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Arbitration Agreements—California Supreme Court Clarifies Scope of Judicial Review of Awards Affecting Unwaivable

April 30, 2010

On April 26, 2010, the California Supreme Court ruled that an arbitration award may be vacated when the arbitrator makes a clear error of law which deprives an individual of a hearing on the merits of an unwaivable statutory employment claim. The Supreme Court separately held that arbitration agreements covered by the Federal Arbitration Act ("FAA") may lawfully restrict employees from seeking administrative adjudication of claims under California's Fair Employment and Housing Act ("FEHA").

Facts

Plaintiff Luis Turcios ("Plaintiff") worked as a janitor for Defendant Pearson Dental Supplies ("Pearson"). Pearson's standard form dispute resolution agreement ("DRA"), which Plaintiff signed, required arbitration of any disputes arising out of the employment relationship "to avoid the inconvenience, cost, and risk that accompany formal administrative or judicial proceedings." After Pearson fired Plaintiff in January 2006, Plaintiff filed a civil lawsuit against Pearson in Los Angeles Superior Court claiming age discrimination under FEHA.

Pearson filed a motion to compel arbitration, which was granted. Pearson then filed a motion for summary judgment with the arbitrator, arguing that Plaintiff's claim was time-barred because Plaintiff had failed to submit it to arbitration within the one-year limitations period imposed by the DRA. The arbitrator agreed with Pearson and dismissed Plaintiff's claim.

Plaintiff petitioned the Superior Court to vacate the arbitrator's award on two grounds. First, Plaintiff argued that the DRA was unconscionable because of the one-year limitations period, which is shorter than that which applies under FEHA. Second, Plaintiff claimed the arbitrator had erred in ruling that the tolling provisions of California Civil Code Section 1281.12 ("Section 1281.12") did not save his claim from being time-barred. The trial court vacated the award, finding that the arbitrator had made a clear error of law by misapplying the tolling period in Section 1281.12.

Pearson appealed. The Court of Appeal agreed that the arbitrator's application of Section 1281.12 was erroneous. It nevertheless reversed the trial court and reinstated the arbitration award, holding that the arbitrator's erroneous decision "is insulated from judicial review and is not a proper basis upon which to … vacate the award."

The California Supreme Court granted review on two issues: (1) what standard of judicial review should a trial court apply to ensure that an employee's anti-discrimination claim is adequately protected when arbitrated pursuant to a mandatory arbitration agreement?; and (2) is it unconscionable for a mandatory arbitration agreement to restrict an employee from seeking administrative remedies for violations of FEHA (which Plaintiff argued was the effect of the DRA's reference to "administrative or judicial proceedings")?

Standard of judicial review for unwaivable statutory claims

On the first issue, the Supreme Court acknowledged that arbitration awards typically may only be vacated on the grounds set forth in California Code of Civil Procedure Sections 1280-1294.2 (*e.g.,* fraud, corruption, misconduct). However, the Court found that more expansive judicial review is appropriate in cases where unwaivable statutory rights are at issue:

Here, as a result of the arbitrator's clear legal error, plaintiff's claim was improperly determined to be time-barred. … It is difficult to imagine a more paradigmatic example of when granting finality to an arbitrator's decision would be inconsistent with the protection of a party's statutory rights.

Accordingly, the Court held that "when, as here, an employee subject to a mandatory employment-arbitration agreement is unable to obtain a hearing on the merits of his FEHA claims, or claims based on other unwaivable statutory rights, because of an arbitration award based on legal error, the trial court does not err in vacating the award."

In so holding, the Court referenced its landmark *Armendariz* decision, which announced a series of prerequisites to the enforceability of mandatory employment arbitration agreements. In that decision, the Court was explicit that "a party to such an arbitration agreement must be able to **fully vindicate his or her statutory cause of action** in the arbitral forum." (Emphasis added.)

Unconscionability of precluding administrative adjudication

On the unconscionability issue, the Court held that arbitration agreements governed by the FAA may lawfully restrict employees "from submitting their claims for adjudication to an administrative entity such as the [California] Labor Commissioner." The Court acknowledged that under federal precedent, an arbitration agreement cannot bar agencies such as the U.S. Equal Employment Opportunity Commission from *prosecuting* statutory antidiscrimination violations. However, as the United States Supreme Court recently recognized, federal law does permit arbitration agreements to prevent resort to administrative agencies that act as *adjudicators* (as opposed to prosecutors) of employment claims. Even if such a provision would violate California law, such law would be preempted when applied to an arbitration agreement covered by the FAA. The Court thus found that the provision precluding resort to an administrative forum did not render the Pearson DRA unconscionable or unenforceable.

On a separate note, Plaintiff also attempted to argue that the DRA was unconscionable due to the one-year statute of limitations discussed above. The Supreme Court declined to decide this issue, finding that Plaintiff had not properly preserved it for appeal. However, the Court of Appeal below ruled that the shortened limitations provision was not unconscionable. Thus, this issue remains an open one in California.

Practical considerations

Pearson provides some much-needed clarity around the issue of when a trial court may properly vacate an arbitration award that affects a statutory employment claim. However, questions remain. For example, *Pearson* leaves open whether *any* significant legal error will justify vacating an award, or whether it is only those errors that would otherwise preclude an employee from receiving a hearing on the merits on his claim. While the facts of *Pearson* might provide a convincing argument for the latter position, the Supreme Court did not explicitly limit its holding to such circumstances.

Pearson's holding that arbitration agreements subject to the FAA may validly preclude administrative adjudication of employment claims is a victory for employers. Employers should consider adding appropriate limiting language to their future arbitration agreements, and may also wish to consult with counsel about the possibility of revising existing agreements to take advantage of this ruling.

Our attorneys have deep counseling and litigation experience on these arbitration issues. If you would like to discuss these issues further or have questions about this *Alert,* please contact one of the attorneys listed above.

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