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Management Alert

California Courts Continue to Resist Federal Policy Favoring Arbitration

In 2011, the California Supreme Court, in *Sonic-Calabasas A, Inc. v. Moreno ("Sonic I"),* held that employers cannot require employees to waive the right to an administrative hearing (a "Berman hearing") before the California Labor Commissioner. The U.S. Supreme Court vacated the *Sonic I* ruling, instructing the California Supreme Court to reconsider its decision in light of *AT&T Mobility v. Concepcion*.

On reconsideration, in *Sonic II*, the California Supreme Court recognized that the Federal Arbitration Act ("FAA") preempts its ruling in *Sonic I*. At the same time, however, the California Supreme Court sounded two cautionary notes about arbitration agreements, one quite conventional and the other more controversial. The conventional note is that the FAA continues to permit courts to decline to enforce arbitration agreements that are unconscionable. The controversial note is that, in California, the standard of unconscionability is broad, permitting courts to examine the fundamental fairness of the bargain. The practical consequence is that even if state public policy does not invalidate an arbitration agreement, the same result might obtain under an aggressive application of the doctrine of unconscionability.

The Facts

The Plaintiff, Frank Moreno, worked for Sonic-Calabasas A, Inc. ("Sonic"), an auto dealership. Upon his hire, Moreno signed Sonic's arbitration agreement, requiring him to submit any employment dispute to binding arbitration under the FAA. The agreement precluded Moreno from pursuing any judicial "or other government dispute resolution forum," subject to certain enumerated exceptions, including claims under the National Labor Relations Act and the California Workers' Compensation Act. The agreement also permitted Moreno to bring claims before the Employment Development Department, the California Department of Fair Employment and Housing, and the U.S. Equal Employment Opportunity Commission.

After Moreno resigned from Sonic, he filed a complaint with the Labor Commissioner for unpaid vacation pay, seeking resolution in a Berman hearing, a form of proceeding that was not among the claims carved out of the arbitration agreement.

The *Sonic I* Decision

Sonic petitioned the trial court for an order compelling enforcement of the arbitration agreement. The trial court denied the petition, allowing a Berman hearing to proceed. Sonic appealed.

The Court of Appeal reversed the trial court, holding that the arbitration agreement lawfully waived Moreno's right to a Berman hearing. Moreno then sought review from the California Supreme Court.

In *Sonic I,* the California Supreme Court reversed the Court of Appeal and upheld the trial court's denial of Sonic's petition to compel arbitration. The Supreme Court held that although Moreno could be compelled to arbitrate, he could not be required to waive his right to a Berman hearing before arbitration, because a required waiver of a Berman hearing was both "contrary to public policy and unconscionable." Sonic then petitioned the U.S. Supreme Court for a writ of certiorari.

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The U.S. Supreme Court vacated the judgment in *Sonic I* and remanded the case for the California Supreme Court to reconsider its decision in light of *Concepcion*, which the U.S. Supreme Court had decided two months after *Sonic I*.

The *Sonic II* Decision

The California Supreme Court acknowledged that the FAA, as interpreted in *Concepcion*, preempts *Sonic I's* categorical ban of Berman-hearing waivers. All seven justices agreed that the FAA preempts a state-law rule whose impact interferes with "fundamental attributes of arbitration." In *Concepcion*, the U.S. Supreme Court held that state-law rules "aimed at destroying arbitration or demanding procedures incompatible with arbitration" would contravene the FAA's "overarching purpose" to "ensure the enforcement of arbitration agreements according to their terms so as to facilitate streamlined proceedings."

The California Supreme Court acknowledged that, under *Concepcion*, courts cannot impose rules that interfere with arbitral efficiency, including rules forbidding waiver of administrative procedures that delay arbitration. Undoubtedly, requiring a dispute to be heard by an administrative agency before arbitration could frustrate the arbitration agreement's prime objective of achieving efficient proceedings and expeditious results.

So far, so good. But then the California Supreme Court noted that the FAA continues to recognize unconscionability as a valid defense against enforcement of arbitration agreements, and reasoned that the benefit lost in waiving a Berman hearing may be one factor to consider in an unconscionability analysis. The Supreme Court remanded the case to the trial court to determine the fact-specific question of whether Sonic's arbitration agreement is unconscionable. The Supreme Court suggested that an arbitration system could be designed to provide an employee with enough of the advantages of a Berman hearing to pass muster under the unconscionability doctrine.

In dissent, Justice Chin (joined by Justice Baxter) disagreed with the majority's decision to remand the case on the issue of unconscionability. Justice Chin called the majority's test for unconscionability "vague, unworkable, and inconsistent with existing California law." He argued that "[b]asing an unconscionability determination on the reasonableness of a contract provision would inject an inappropriate level of judicial subjectivity into the analysis." Justice Corrigan's separate concurrence agreed with the dissent "that the proper test for determining unconscionability here is whether the terms are so one-sided as to shock the conscience," ***not*** whether the agreement is simply "unreasonably one-sided" in favor of the employer.

What *Sonic II* Means for Employers

In *Concepcion* and its progeny, the U.S. Supreme Court has limited the ability of courts to rely on "state public policy" to dismantle arbitration agreements. But the California Supreme Court has armed the opponents of arbitration with what may amount to an enhanced version of the unconscionability doctrine. Undoubtedly, plaintiffs will cite this aspect of the case as having broad impact, beyond the narrow confines of Berman-hearing waivers.

As to Berman-hearing waivers themselves, the California Supreme Court clearly has signaled that courts can consider, in reviewing a Berman-hearing waiver as unconscionable, whether the arbitration agreement provides the employee-friendly features of a Berman hearing.

While *Sonic II* will not be the last word on the enforceability of arbitration agreements in California, employers with mandatory arbitration agreements should consult with counsel to determine what, if any, changes should be made to their agreements.

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