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Through the Lens of *Concepcion*: California Supreme Court Revisits the Validity of Agreements Requiring Employee Waiver of Wage Claim Administrative Processes

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Almost one year after the U.S. Supreme Court summarily vacated the original 2011 *Sonic-Calabasas* opinion (*Sonic I*[1]), the California Supreme Court issued its opinion on remand in *Sonic-Calabasas A, Inc. v. Moreno* (*Sonic II*[2]).

The Court's five-to-two *Sonic II* majority opinion conceded that U.S. Supreme Court precedent and the Federal Arbitration Act (FAA) preclude California courts from striking down arbitration agreements simply because they deny an employee's access to administrative wage claim (Berman) hearings in lieu of an arbitral process.

Despite the Court's recognition that "courts cannot impose unconscionability rules that interfere with arbitral efficiency," *Sonic II* affirms California courts' continuing authority to invalidate arbitration agreements that are unfair (unconscionable) to employees.

The Case's History

In *Sonic I*, the Court held that arbitration agreements that required employees to waive the right to a Berman hearing (an administrative hearing before the Labor Commissioner in wage disputes) were categorically unenforceable as contrary to public policy and were also unconscionable.

In October 2012, the U.S. Supreme Court summarily vacated *Sonic I* for reconsideration in light of the U.S. Supreme Court's 2011 decision in *AT&T Mobility LLC v. Concepcion* (*Concepcion*).[3] In *Concepcion*, the U.S. Supreme Court overruled a California Supreme Court holding that state public policies supporting the availability of class-wide relief for small individual fraud claims trumped an arbitration clause that required bilateral, non-class arbitration only.

The *Sonic II* Decision

Sonic II's core holding is that the FAA pre-empts *Sonic I*'s ruling categorically prohibiting an adhesive arbitration agreement from requiring an employee to waive access to a Berman hearing.

1 51 Cal.4th 659; *see also* Henry Lederman and Christopher Cobey, *California Supreme Court Holds Right to File Wage Claim with State Labor Commissioner Trumps Pre-Dispute Arbitration Provision*, Littler ASAP (Mar. 1 2011).

2 __ Cal. 4th ___; 2013 Cal. LEXIS 8111.

3 563 U.S. __, 131 S.Ct. 1740; *see* Henry Lederman, *Supreme Court Finds California Class Action Arbitration Waiver Enforceable*, Littler ASAP (Apr. 27, 2011).

However, in an important counterpoint, the majority opinion also reiterated the availability of the unconscionability defense in analyzing the validity of an arbitration agreement under California law. The decision described the unconscionability doctrine as "the absence of meaningful choice on the part of one of the parties together with contract terms which are unreasonably favorable to the other party." Any arbitral remedy imposed by an employer in an agreement with an employee must be "accessible and affordable."

The majority opinion, authored by Justice Goodwin Liu, provided examples of unconscionable agreements which would not "interfere[ ] with the fundamental attributes of arbitration," as *Concepcion* proscribed, including contracts that had provisions requiring a $50,000 threshold for an arbitration appeal, damages limitations, one-way recovery of attorneys' fees for a prevailing party, and $8,000 in mandated administrative fees for an employee to commence arbitration.

The majority's opinion suggests that enforceability does not require a perfect arbitration process: "[t]he unconscionability inquiry is not a license for courts to impose their renditions of an ideal arbitral scheme." The "unconscionability doctrine does not mandate the adoption of any particular form of dispute resolution mechanism, and courts may not decline to enforce an arbitration agreement simply on the ground that it appears to be a bad bargain or that one party could have done better." The majority also reiterated that a determination of unconscionability was normally determined on motion procedure, not on taking live testimony of witnesses.

However, the majority also listed six features of a Berman hearing that may be waived in an appropriately drafted arbitration agreement, so long as arbitration remains "accessible and affordable" for the employee:

> "The Berman statutes include various features designed to lower the costs and risks for employees in pursuing wage claims, including *procedural informality, assistance of a translator, use of an expert adjudicator* who is authorized to help the parties by questioning witnesses and explaining issues and terms, and provisions on *fee shifting, mandatory undertaking*, and *assistance of the Labor Commissioner* as counsel to help employees defend and enforce any award on appeal. Waiver of these protections does not necessarily render an arbitration agreement unenforceable, nor does it render an arbitration agreement unconscionable per se. But waiver of these protections in the context of an agreement that does not provide an employee with an accessible and affordable arbitral forum for resolving wage disputes may support a finding of unconscionability."

(Emphasis added.) Further, the majority also suggested that an appropriately drafted statute could create additional procedural requirements for arbitration agreements (applicable to wage claims) that would not contravene the FAA.

In responding to the dissent's claims that the majority opinion fails to provide a bright-line test of what constitutes substantive unconscionability in an arbitral agreement covering wage claims, instead relying on undefined standards such as "accessible," "affordable," "low-cost," "speedy," and "effective," the majority said that common-law courts make case-by-case determinations using such terms daily. The majority also quoted with approval the statement in the concurring opinion that "[this decision] does not require trial courts to adopt a new procedure or analytical approach when an unconscionability defense concerns an arbitration provision in an employment contract."

As he had in *Sonic I*, Justice Chin dissented, although with one less vote than he had in *Sonic I.* Justice Chin did agree with the majority that *Sonic I* should be reversed as violative of the FAA. However, he also contended that the plaintiff had forfeited his unconscionability claim by failing to raise and pursue it in the trial court (one basis for his *Sonic I* dissent). The major portion of his dissent was a detailed critique of why the majority's unconscionability defense was "a case-by-case, hopelessly vague, and indeterminable assessment." Justice Chin (and the concurring justice) also criticized the majority's refusal to adopt the standard, in determining whether an arbitration agreement was unconscionable, that an agreement's terms are so one-sided as to "shock the conscience" of the reviewing court.

Going Forward

The case was remanded to the trial court to develop an evidentiary record on the former employee's defense of unconscionability of the arbitration agreement.

Sonic II's 70-page majority opinion is the California Supreme Court's latest pronouncement on the validity of mandatory arbitration agreements that are attacked on unconscionability grounds. The U.S. Supreme Court observed in *Concepcion* that "California's courts have been more

likely to hold contracts to arbitrate unconscionable than other contracts,"[4] and whether *Sonic II* will ultimately be interpreted to reverse or advance that trend remains to be seen. Two cases currently under review by the California Supreme Court may provide California employers further guidance on the application of the defense of FAA preemption: *Iskanian v. CLS Transportation of Los Angeles*[5] and *Sanchez v. Valencia Holding Co. LLC*.[6]

Next Steps For Employers

1. If an employer has an arbitration agreement with an employee, the employer should review it to confirm that it complies with current California case law, including *Sonic II*, assessing the validity of such an agreement against an unconscionability defense,[7] and that it includes wage claims within its scope. Arbitration agreements can be effective tools for minimizing legal risks, but they are of no value if they cannot be enforced if challenged.
2. If an enterprise's arbitration agreement incorporates the rules of an outside provider, (such as the American Arbitration Association, JAMS, or ADR Services), the enterprise should determine whether its rules and processes meet the standards suggested by the *Sonic II* decision. An employer is free to draft rules that supplement or even replace provider rules to ensure compliance with applicable law.
3. If the enterprise currently has no arbitration agreement, the enterprise should assess whether such an agreement could make dispute resolution more efficient and cost-effective.
4. Employers should remind those in the enterprise who will first receive notice of any California Labor Commissioner claims of former employees to alert counsel of the claims so that a determination can be made whether to proceed administratively or seek enforcement of an agreement to arbitrate the dispute.

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4 131 S. Ct. at 1747.

5 The Supreme Court's online case summary states: "This case presents the following issues: (1) Did *AT&T Mobility LLC v. Concepcion* (2011) 563 U.S. __ [131 S. Ct. 1740, 179 L.Ed.2d 742] impliedly overrule *Gentry v. Superior Court* (2007) 42 Cal.4th 443 with respect to contractual class action waivers in the context of non-waivable labor law rights? (2) Does the high court's decision permit arbitration agreements to override the statutory right to bring representative claims under the Labor Code Private Attorneys General Act of 2004 (Lab. Code, § 2698 et seq.)? (3) Did defendant waive its right to compel arbitration?"

6 The Supreme Court's online case summary states: "This case includes the following issue: Does the Federal Arbitration Act (9 U.S.C. § 2), as interpreted in *AT&T Mobility LLC v. Concepcion* (2011) 563 U. S. __, 131 S.Ct. 1740, preempt state law rules invalidating mandatory arbitration provisions in a consumer contract as procedurally and substantively unconscionable?"

7 *See* 2011 Littler ASAPs, *supra* notes 1 and 2. *See also* Rob Friedman, *Narrow Supreme Court Ruling Upholds Arbitrator's Decision that Parties' Agreement Permits Class Arbitration*, Littler ASAP (Jun. 12, 2013), Edward Berbarie, *Supreme Court's Amex Decision Creates High Hurdle for Plaintiffs Seeking to Invalidate Arbitration Agreements with Class Action Waivers*, Littler ASAP (Jun. 20, 2013), and discussion in Littler's 2013-2014 *The California Employer*, Chapter 6 ("The Evolution of California Law on Arbitration Agreements," pp. 352-355; *see also* "Class Action Waivers in California Employment Arbitration Agreements," pp. 349-351).