A Rare Victory On Arbitration Agreement Enforceability

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Can an agreement to arbitrate all employment-related disputes be rendered unenforceable where a choice-of-law clause — interpreted in conjunction with a delegation clause — restricts the arbitrator’s power to apply California’s rules regarding unconscionability?

The United States Supreme Court decision in AT&T v. Concepcion favored employers not only because it upheld a class action waiver in arbitration, but also because of its conclusion that California unconscionability law stood as obstacle to enforcing arbitration agreements. [1]

Despite this ruling, California employees continue to challenge employment arbitration agreements based on unconscionability. Employment arbitration agreements typically include a “delegation clause” in order to give the arbitrator the exclusive authority to determine questions of enforceability of the arbitration agreement. In the past year, the California courts have only decided a handful of cases analyzing the enforceability of an employment arbitration agreement based on its delegation clause. California employees challenging delegation clauses on the basis of unconscionability have been largely unsuccessful in the wake of the United States Supreme Court’s decision in Concepcion.[2]

However, the recent case of Pinela v. Neiman Marcus Group, Inc. provides an example of an employee’s successful challenge to a delegation clause, based on its relationship with a choice of law clause.[3] The relationship of the two resulted in the failure of the entire arbitration agreement based on unconscionability.

Pinela v. Neiman Marcus Group

In Pinela v. Neiman Marcus Group Inc., the plaintiff, a California employee working for Neiman Marcus, a Texas-based company, filed a lawsuit alleging various individual and class claims for violations of the California Labor Code. [4] The trial court compelled arbitration under Neiman Marcus’s broad arbitration clause requiring both the employer and employee to arbitrate any and all complaints, disputes or legal claims that each may have against one another arising from or connected in any way with the plaintiff’s employment.[5] The arbitration clause also prohibited the arbitrator from considering claims on a class basis.
In concluding the arbitration agreement was unenforceable, the California Court of Appeal took several unusual steps. First, the court upheld the trial court’s decision to reverse its own order compelling arbitration although an order compelling arbitration is usually challenged by a writ of mandate. [6] Second, the court relied primarily on the choice of law clause to invalidate not only specific clauses within the agreement, but to declare the entire agreement unconscionable.[7]

Foreign State Choice of Law Clause

California strongly favors enforcement of choice of law provisions and courts have upheld application of other states’ internal statutes, rules and laws to arbitration contracts.[8] Where an agreement’s choice of law clause adopts another state’s law, with few exceptions, California choice of law rules will require the application of the selected state’s law to determine enforceability of the agreement.[9]

In Pinela, the arbitration agreement’s choice of law clause required the agreement to be construed, governed by, and enforced in accordance with the laws of the state of Texas. [10] The delegation clause required all questions of enforceability to be submitted to the arbitrator, but at the same time prohibited the arbitrator from enlarging, adding to, subtracting from, disregarding or otherwise altering the rights of the parties. [11]

When read together, the court in the Pinela opinion concluded these clauses prohibited the arbitrator from applying California unconscionability standards on enforcement issues, a result which the court concluded was itself substantively unconscionable.[12] Without severing any of language from the offending clauses, the court then went on to declare the entire arbitration agreement otherwise unconscionable because under Texas law, the plaintiff had no ability to bring a private cause of action for violations of Texas wage-and-hour statutes. This result served as an advance waiver of statutory rights under California law.[13]

Conclusion

Although California generally favors the enforcement of choice of law clauses, the Pinela plaintiff successfully used California unconscionability law to invalidate an entire arbitration agreement based primarily on the existence and effect of a choice of law clause. Companies employing people in California may think it is a good idea to include a clause requiring application of pro-employer state’s law in an arbitration agreement. As the case of Pinela demonstrates, doing so will not always lead to the desired result. The selection of favorable state, such as Texas, combined with a delegation clause, which unreasonably restricts the power of the arbitrator, may well cause the entire arbitration agreement to fail.

—By Anita V. Shah, Carico Johnson Toomey LLP

Anita Shah is a litigation partner in Carico Johnson Toomey’s El Segundo, California, office. Prior to joining the firm, she served as an insurance coverage associate at Bolender & Associates, litigation counsel at McPharlin Sprinkles & Thomas, and a deputy district attorney for the county of Los Angeles.

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[5] *Id.* at p. 3.
[7] *Id.* at p. 16-17
[12] *Id.* at 20.