

7-1-2012

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### Recommended Citation

Skipper Dean, *Tenth Circuit Affirms the District Court's Original Decision to Compel Arbitration in an Appeal Made by the Appellant After Losing in Arbitration*, 4 259 (2012).

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# TENTH CIRCUIT AFFIRMS THE DISTRICT COURT'S ORIGINAL DECISION TO COMPEL ARBITRATION IN AN APPEAL MADE BY THE APPELLANT AFTER LOSING IN ARBITRATION

Skipper Dean\*

## I. INTRODUCTION

In *Kepas v. eBay*,<sup>1</sup> the Tenth Circuit considered an appeal from the Plaintiff-Appellant arguing the district court erred in its decision to compel arbitration over disputes arising out of the employment arbitration agreement.<sup>2</sup> Before compelling arbitration, the district court modified the arbitration agreement, eliminating the clause which would allow an arbitrator to impose the costs of arbitration on the employee and also included Salt Lake County as an alternative location in the forum-selection clause.<sup>3</sup> It was only after the Appellant pursued his claim through arbitration and lost, and after the district court confirmed the arbitrator's decision, that the Appellant appealed the original motion to compel arbitration with the appellate court.<sup>4</sup> Applying California law as required by the contract's choice of law provision, the court used the standard dictated in *Armendariz v. Fountain Health Psychare Services, Inc.*,<sup>5</sup> to determine whether the district court had erred in determining the arbitration agreement was enforceable after making two modifications.<sup>6</sup>

## II. BACKGROUND

In July of 2003, eBay hired Emmanuel Kepas to manage its Draper, Utah facility, but was first subject to a probationary period.<sup>7</sup> At the end of the probation period, eBay offered Appellant continued employment on the condition Kepas sign an arbitration agreement recognizing this condition.<sup>8</sup> The agreement stated that the parties agreed to arbitrate any dispute arising from the employment relationship—specifically listing each claim that would later be alleged by Kepas.<sup>9</sup> But the agreement excluded claims made by either party that arose out of the “Employee Proprietary Information and Inventions Agreement.”<sup>10</sup> The agreement included a forum selection clause, which designated Santa Clara County, California as the designated forum.<sup>11</sup> Additionally,

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<sup>1</sup> *Kepas v. eBay*, 412 F. App'x 40 (10th Cir. 2010).

<sup>2</sup> *Id.* at 41.

<sup>3</sup> *Id.* at 43.

<sup>4</sup> *Id.*

<sup>5</sup> *Armendariz v. Fountain Health Psychare Servs., Inc.*, 6 P.3d 669 (Cal. 2000).

<sup>6</sup> *Kepas*, 412 F. App'x at 43–44.

<sup>7</sup> *Id.* at 41.

<sup>8</sup> *Id.* at 41–42.

<sup>9</sup> *Id.* at 42.

<sup>10</sup> *Id.*

<sup>11</sup> *Id.*

the agreement provided that the American Arbitration Association (“AAA”) rules would apply and the choice of law provision within the agreement stated the proceedings would be governed by the laws of the State of California.<sup>12</sup> The agreement provided that the employer would pay the arbitrator’s fee for the proceeding, as well as other AAA charges.<sup>13</sup> This provision also granted the arbitrator authority to award any type of legal or equitable relief available to a court, including attorney’s fees, punitive damages, and the costs of arbitration, which under the AAA rules, included all the arbitrator and AAA expenses.<sup>14</sup>

Kepas filed his complaint alleging civil rights<sup>15</sup> and age discrimination claims,<sup>16</sup> as well as breach of contract and breach of good faith and fair dealing.<sup>17</sup> eBay responded with a motion to compel arbitration.<sup>18</sup> In granting the motion, the court required that the arbitrator shall not award eBay with arbitrator fees and could only award eBay costs that would similarly be awarded under the Federal Rules of Civil Procedure.<sup>19</sup> The court also modified the agreement to enable Kepas to pursue the arbitration in Utah.<sup>20</sup> Although securing his choice of forum, Kepas’ were all dismissed by the arbitrator on summary judgment. The district court subsequently confirmed the arbitration award.<sup>21</sup> Kepas then appealed the *initial* district court decision to compel arbitration, arguing that the arbitration agreement was unenforceable on grounds of unconscionability.<sup>22</sup>

### III. ANALYSIS

Kepas argued that the arbitration agreement failed to satisfy the minimum requirements established in *Armendariz v. Fountain Health Psychare Services, Inc.*,<sup>23</sup> rendering the agreement unconscionable.<sup>24</sup> He further argued those defects rendered the entire arbitration agreement unenforceable.<sup>25</sup> The *Armendariz* standard applies to employer mandated arbitration agreements that force employees to waive their statutory rights, requiring that arbitration agreements provide employees with the ability to secure (1) neutral arbitrators, (2) more than minimal discovery, (3) an arbitral decision in writing, (4) all relief that would otherwise be available in court, and (4) assurance from employers that they will not require employees to pay unreasonable costs, arbitrator fees, or expenses as a condition to arbitrate.<sup>26</sup> The court determined that California law

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<sup>12</sup> *Id.*

<sup>13</sup> *Id.*

<sup>14</sup> *Id.*

<sup>15</sup> 42 U.S.C. § 1981 (2006).

<sup>16</sup> 29 U.S.C. §§ 621–34 (2006).

<sup>17</sup> *Kepas*, 412 F. App’x at 41–42.

<sup>18</sup> *Id.*

<sup>19</sup> *Id.* at 42–43.

<sup>20</sup> *Id.* at 43.

<sup>21</sup> *Id.*

<sup>22</sup> *Id.*

<sup>23</sup> *Armendariz v. Fountain Health Psychare Servs., Inc.*, 6 P.3d 669 (Cal. 2000).

<sup>24</sup> *Kepas*, 412 F. App’x at 43.

<sup>25</sup> *Id.*

<sup>26</sup> *Id.* at 43–44 (citing *Armendariz*, 6 P.3d at 682).

governed the dispute, as this was listed as the choice-of-law within the arbitration agreement.<sup>27</sup> *Armendariz* was thus the legal standard applicable between Kepas and eBay.<sup>28</sup>

Kepas argued the arbitration agreement failed under *Armendariz* because the employee could be forced to pay the arbitrator fees and AAA costs through the arbitral award.<sup>29</sup> The court stated the agreement allowed for an arbitrator to award any legal or equitable remedy available in a court proceeding, including the costs of arbitration.<sup>30</sup> Following the parties' choice of law provision, the court looked to the AAA meaning of "costs of arbitration", which defined the term as "all expenses of the arbitrator...and any AAA expenses." The court determined that under this meaning the arbitration agreement failed the minimum requirements because it imposed a significant risk on the employee to pay the arbitration costs.<sup>31</sup> The court rejected eBay's argument that a provision provided for the employer to pay the arbitrator fees and other AAA costs, emphasizing that the provision only suggested that eBay would bear these costs initially, but created the possibility of the arbitrator later enforcing these costs on the employee.<sup>32</sup> Since the agreement gave the arbitrator authority to impose the costs of arbitration as part of the award, creating a significant risk that employees could be required to bear arbitration costs, the award provision was contrary to public policy.<sup>33</sup>

Before determining the result of this defect, the court addressed Kepas's second argument that the forum-selection provision failed *Armendariz* because employees could be required to incur unreasonable travel costs for employee witnesses who were forced to travel from Utah to a distant arbitration proceeding in California.<sup>34</sup> The court found this argument unpersuasive because witness travel costs are not unique to arbitration and did not violate the *Armendariz* requirements.<sup>35</sup>

Kepas also argued that the scope of the arbitration agreement and the forum-selection clause were unconscionable.<sup>36</sup> To be found unconscionable under California state law, agreements are required to be both procedurally and substantively unconscionable, although it is not required that each element be equally unconscionable.<sup>37</sup> In determining the procedural element, the court considered whether the arbitration agreement was a contract of adhesion, whether oppression played a role in the process, and whether a party was surprised by hidden terms.<sup>38</sup> The court determined that this was an adhesive contract because it was a standard contract, drafted and imposed by the stronger party, and left the employee only with the option of accepting or rejecting the terms as written.<sup>39</sup> The court next determined the agreement was oppressive because, as an employee, Kepas was not in a position to bargain for alternative contract terms.<sup>40</sup> Last, the court determined that the agreement lacked the remaining element of

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<sup>27</sup> *Id.* at 42–43.

<sup>28</sup> *Id.* at 44.

<sup>29</sup> *Id.*

<sup>30</sup> *Id.*

<sup>31</sup> *Id.*

<sup>32</sup> *Id.*

<sup>33</sup> *Id.* at 44–45.

<sup>34</sup> *Id.* at 45.

<sup>35</sup> *Id.*

<sup>36</sup> *Id.*

<sup>37</sup> *Id.* (citing *Armendariz v. Fountain Health Psychare Servs., Inc.*, 6 P.3d 669, 690 (Cal. 2000)).

<sup>38</sup> *Id.* (citing *Parada v. Superior Court*, 98 Cal. Rptr. 3d 743, 756–57 (Cal. Ct. App. 2009)).

<sup>39</sup> *Id.* at 46.

<sup>40</sup> *Id.*

surprise because the agreement was typewritten on two pages, and the terms, such as the forum clause selecting the state of the employer’s headquarters as the location, were not beyond Kepas’s reasonable expectations.<sup>41</sup> Therefore, while there was procedural unconscionability under the first two elements, the level was reduced due to the lack of surprise.<sup>42</sup>

Substantive unconscionability exists when an arbitration agreement lacks mutuality.<sup>43</sup> This occurs when the agreement compels arbitration for the claims most likely to be brought by the weaker party, but exempts those most likely to be brought by the stronger party,<sup>44</sup> or when employees are required to arbitrate claims that arise out of the same transaction that the employer can litigate.<sup>45</sup> Kepas argued the arbitration agreement lacked mutuality because it excluded from arbitration the claims of either party that “arise out of the Employee Proprietary Information and Inventions Agreement”, and Kepas contended that eBay was the party more likely to bring these types of claims.<sup>46</sup>

In determining that the agreement was sufficiently bilateral, the court rejected this argument because Kepas could not identify the types of claims which would be excluded and had not satisfied his burden to support his claim.<sup>47</sup> The court found that both cases Kepas used as precedents, *Mercurio v. Superior Court*<sup>48</sup> and *Fitz v. NCR Corp.*,<sup>49</sup> did not apply because they were distinguishable.<sup>50</sup> The court distinguished *Mercurio* because the language in the agreement excluded claims for injunctive or equitable relief, and lacked mutuality because employers would generally seek injunctive relief, not employees.<sup>51</sup> By contrast, the exclusion in eBay’s agreement excluded claims arising out of the “Employee Proprietary Information and Inventions Agreement,” which applied to both employer and employee claims regardless of the relief sought.<sup>52</sup>

In *Fitz*, the agreement excluded claims arising from “intellectual property rights,” and the court held the agreement lacked mutuality because the exclusion would most likely be used by the employers and not employees.<sup>53</sup> While the court stated *Fitz* was more analogous to the arbitration agreement at issue here, the court emphasized the key distinction was that many eBay employees develop their own inventions, and this unique industry made it likely that both employees and eBay could bring the type of claims excluded from the arbitration agreement, and, therefore, *Fitz* did not apply.<sup>54</sup> Since the claims excluded from arbitration were likely to be brought by either party, the court determined the arbitration agreement did not lack mutuality.<sup>55</sup>

Substantive unconscionability similarly exists when an arbitration agreement is harsh or oppressive, and Kepas argued the forum-selection clause was unreasonably oppressive because it

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<sup>41</sup> *Id.*

<sup>42</sup> *Id.*

<sup>43</sup> *Id.* at 47.

<sup>44</sup> *Id.* (citing *Armendariz v. Fountain Health Psychare Servs., Inc.*, 6 P.3d 669, 692 (Cal. 2000)).

<sup>45</sup> *Id.*

<sup>46</sup> *Id.*

<sup>47</sup> *Id.*

<sup>48</sup> *Mercurio v. Superior Court*, 116 Cal. Rptr. 2d 671 (Cal. Ct. App. 2002).

<sup>49</sup> *Fitz v. NCR Corp.*, 13 Cal. Rptr. 3d 88 (Cal. Ct. App. 2004).

<sup>50</sup> *Kepas*, 412 F. App’x at 47.

<sup>51</sup> *Mercurio*, 116 Cal. Rptr. 2d at 677.

<sup>52</sup> *Kepas*, 412 F. App’x at 47–48.

<sup>53</sup> *Fitz*, 13 Cal. Rptr. 3d at 104–05.

<sup>54</sup> *Kepas*, 412 F. App’x at 48, 50–51 (Lucero, J., dissenting) (noting that the majority held in distinguishing *Fitz*, which dealt with a technology company, and where the court rejected almost the identical argument eBay used.).

<sup>55</sup> *Id.* at 48.

imposed additional expenses and impaired his ability to secure witnesses.<sup>56</sup> The court emphasized that Kepas was required to prove that enforcement would be unfair or unreasonable, that the forum would be so overly difficult and inconvenient that it essentially deprives the employee of his day in court, or show there is no rational basis for the forum choice.<sup>57</sup> The court determined that Kepas had not shown that the forum would effectively preclude him from bringing his dispute, and the hardship in securing witnesses was diminished because Kepas could obtain their testimony through a deposition in Utah.<sup>58</sup> In addition, since eBay's principal place of business is California, the court noted that there was a reasonable connection between the cause of action and the forum selected.<sup>59</sup> Therefore, although the district court originally modified the forum-selection provision in its decision to compel arbitration, the court determined that the original forum-selection provision was not substantively unconscionable, because it did not preclude Kepas from asserting his claims and the forum was rationally related to the cause of action.<sup>60</sup>

The court concluded that the potential for the arbitrator to impose the "costs of arbitration" on the employee was the sole defect in the arbitration agreement and determined that the objectionable term could be severed, allowing for the enforcement of the remainder of the arbitration agreement.<sup>61</sup> An arbitration agreement that fails the conscionability standard can still be enforceable if the offending term can be severed,<sup>62</sup> the main inquiry being whether the severance would further "the interests of justice."<sup>63</sup> The court noted several factors used by California courts to determine severability: whether the illegality is collateral to the main purpose, whether the agreement contains more than one objectionable term, and whether striking the single provision would remove the illegality from the agreement.<sup>64</sup> The court determined the objectionable provision was severable because the provision allowing the costs of arbitration as an award was collateral to the central purpose, the award provision was the only objectionable provision, and the deficiency of the arbitration agreement could be easily reconciled by removing the offending term.<sup>65</sup> The court agreed with the district court's determination that the remainder of the arbitration agreement was enforceable and affirmed the district court's decision to compel arbitration in the original proceedings.<sup>66</sup>

#### IV. SIGNIFICANCE

*Kepas* is significant because it allows for judicial review of an original court decision after the party has already completed the arbitration proceedings and lost. After the district court modified the arbitration agreement and compelled arbitration, Kepas decided to comply with the

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<sup>56</sup> *Id.* at 46–48.

<sup>57</sup> *Id.* at 48–49 (citing *Furda v. Superior Court*, 207 Cal. Rptr. 646 (Cal. Ct. App. 1984); *Aral v. Earthlink, Inc.*, 36 Cal. Rptr. 3d 229 (Cal. Ct. App. 2005); *Intershop Commc'ns v. Superior Court*, 127 Cal. Rptr. 2d 847 (Cal. Ct. App. 2002)).

<sup>58</sup> *Id.* at 49.

<sup>59</sup> *Id.*

<sup>60</sup> *Id.*

<sup>61</sup> *Id.*

<sup>62</sup> *Id.* (citing *Abramson v. Juniper Networks, Inc.*, 9 Cal. Rptr. 3d 422, 437 (Cal. Ct. App. 2004)).

<sup>63</sup> *Id.* (citing *Armendariz v. Fountain Health Psycare Servs., Inc.*, 6 P.3d 669, 696 (Cal. 2000)).

<sup>64</sup> *Id.* at 50 (citing *Abramson*, 9 Cal. Rptr. 3d at 438–39).

<sup>65</sup> *Id.*

<sup>66</sup> *Id.*

decision and pursue his claims through the arbitration process.<sup>67</sup> It was only after the arbitrator ruled in favor of eBay that Kepas appealed to have the original motion to compel arbitration reversed. This expands the scope of judicial review beyond the narrow means mandated in Section 10 of the Federal Arbitration Act (“FAA”).<sup>68</sup>

*Kepas* also illustrates that the Tenth Circuit will employ the choice-of-law provision as written by the parties, even when the designated law is from another jurisdiction. Here, the court used California law to review the dispute based on the choice-of-law provision agreed upon by the parties within the arbitration agreement.<sup>69</sup> This gives guidance to practitioners when drafting arbitration agreements in knowing that the Tenth Circuit will honor the agreement and analyze the dispute under the designated choice-of-law agreed upon by the drafting parties.

## V. CONCLUSION

While it is not uncommon for courts to sever or modify offending provisions in otherwise valid and enforceable arbitration agreements, the district court’s decision to insert Salt Lake County as an additional arbitral forum requires some analysis. While the opinion does not contain the district court’s reasoning in making the modification, it is interesting to note that the appellate court determined that the original forum-selection clause did not fail the *Armendariz* standard, and was not substantively unconscionable.<sup>70</sup> The court ultimately determined that the district court properly restricted the arbitration agreement in regards to the arbitral award provision, and was correct in compelling arbitration.<sup>71</sup> Yet it would seem that if the original forum-selection clause was valid and enforceable, the district court overstepped its authority in modifying this. It is unclear why the appellate court does not address this.

In addition, the most alarming and confusing aspect of this opinion is that the appellate court granted the appeal of the original motion to compel arbitration after the Kepas had completed the arbitration proceedings and lost.<sup>72</sup> It should appear that if the Kepas disagreed with the district court’s ruling, the proper time to appeal would be immediately after the district court decision, not after the Kepas failed to achieve a favorable result in arbitration. This creates the impression of a losing party attempting to get another bite at the apple after an unfavorable ruling in arbitration. Entertaining this claim questions the binding nature and finality of the arbitrator’s decision established under section two of the FAA.<sup>73</sup> It is unclear as to the court’s reasoning for this, because it says nothing in regards to the timing of the appeal. And the effect remains to be seen in the Tenth Circuit.

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<sup>67</sup> *Id.* at 43.

<sup>68</sup> Federal Arbitration Act, 9 U.S.C. §§ 1–16 (2006).

<sup>69</sup> *Kepas*, 412 F. App’x at 42–43.

<sup>70</sup> *Id.* at 45–49.

<sup>71</sup> *Id.* at 50.

<sup>72</sup> *Id.* at 43.

<sup>73</sup> 9 U.S.C. § 2.