

Improving Fairness of Litigation Climate Can Help California Businesses Compete

When employers consider where to locate and expand their businesses, they take many factors into consideration, including the business tax climate, quality of the local education system, labor costs, environmental and regulatory burdens, availability/affordability of resources like land and electricity, and the legal climate. Unfortunately, California continues to rank poorly on many of these measures, particularly its legal climate.

According to the U.S. Chamber's Institute for Legal Reform (ILR), California ranked 46th for the fairness of its litigation environment in 2010 and has consistently placed amongst the bottom six states over the last decade. California also remains on the American Tort Reform Association's "Judicial Hellholes Watch List" for 2011 because of continued class action abuse, predatory lawsuits against small businesses premised on technical violations of the state's Americans with Disabilities Act (ADA) laws, new rules encouraging private law firms to pursue speculative claims at the taxpayer's expense, and two court decisions allowing awards for so-called "phantom damages," losses never actually incurred by the plaintiff.

All Bear the Costs of Litigation

Many people argue that the vast web of laws in place today regulating the legal environment are necessary to protect Californians and ensure big corporations do not shirk responsibility for the harm they cause. This argument, however, is based on an over-simplified view of the employer community and how the legal system works.

In addition, over the years, this rationale has been used to justify the creation of anti-business rules of civil procedure, limit judicial discretion over attorneys fees, restrict use of arbitration and other expedited means of dispute resolution, shift more of the ever-growing costs of litigation to employers, and provide more private rights of action, all at a great, but hidden cost, to individual Californians.

In a recent study, the ILR estimated that the U.S. tort system cost the economy \$261 billion, an average of \$880 for every person in the country during 2006, the most recent year for which the ILR had data. The American Tort Reform Association also found that growth of the legal system has exceeded annual growth of the national gross domestic product (GDP) by two to three percentage points over the last 50 years, and yet remains incredibly inefficient, returning only about 22 cents for every dollar of actual loss experienced by claimants.

Small businesses bear a particularly large share of this burden. According to the ILR, they spent almost 40% of that \$261 billion in 2006, and in 2008, their costs increased to \$105.4 billion. An estimated 65% of new jobs have come from small businesses in the last 15 years, making these employers the best hope for economic recovery, but they need a more supportive legal climate if we hope to rely on that growth in the future.

In addition, despite what many believe, increasing litigation costs ultimately must be passed down to individuals if California employers are to remain competitive. According to a 2007 Harris poll of business owners and managers, employers frequently make business decisions to avoid and offset their increasing litigation costs, including making some products and services unavailable to customers, charging more to consumers for what they do offer, and by laying off employees, here in California.

But there is good news—in a time of continuing budget deficits and flagging economic growth, legal reform is an inexpensive way for state policy makers to help increase California's competitiveness to lure new businesses to the state, and also free up resources within existing businesses so they can expand and hire new workers. In turn, the state would reap the benefits of such reform through increased income tax revenues and better benefits for existing employees.

Legislative Activity in California

Each year a handful of legislators introduce tort reform bills to help bring more balance to the justice system and protect jobs. In all, six such bills were introduced during 2011 covering a host of topics, including construction defects, products liability, and punitive damage awards. While these proposals together would have done a great deal to help improve the legal environment for employers, none of them made it out of their first policy committee.

At the same time, legislators continue to introduce measures to expand employer liability, make it easier for plaintiffs' attorneys to file questionable claims, and undermine procedural protections for litigants. In 2011, three such bills made the California Chamber of Commerce "job killer" list because they proposed broad, unnecessary changes to the legal system, threatening to worsen the legal climate and further discourage employers from doing business in California.

Expanding Employer Liability

SB 111 (Yee; D-San Francisco), a reintroduction of a "job killer" that was vetoed in 2010, proposed to create a new civil rights violation for businesses or organizations that imposed a language restriction on customers or patrons. The bill originally was drafted in response to a policy by the Ladies Professional Golf Association (LPGA) to suspend players who do not speak English. After objections from Senator Leland Yee and letters from more than 50 civil rights organizations, the LPGA rescinded the proposal, but the senator moved ahead with his legislation.

Part of the CalChamber's early concern with the bill was the lack of clarity about what behavior it sought to prohibit, other than the specific scenario that had given rise to it. In addition, because it included a provision for automatic statutory damages, many employers were concerned that they would be subject to frivolous lawsuits, like those commonly filed under California's ADA laws, simply because they could not be sure what SB 111 required them to do, or prohibited them from doing.

While the measure remained a concern, the CalChamber was able to secure amendments to help provide enough clarity for employers, and subsequently removed its opposition. However, Governor Edmund G. Brown Jr. ultimately vetoed the measure, saying it was duplicative of existing protections in the law and likely to harm small businesses despite their good faith attempts to comply with its terms.

CalChamber Position

The CalChamber opposes unnecessary expansions of employer liability that do little to increase protections for individuals, but which increase litigation costs for employers, making them less competitive, and leaving them with fewer resources to expand and grow within the state.

Legislating by Anecdote: A Recipe for Trouble

SB 111, drafted in response to a single incident, reflects a common practice in California of crafting broad legislation in response to an anecdotal story or court decision that receives media attention. This type of proposal usually develops in response to unique circumstances that will rarely, if ever, arise again in the state, with or without intervention by the Legislature.

Another bill that developed in this way and which highlights the problem with this approach was AB 559 (Swanson; D-Alameda), also a rerun of a bill vetoed in 2010. In seeking to overrule the recent California Supreme Court decision in *Chavez v. City of Los Angeles*, AB 559 would have undermined judicial discretion and made it easier for plaintiffs lawyers to get exorbitant attorney fees in employment cases.

A look at the specific facts of the case shows the importance of allowing judicial discretion over awards of attorney fees. In *Chavez*, a jury awarded the plaintiff \$11,500, less than half of the damages limit required for the type of civil case he filed, after he prevailed on only one claim out of more than 11 he pursued in two separate lawsuits. Despite this, the plaintiff sought \$870,935.50 in attorney fees, approximately \$470 an hour, for his attorney's work pursuing all claims in both lawsuits. In addition, even though the attorney billed for 1,851.43 hours of work, she presented no evidence regarding the amount of economic loss suffered by the plaintiff in relation to the successful claim, and the evidence offered to prove his emotional distress was "equally sparse," according to the court.

It was based on these facts that the California Supreme Court appropriately held that the trial court did not abuse its discretion in disallowing the attorney fees, saving the taxpayers of the City of Los Angeles almost \$900,000 in indefensible attorney fees and costs.

Despite the unusual circumstances of the case involved, and the complete lack of evidence that the law at issue had ever been used to deny attorney fees in another case, proponents of AB 559 argued that the *Chavez* decision would limit access to the courts for victims of employment discrimination by discouraging lawyers from taking their claims on a contingency fee basis. In other words, the author proposed to make a drastic change affecting an entire body of law, without any justification besides a single case with unusual and extreme facts.

Despite the lack of need for the solution it offered, the bill passed easily through the Legislature a second time only to be vetoed again, this time by Governor Brown, who stated, "I think the Supreme Court got it right. Judges are in the best position to decide whether to award or deny fees in these instances."

Several other bills that sought to pass attorney fees

and costs on to employers met a similar fate during recent legislative sessions. Despite this recent veto, it is likely that proposals like these will remain popular in 2012. They will continue to pose a significant threat to employers seeking to predict and control future litigation costs, and will only worsen California's competitiveness should they become law.

CalChamber Position

The CalChamber opposes making sweeping changes to the legal system without evidence of a widespread problem, and will continue to work with the Legislature to prevent passage of unnecessary laws that worsen the legal climate for employers and make the state less competitive.

The CalChamber opposes attempts to pass attorney fees and costs onto employers, the establishment of disproportionate attorney fees, and limits on judicial discretion over awards of attorney fees.

Undermining Arbitration Agreements

Another category of bills commonly introduced each year seeks to limit the enforceability of arbitration agreements in contracts. In 2011, for example, AB 1062 (Dickinson; D-Sacramento) proposed to eliminate one procedural mechanism for enforcing arbitration agreements, the right to an automatic appeal when a judge denies a defendant's motion to compel arbitration.

The primary argument in favor of AB 1062 offered by proponents was that these appeals are often frivolous and used by defendants to delay resolution of disputes at the expense of plaintiffs and the courts. Ironically, since trials take significantly longer than arbitration proceedings, AB 1062 would have lengthened the time it took for many disputes to be resolved. In addition, the bill would have pushed more cases into the courts, further adding to their backlog of cases and increasing delays.

Unlike AB 1062, which could have affected enforcement of an arbitration agreement in any type of contract, most anti-arbitration bills that are introduced in California tend to focus on mandatory arbitration agreements in employment contracts. The employer typically sets the terms of these agreements, and is in a position to require employees to agree to those terms as a condition of employment.

By itself, the fact that one party has been forced to accept a contract term is not necessarily a problem. The real concern motivating this type of legislation is that arbitration is somehow inherently unfair to employees, at least when the stronger party sets the conditions under which it will be conducted. While an arbitration proceeding is much less formal than a civil trial, both California and federal law offer protections to parties that use arbitration.

Laws Governing Arbitration Agreements

Both the Federal Arbitration Act (FAA) and the California Arbitration Act (CAA) provide that arbitration

agreements are, "valid, enforceable, and irrevocable, save upon such grounds as exist at law or in equity for the revocation of any contract." Both statutes evidence a strong preference for enforcement of arbitration agreements, so long as the underlying contract is fair, and the FAA generally prohibits state laws that restrict enforcement of arbitration agreements.

One significant protection for plaintiffs is the rule that a party may not be forced to forfeit rights granted to him/her by a statute enacted for the benefit of the public at large. For example, an arbitration agreement that prohibits an employee from recovering under California's Fair Employment and Housing Act (FEHA), which prohibits employment discrimination on the basis of race, religion, color, national origin, ancestry, physical handicap, medical condition, marital status, sex or age, would be invalid as a violation of public policy because this employment discrimination law was intended to benefit the public, not just an individual seeking to enforce it.

This means that, while an employee can be required by contract to arbitrate a FEHA claim, he/she must be allowed access to all of the remedies provided for under that law.

The courts have also set forth five minimum requirements that an arbitration agreement must meet if it is agreed to as a mandatory condition of employment and requires arbitration of statutory rights. Such an agreement must:

- Provide for a neutral arbitrator;
- Provide for adequate discovery;
- Require a written award to allow for limited judicial review;
- Allow for all types of relief that otherwise would be available in court; and
- Does not require employees to pay unreasonable costs or any of the arbitrator's fees.

Assuming an arbitration agreement meets these requirements, the primary basis on which courts may strike down an arbitration agreement is by applying the doctrine of unconscionability. In the context of employment contracts, there are two things a court must find to strike down an arbitration agreement as unconscionable. The first is substantive unconscionability, which means the terms would not fall within the reasonable expectations of the weaker party (the employee), and thus create overly harsh, one-sided results. The second is procedural unconscionability, which means the terms of the agreement are unduly oppressive or surprising as a result of being imposed on a weaker party.

Examples of terms that would most likely lead to a finding of unconscionability include:

- Requiring an employee to arbitrate his or her claims without imposing the same restriction on the employer.
- Limiting access to commonly imposed contractual damages like "front pay."

Benefits of Arbitration

Many businesses favor arbitration because it is faster and usually less costly than litigation. According to the American Arbitration Association (AAA), federal civil trials take an average of two years to resolve, while arbitration proceedings require less than 10 months, on average, under the AAA's commercial rules. Significantly, according to a 2002–03 article by legal researcher Elizabeth Hill, most employment claims are contractual in nature, not statutory, meaning most would fall within the timelines described by the AAA.

Opponents of arbitration claim that the process is biased against plaintiffs, but the evidence does not support this claim. A 2003 article by Hill from the *Dispute Resolution Journal* examined data from the AAA on 200 awards in employment arbitration cases to evaluate whether these criticisms of arbitration are fair. She concluded that employment arbitration is affordable and substantially fair to employees at the lower end of the income scale.

Specifically, she found that the win rate for employees was 49%, showing no evidence of bias. Her examination of the size of the awards showed employees recovered, on average, nearly three times the average award given to an employer, and lower-income employees actually recovered a larger percentage of their demand than higher-income employees through arbitration. In addition, 32% of lower-income employees incurred no costs from arbitrating, a number that has likely increased since then due to recent case law requiring businesses to cover any costs that would not be incurred by a plaintiff if they had access to the courts.

Finally, for many lower-income workers, arbitration may be the only available option. According to a 1995 survey of 321 plaintiffs attorneys by William Howard, lawyers required an average of \$60,000–\$65,000 in provable damages and a 35% contingency fee before they would take an employment discrimination claim. Other studies have similarly found that higher-income workers

are more likely to bring their general employment claims to trial, and one reason may be that “provable damages” in employment-related cases correlates to the size of the salaries involved, incentivizing lawyers to take on wealthier clients. Limiting access to arbitration may actually hurt the very people state legislators are most trying to protect.

CalChamber Position

The CalChamber supports the freedom of businesses to utilize arbitration as a means of resolving disputes, and to include arbitration agreements within consumer and employment contracts. The CalChamber also is supportive of legislation that requires arbitration to be fair and provide procedural protections for all parties involved.



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