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News & Types: Employment, Labor & Benefits Update

Drafting Mistakes Sink an Arbitration Agreement

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Practices: Employment, Labor & Benefits

Executive Summary

Clients are contacting our Firm to draft arbitration agreements for their employees. Some clients are finding sample agreements on the Internet. This is dangerous, because companies must use the correct language in the arbitration agreements to prevent a court from allowing the case to proceed in court rather than before an arbitrator.

Courts throughout the United States are closely examining arbitration agreements, especially when current and former employees are seeking to proceed with their cases in court. Recently, an appellate court in California examined an arbitration agreement and dismissed the company's request to force the employee to arbitrate the claim. Instead, the former employee will be allowed to prosecute a class action overtime case in court.

Richard Smigelski was an account executive for PennyMac, which originates and services mortgages. On his first day of employment, he signed an Employee Agreement to Arbitrate ("Agreement") and a Mutual Arbitration Policy ("MAP"). In both, Smigelski agreed to arbitrate any and all claims and disputes relating to his employment and the termination of his employment. Both the Agreement and MAP stated that he would forego a jury trial and the right to bring claims on a representative or class basis. Knowing that every word is important, PennyMac included a severability provision. The Agreement stated that if a court finds any provisions in the MAP unenforceable, that provision would be severed; the rest of the MAP would be enforceable. The Agreement did not address the severing of provisions in the Agreement. Apparently, PennyMac believed that both the Agreement and MAP would be read and enforced together as one "agreement."

Despite signing both documents, Smigelski brought a claim under California's Private Attorneys' General Act (PAGA), alleging that PennyMac miscalculated overtime. Under PAGA, employees act as private attorneys' generals who bring claims on behalf of the state against employers for violation of employment laws. Under PAGA, employees may bring claims personally or as a representative action on behalf of other employees. As the court explained, PAGA is a procedural statute allowing employees to recover civil penalties that otherwise would be sought by state agencies.

The court found that employees may waive individual and class action claims and take these to arbitration and not into court. However, because the court found that PAGA claims are claims by the state acting through an employee as an agent of the state, the court ordered that employees may not waive representative (i.e.,

PAGA) claims. Finally, the court ruled that it would not sever the PAGA waiver from the MAP or the Agreement. Therefore, the court found the entire MAP and Agreement unenforceable. As the court stated, “that PennyMac must now litigate non-PAGA causes of action is the result, not of the trial court’s error, but its own drafting decisions.”

As a result of this decision, every company should review its arbitration agreements and carefully draft them to comply with state law. In California, if the agreement includes a waiver of representative and class actions, rights of employees in California under PAGA apply. Companies also need to include severability clauses, but ambiguity hurts the drafter. Clear and unmistakable language is the key to enforceability of the contract.