disclosure of trade secrets, conversion, fraud, infringement of intellectual property rights, interference with contractual relations or trade, and breach of the duty of loyalty, etc.

Since fixing such one-sided agreements likely requires a court to impermissibly add terms to the agreement, rather than simply severing terms, employers should not expect courts to enforce agreements that exclude employers' claims from arbitration.

Agreements that require an arbitration claim to be filed within the time for filing a charge or complaint with an administrative body before filing in court are likely unreasonable limitations because the shortened limitations period does not allow for administrative enforcement.

It is important to ensure arbitration agreements that provide for limited discovery also authorize the arbitrator to allow for additional discovery that is necessary to adequately arbitrate claims.

Employers no longer need to fear that their arbitration agreements will be deemed unenforceable simply because three or more provisions are challenged. In other words, arbitration agreements need not be perfect to be enforceable. However, employers should not expect courts to enforce or save arbitration agreements designed to disadvantage employees.

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