Employer Update

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November 2019

# California Delivers Another Blow To Pre-Dispute Employment Arbitration

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**In This Issue**



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The #MeToo movement has brought renewed attention to mandatory arbitration of employment disputes, and the question of whether such programs lead to the reduction of employee complaints. Notwithstanding the prevalence of arbitration programs, companies that continue to adopt mandatory arbitration are increasingly facing public backlash. Over the past few years, state lawmakers have also sought to pass legislation to restrict such arbitration programs, but have faced the challenge of passing laws that would survive federal preemption.

The California state legislature has been exploring its ability to prohibit mandatory arbitration for some time, but has had to address the challenge of passing a law that the Federal Arbitration Act ("FAA") does not preempt. For example, in September 2018, former California Governor Edmund G. Brown, Jr. vetoed Assembly Bill 3080 ("A.B. 3080"), a prior bill that sought to ban mandatory arbitration agreements and criminalize employer conduct to implement such an agreement. The employer community reacted vociferously against this bill, arguing that the U.S. and California Supreme Courts have clearly rejected such a position and that federal law would preempt such a state law. Thus, former Governor Brown said in his veto message: "Since this bill [A.B. 3080] plainly violates federal law, I cannot sign this measure." Former Governor Brown also rejected the legislature's argument that A.B. 3080 sought only to regulate behavior prior to reaching an agreement, acknowledging that the FAA regulates not only enforcement of such agreements, but also their initial formation. Thus, Governor Brown vetoed the bill.[1]

In vetoing A.B. 3080, former Governor Brown specifically highlighted the issue of whether states may seek to rebalance the bargaining power when parties first enter an arbitration agreement. More specifically, while the FAA and federal precedent prohibit states from targeting the *enforcement* of arbitration agreements,[2] proponents of the prior California legislation sought to argue that precedent did not clearly address whether the FAA regulates the *formation* of arbitration agreements in the first place. However, in *Southland Corp. v. Keating*, the U.S. Supreme Court stated unequivocally that the FAA "declared a national policy favoring arbitration,"[3] untethered to the enforcement or formation stage of arbitration agreements.

## Provisions of A.B. 51

In a renewed effort to restrict mandatory arbitration agreements, in mid-October, California Governor Gavin Newsome signed Assembly Bill 51

("A.B. 51"), which goes into effect on January 1, 2020. The bill adds a new section to the California Labor Code, Section 432.6, and imposes restrictions on "contracts for employment" entered into, modified, or extended on or after January 1, 2020. A.B. 51 prohibits employers from conditioning new or continued employment or the receipt of any employment-related benefit on an applicant's or employee's consent to waive any right, forum, or procedure to resolve any discrimination, wage and hour, and other claims under the Fair Employment and Housing Act ("FEHA") or the California Labor Code. The law also imposes liability on employers who "threaten, retaliate or discriminate against, or terminate any applicant for employment or any employee" who refuses to consent to such a provision.

A.B. 51 further provides that requiring an employee voluntarily to opt out of an agreement to avoid being bound, or to take affirmative action to preserve his or her rights is "a condition of employment." Notably, A.B. 51 also includes a so-called "savings" provision that was not in the vetoed A.B. 3080: "Nothing in this [Section 432.6] is intended to invalidate a written arbitration agreement that is otherwise enforceable under the Federal Arbitration Act."

Under A.B. 51, an employee whose employer has threatened, retaliated or discriminated against him or her, or terminated him or her for refusing to consent to a mandatory arbitration program, may file a complaint with the California Department of Fair Employment and Housing ("DFEH"), which may ultimately lead to the issuance of a "right to sue notice," permitting the complainant to bring a civil action against the employer.[4] An employee or applicant whose employer or prospective employer has threatened, retaliated or discriminated against him or her, or terminated him or her in violation of A.B. 51, may also be entitled to recover back pay, front pay, injunctive relief (i.e., hiring/reinstatement, promotion, training), damages for emotional distress, punitive damages, and attorney's fees.[5]

A.B. 51 also sets forth specific instances in which it does not apply: (i) it does not apply to post-dispute settlement agreements or negotiated severance agreements; and (ii) it does not apply to a person registered with a self-regulatory organization under the Securities Exchange Act of 1934, or regulations adopted under that act pertaining to the arbitration of disputes.

## Does Federal Law Preempt A.B. 51?

A.B. 51 will almost certainly face a preemption challenge. Indeed, states, including California, that have previously targeted mandatory arbitration programs have seen those efforts struck down as preempted by federal law and policy, or otherwise limited in application. For example, in *AT&T Mobility LLC v. Concepcion*, the U.S. Supreme Court addressed California's judicially created *Discover Bank* rule, which provided that waiver of the right to bring collective or class action proceedings in arbitration was unconscionable under general contract principles, such that it would render arbitration agreements unenforceable.[6] The Court made clear that state laws disfavoring enforcement of arbitration agreements are preempted by the FAA, and thus, the *Discover Bank* rule was preempted.[7] The Court further explained that the FAA preempts laws which "undermine the goals and policies of [the FAA]" and that the "overarching purpose of [the FAA] . . . is to ensure the enforcement of arbitration agreements according to their terms."[8]

More recently, in *Latif v. Morgan Stanley & Co. LLC*, Judge Denise Cote of the U.S. District Court for the Southern District of New York addressed a New York state statute seeking to prohibit mandatory arbitration of sexual harassment claims, N.Y. C.P.L.R. § 7515 ("Section 7515").[9] Section 7515 rendered agreements to arbitrate sexual harassment claims "null and void '[e]xcept where inconsistent with federal law.'"[10] Judge Cote noted that in this case it would be "inconsistent with the FAA" to render null and void, and invalidate the parties' agreement to arbitrate the plaintiff's sexual harassment claims because any "state law prohibit[ing] outright the arbitration of a particular claim" is displaced by the FAA's strong presumption that "arbitration agreements are enforceable."[11] The Court further rejected the plaintiff's arguments that Section 7515 merely reflects a general intent to protect victims of sexual harassment, as opposed to a specific intent to single out arbitration agreements, and that Section 7515 only disfavored arbitration of sexual harassment claims, not all claims. Finding that Section 7515 could not prevail over "the FAA's command that the parties' Arbitration Agreement be enforced," Judge Cote granted the defendant's motion to compel arbitration.

In *Saheli v. White Memorial Medical Center*, a California Court of Appeals held that provisions of two California statutes were preempted by the FAA, to the extent the provisions conditioned enforceability of arbitration agreements on special requirements not applicable to contracts generally.[12] The two statutes provided that a covenant to arbitrate certain claims would not be enforceable where it was offered as a "condition" of entering into certain contracts.[13] Ultimately, the court held that the statutes at issue placed special restrictions, not applicable to contracts generally, on the enforceability of agreements to arbitrate.[14] More specifically, the court held "[i]n practice, such restrictions discourage arbitration by invalidating otherwise valid arbitration agreements. It is precisely this sort of hostility to arbitration that the FAA prohibits."[15]

These are but a few examples of states' attempts to restrict parties with greater bargaining power from presenting on a take-it-or-leave-it basis contracts containing mandatory covenants to arbitrate claims arising out of the employment relationship. Proponents of A.B. 51 have nevertheless argued that the bill targets mandatory arbitration provisions at the *formation* stage and does not impact the *enforceability* of such provisions. In other words, supporters have argued that while courts have been hostile towards statutes that outright invalidate arbitration agreements, A.B. 51 permits the enforceability of arbitration agreements that would otherwise be enforceable under the FAA.[16] Indeed, according to the author of A.B. 51, "once a mandatory arbitration agreement has been signed, this bill has nothing more to say about the situation."[17]

Certainly the courts will be called upon to resolve the preemption issue, but the opponents to A.B. 51 will have serious grounds supporting FAA preemption, including the strong federal policy favoring arbitration, recent U.S. Supreme Court precedent interpreting the FAA, and lower federal and state court precedent discussed above. Supporters of A.B. 51 also have argued that A.B. 51 should not be preempted by the FAA because it impacts only "mandatory" arbitration agreements, as opposed to "voluntary" agreements. But again, the bill prohibits "opt-out" or other affirmative actions by employees to preserve their judicial rights and provides a basis for opponents to argue that this law also would impact "voluntary" agreements.

## Takeaways for Employers

While the validity of A.B. 51 stands on shaky ground, employers should still review their existing arbitration programs and agreements, and evaluate any pending programs to be implemented, particularly after January 1, 2020. Employers should specifically be mindful of the following:

- First, by its own terms, A.B. 51 applies only to contracts for employment "entered into, modified, or extended on or after January 1, 2020." However, A.B. 51 does not explain what it means for an agreement to be "extended on or after January 1, 2020." As such, employers should bear in mind that individuals may seek to argue that even mandatory arbitration agreements that were entered into before January 1, 2020, but that were automatically renewed or extended after January 1, 2020, are impacted by A.B. 51.
- Second, employers should review the content of their arbitration agreements and the method by which these agreements are presented to applicants and employees (whether these agreements be standalone documents, part of the employee handbook, or some other employment policy or document). If courts ultimately hold that A.B. 51 is enforceable, even to a limited extent, employers should review how they obtain applicants' and employees' consent to arbitrate FEHA or Labor Code claims, and whether employees or applicants are expected to take any

steps to opt out of arbitration or to preserve their rights to a judicial forum.

- Third, employers should evaluate the advantages and disadvantages of employing different dispute resolution mechanisms for different claims. A.B. 51 applies to California Labor Code and FEHA claims, but not to many other employment claims, such as breach of contract, tort, or federal discrimination or wage and hour claims.
- Fourth, employers must remain cognizant of other factors that bear on the enforceability of arbitration provisions, such as whether an agreement to arbitrate is bilateral, the extent of the arbitration fees imposed upon the employee, and the availability of procedural rights and substantive remedies, as compared to those available in a court of law.[18]
- Finally, because A.B. 51, if enforced, has essentially created a new class of individuals protected by FEHA's antidiscrimination laws, employers must be aware of whether their conduct can be perceived as hostile to individuals who oppose mandatory arbitration.

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[1] In 2015, also citing preemption concerns and a desire to avoid legal uncertainty and costly litigation, former Governor Brown also vetoed A.B. 465, which prohibited employers from threatening, retaliating against, or discriminating against any employee or potential hire who refused to sign an arbitration clause offered as a condition of employment. A.B. 465 would have deemed unenforceable arbitration agreements that were presented as a condition of employment.

[2] *See e.g.*, *AT&T Mobility LLC v. Concepcion*, 563 U.S. 333, 334 & 344 (2011) (the "overarching purpose of [the FAA] . . . is to ensure the enforcement of arbitration agreements according to their terms.")

[3] *Southland Corp. v. Keating*, 465 U.S. 1, 2, 10 (1984).

[4] CAL. GOV'T CODE § 12960.

[5] *See* California Department of Fair Employment and Housing: Employees and Job Applicants Are Protected From Bias, accessed Nov. 3, 2019, https://www.dfeh.ca.gov/employment/; *see also* CAL. GOVT. CODE §§ 12920.5 & 12965(b).

[6] *Concepcion*, 563 U.S. at 339-40.

[7] *Id*. at 341-42, 352.

[8] *Id.* at 334, 344.

[9] *Latif v. Morgan Stanley & Co. LLC*, 2019 WL 2610985, at *2-3 (S.D.N.Y. June 26, 2019).

[10] *Id*. at *3.

[11] *Id*. (quotations omitted).

[12] *Saheli v. White Memorial Medical Center*, 21 Cal.App.5th 308, 320 (Cal. Ct. App. 2018).

[13] *Id*. at 322.

[14] *Id*. at 323.

[15] *Id*. at 326.

[16] *S. Rules Comm. Office of Senate Floor Analyses, Emp't Discrimination: Enforcement*, Cal. A.B. 51, 2019-2020 Reg. Sess. (2019).

[17] *Id*.

[18] Jeffrey S. Klein, Nicholas J. Pappas, and Celine J. Chan, *Enforceability of Cost-Sharing Provisions in Arbitration Agreements*, Weil Employer Update, July 2018, https://www.weil.com/~/media/publications/employer-update/2018/employer-update_august-2018_082318.pdf.

# Secret Recordings – Can They Amount to Gross Misconduct?

*By Simon Gorham*

With the technology available on mobile phones, it is now relatively easy for employees to record workplace meetings secretly. When an employee secretly records a meeting with their employer, the general rule in the UK is that the recording of any parts of the meeting during which the employee was present may be admissible as evidence in litigation if the employment tribunal believes it is relevant to the issues in the case. However, whilst recording a meeting without telling the employer will generally amount to misconduct in the UK, it is less clear whether or not it will amount to gross misconduct entitling the employer to dismiss the employee summarily for cause. In the case of *Phoenix House Ltd v Stockman UKEAT/0284/17 (No. 2)* the Employment Appeal Tribunal ("EAT") provided some helpful guidance on secret recordings made by employees and the factors which an employer should consider when determining whether or not such conduct amounts to gross misconduct.

## The Facts

The employee in this case, Ms. Stockman, was employed by Phoenix House Limited ("Phoenix House") as a Financial Accountant. Her post was removed following a restructure, and she obtained an alternative, albeit more junior, role. She complained to her line manager, the Head of Finance, that the Finance Director had been treating her differently and that the restructure was biased against her. She was supported by a colleague and a meeting was held between her colleague, the Head of Finance and the Finance Director, but not Ms. Stockman, to discuss matters. Upon finding out about the meeting, Ms. Stockman interrupted it, demanded to know what was said and refused to leave. The same day she was invited to attend a meeting with the Head of HR at which she was told that she would be disciplined for her conduct. She secretly recorded the meeting. She submitted a grievance which was dismissed and the disciplinary offence was upheld.

Attempts to mediate the dispute were unsuccessful and, although Ms. Stockman claimed that she wanted to put the grievance behind her, her employer's position was that Ms. Stockman maintained a distrust of senior management and, therefore, the relationship had irretrievably broken down. Ms. Stockman was subsequently dismissed and she brought successful claims in the employment tribunal for unfair dismissal, whistleblowing detriment and victimization. However, the damages awarded to Ms. Stockman were reduced by 30%, including a 10% reduction for secretly recording the meeting with the Head of HR, on the basis that the recording was made without the employer's consent.

Phoenix House appealed against the decision to the EAT. Its position was that it was unaware of the secret recording at the time it took the decision to dismiss Ms. Stockman, but had it known that Ms. Stockman had secretly recorded the meeting, it would have dismissed her summarily for cause. Against that background, Phoenix House argued that she should not receive any compensation.

## The EAT's View

The EAT dismissed the appeal and upheld the employment tribunal's view. In the EAT's view, secret recordings might take place for a variety of reasons e.g. to keep a record, to protect the employee from a risk of misrepresentation, or to enable the employee to take subsequent legal advice, and therefore it does not necessarily follow that they undermine the relationship of mutual trust and confidence. In the EAT's view, it is not the fact that a recording is made but other factors that should be considered. Therefore, whether or not secretly recording a meeting undermines trust and confidence between employer and employee will depend on a variety of factors:

- The content of the recording: A meeting in which highly confidential business information is recorded is more likely to amount to gross misconduct as opposed to a meeting concerning an employee of which a record would normally be kept and shared in any event.

- The purpose of the recording: Was the employee seeking to entrap the employer or, alternatively, was the employee seeking to e.g. keep a record or guard themselves against misrepresentations?
- The blameworthiness of the employee: Was the employee told not to recording the meeting but did so irrespective of the instruction not to do so? Had the employee not considered the implications of making such a recording because they are inexperienced and/or distressed?
- The employer's attitude to such conduct: Is secretly recording meetings identified in the employer's disciplinary policy as an example of gross misconduct?

The EAT was persuaded that Ms. Stockman had not recorded the meeting with the intention of entrapment and that secretly recording meetings was not identified in the employer's disciplinary policy as an example of gross misconduct.

As the EAT commented, it remains good practice for parties to communicate an intention to record a meeting and not to do so would generally constitute misconduct. However, in the UK, it is relatively uncommon for such conduct to be identified as an example of gross misconduct in an employer's disciplinary policy which would entitle the employer to dismiss the employee summarily for cause.

## Practical Tips

We set out below some practical tips and lessons for employers of UK-based employees, following this case:

- Managers conducting disciplinary or grievance meetings should consider informing the employee at the start of any meeting that no recordings are allowed and to ask employees and anyone who is accompanying them to turn off mobile phones.
- Mangers should leave the meeting room to conduct their deliberations to avoid these being recorded secretly.
- Employer's should review their disciplinary policy and consider including covert recordings as an example of gross misconduct.

Individuals involved in conducting disciplinary and/or grievance meetings should always remember that covert recordings (regardless of the circumstances in which they have been obtained) may be admissible as evidence in litigation if they are relevant to the case. Therefore, they should avoid making any unguarded comments and behave reasonably at all times.

# Personal Liability of Directors for Breaches of an Employment Contract

*By Simon Gorham*

In the UK, the general principle is that directors of a company will not be liable for the tort of inducing a breach of contract by a company, if the director is acting bona fide (i.e. in the best interests of the company) within the scope of their authority. This principle has been consistently applied by the UK courts, albeit without detailed analysis of what it means to act bona fide within the scope of the director's authority. A landmark ruling in the UK High Court in the case of *Antuzis v DJ Houghton [2019] EWHC 843* has confirmed that directors of a limited company may be held personally liable for the tort of inducing a breach of contract, where they were deliberately involved in causing the company to commit contractual and statutory breaches.

## The Facts

The claimants in this case worked as chicken catchers for DJ Houghton Catching Services Ltd ("DJ Houghton"). Whilst DJ Houghton issued payslips recording their pay, they contained significant and material irregularities:

- Wages were withheld for alleged transgressions and fees for finding work and/or for accommodation were routinely deducted from employees' pay;
- The employees were not paid the national minimum wage, nor were they paid holiday pay they were entitled to;
- Deductions for rent were made for premises which the employees were required to reside at. The rent charged was in excess of the maximum amount permitted under UK law; and
- DJ Houghton required a license to employ the individuals on the farms but it did not have such a license.

The employees brought claims for damages and unpaid wages and, because DJ Houghton was experiencing financial difficulties, claims were also brought against its director and company secretary.

## The Court's Decision

The central issue in the case was whether or not DJ Houghton's sole director, and company secretary, could be personally liable for inducing the company to breach the claimants' employment contracts. For a director to be personally liable for the tort of inducing a breach of contract, a claimant must show that the director:

- was not acting bona fide; or
- was acting outside the scope their authority; and
- knowingly induced the breach of contract.

In reaching its decision, the court assessed what it means to act bona fide within the scope of the director's authority and concluded that it is the director's conduct and intention in relation to his duties towards the company (rather than towards any third party, i.e. the company's employees) that is the key area of enquiry. Additionally, the nature of the breach of contract between the company and the third party may inform whether or not the director has breached their statutory duties owed to the company under the Companies Act 2006. The court found that, whilst the director and company secretary had been acting within the scope of their authority, they had been running the company in a deliberate manner that amounted to systematic abuse of the company's employees. The court found that neither the director nor the company secretary believed that they were paying the national minimum wage or that they were entitled to withhold payments from the employees' wages or that the employees were not entitled to holiday pay. Their conduct and actions had serious adverse consequences for the reputation of the company and was not in the interests of the company's employees.

In directing the company not to pay the national minimum wage, holiday pay and withholding payments from wages, the director and the company secretary were in breach of the statutory duties under the Companies Act 2006 to promote the success of the company and to use reasonable care, skill and diligence. Additionally, the court's view was that the director and the company secretary knew that their actions had caused the company to breach its contractual obligations to the claimants and, therefore, they were not acting bona fide. Therefore, they were held personally liable for the breaches of contract that they had induced.

## What to Take Away?

What is clear is that directors must exercise caution when leading their company to induce a breach of contract. A director who directs a company to not fulfil its contractual commitments risks breaching their duties and creating potential liabilities for the company. Whilst there may be circumstances in which directors can say that they acted honestly, in good faith and in the company's wider interests (e.g. by not paying a supplier on time because the company unusually has cash flow difficulties), a director who intentionally acts in breach of statutory and contractual obligations which is detrimental to their company may be personally liable. The court gave an example of a director of a restaurant who decides the company should supply horse meat instead of beef because it is cheaper. In such a scenario, the discovery is likely to cause severe reputational damage to the company and would breach UK food and trading standards rules, actions and conduct for which the director is likely to be held personally liable.

Going forwards, while *Antuzis v DJ Houghton [2019] EWHC 843* could be relied on to extend personal liability to directors for the tort of inducing a breach of contract based on other aspects of the employment contract which have a statutory element, on a practical level, it is hard to envisage many cases where the facts would support such a finding.

***Employer Update*** is published by the Employment Litigation and the Executive Compensation & Benefits practice groups of Weil, Gotshal & Manges LLP, 767 Fifth Avenue, New York, NY 10153, +1 212 310 8000, www.weil.com.

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