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Management Alert

Enforceability of Handbook Arbitration Provisions Called Into Question

On July 30, 2012, in *Sparks v. Vista Del Mar Child & Family Services*, the California Court of Appeal affirmed the trial court's denial of the defendant employer's petition to compel arbitration. *Sparks* examines the enforceability of arbitration provisions in employee handbooks and provides a roadmap for employers wishing to improve the enforceability of their arbitration agreements.

Case Background

Perry Sparks sued his former employer, Defendant Vista Del Mar Child and Family Services, for wrongful termination. Vista Del Mar moved to compel arbitration on the grounds that Sparks agreed to arbitrate any claims arising out of the termination of his employment by virtue of his signed acknowledgment of receipt of the company's employee handbook.

Sparks had received a copy of the Vista Del Mar employee handbook upon his hire. The handbook contained an arbitration provision at pages 35 and 36 of the document, printed in the same typeface and size as all other provisions. The arbitration provision provided that all employment-related disputes would be subject to arbitration under the Federal Arbitration Act ("FAA") and the applicable rules of the American Arbitration Association. The handbook contained a clause immediately following the arbitration provision entitled "Amendments, Revisions and Modifications," which provided that the handbook "may be amended, revised and/or modified by [Vista Del Mar] at any time without notice." The handbook also contained a clause disavowing any intent to create an employment contract.

Sparks signed a document acknowledging his receipt of Vista Del Mar's employee handbook. The acknowledgment stated, "I understand that I am governed by the contents of the Handbook and that [Vista Del Mar] may change, rescind, or add to any policies, benefits or practices described in the Handbook from time to time in its sole and absolute discretion, with or without notice." Although he signed this acknowledgment, Sparks claimed he was not aware of the handbook's arbitration provision.

The trial court denied Vista Del Mar's petition to compel arbitration. The court held that Sparks's mere acknowledgment of receipt of the handbook did not create an enforceable arbitration agreement, notwithstanding the arbitration provision. Vista Del Mar appealed.

The Court of Appeal's Holding

The Court of Appeal affirmed the trial court's denial of Vista Del Mar's petition to compel arbitration, holding that (a) Sparks never agreed to submit to binding arbitration and, even if he had, (b) the arbitration provision was unenforceable.

The Court of Appeal set the stage for its analysis by holding that California law, not the FAA, would determine whether the handbook's arbitration provision was enforceable. The court distinguished the U.S. Supreme Court's 2011 decision in *AT&T Mobility v. Concepcion*, which held that the FAA preempted a California state law rule regarding arbitration. Concepcion did not abrogate the principle that the existence of an agreement to arbitrate must be determined under state law contract principles. Nor did *Concepcion* supersede state law on contract formation or on the use of unconscionability as a defense to the enforcement of contracts. Thus, notwithstanding the handbook's statement that the FAA controlled, the Court of

Appeal was free to determine the enforceability of the arbitration provision under California law.

Applying California contract law, the Court of Appeal then determined that there was never an agreement to arbitrate between Sparks and Vista Del Mar. Although Sparks signed the acknowledgment of receipt, it did not mention the arbitration provision. The acknowledgment merely stated that Sparks agreed to "read and understand" the handbook, not that he agreed to be bound by its provisions. Further evidence of a lack of any contractual agreement to arbitrate was the fact that the arbitration clause was buried in the handbook, as well as the handbook's express disavowal of any intent to create a contractual relationship.

The Court of Appeal deemed the arbitration provision unenforceable, in any event. Vista Del Mar's retention of the right to unilaterally modify the handbook rendered any agreement to arbitrate illusory, and thus, void. Further, the court found the arbitration provision unconscionable because Vista Del Mar failed to provide Sparks with a copy of the American Arbitration Association rules that would govern any arbitration, because the arbitration provision was buried in the handbook and was not subject to negotiation, and because there was no express provision for discovery rights during arbitration, which was problematic in light of AAA rules that gave the arbitrator the discretion to deny discovery.

What *Sparks* Means For Employers

Sparks exemplifies how California courts can be hostile to mandatory employment arbitration, even after the U.S. Supreme Court's ruling, in *Conception*, that the FAA strikes down state rules that discriminate against the enforcement of arbitration agreements. Employee handbooks often have provisions that make them inconvenient places to place an arbitration agreement. For example, they often assert the employer's right to unilaterally modify the document and they sometimes disavow the existence of contractual commitments. These provisions, if not carefully tailored to avoid application to an embedded arbitration agreement, can inadvertently foil the employer's chance to enforce a handbook arbitration agreement. Employers implementing arbitration agreements should consider these possibilities:

- presenting employees with a stand-alone arbitration agreement instead of relying on employee handbooks to establish binding arbitration agreements,
- ensuring that handbook acknowledgments explicitly point to the embedded agreement to arbitrate,
- and ensuring that "no contract" and unilateral-modification language does not apply to the arbitration agreement.

Sparks also highlights steps employers can take to decrease the likelihood that their arbitration agreements will be deemed unconscionable. Because California courts are apt to find some degree of procedural unconscionability in any employment-related arbitration agreement, employers might focus on crafting agreements that will withstand scrutiny under a substantive unconscionability analysis. Attaching a copy of the applicable arbitration rules to the agreement and including an express provision for discovery rights are simple measures that should guard against a finding of substantive unconscionability.

Finally, employers should take note that state law defenses to the enforceability of an arbitration agreement are not foreclosed to an employee even where the FAA expressly governs the agreement. *Sparks* is yet another post-*Concepcion* decision indicating that California courts may be inclined to sidestep the FAA in favor of applying considerably less arbitration-friendly state law.

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