A Timely Analysis of Legal Developments

ASAP®

In This Issue:

February 2011

In a decision that reduces the utility of pre-dispute arbitration agreements for California employers, the California Supreme Court held that such agreements are invalid as against public policy in barring an employee's right to a Berman hearing before the California Labor Commissioner, but may be enforceable for any appeal from that hearing's determination.

California Supreme Court Holds Right to File Wage Claim with State Labor Commissioner Trumps Pre-Dispute Arbitration Provision

By Henry Lederman and Christopher E. Cobey

In the California Supreme Court opinion of *Sonic-Calabasas A, Inc. v. Moreno*, a 4-3 majority of the court concluded that a pre-dispute employee-employer arbitration agreement requiring the arbitration of employee wage claims, which could otherwise be brought before the state's Labor Commissioner, is contrary to public policy and unconscionable, and is thus unenforceable. The court's majority declared that the 2008 U.S. Supreme Court case of *Preston v. Ferrer*[1] did not compel a different conclusion and that the court's holding was not preempted by the Federal Arbitration Act (FAA; 9 U.S.C. §§ 1 *et seq.*).

For California employers with existing pre-dispute arbitration agreements in place, the decision means that the employer cannot count on having wage claims resolved at the outset through the arbitration process described in the agreement. By this decision, even with such an agreement in place, the initial wage claim must be heard by the Labor Commissioner if the employee so chooses. However, the option of arbitration remains for any appeal of the Labor Commissioner's initial decision, which would normally be heard by the superior court.

Whether this decision of the California Supreme Court will be appealed to the U.S. Supreme Court for interpretation in light of the *Preston* case, modified by action of the California Legislature, or rejected by federal courts as being contrary to and preempted by the FAA, remains to be seen.

Factual Background

As a condition of his hire as an employee of a car dealership owned and operated by Sonic, Frank Moreno signed an employment agreement that included a pre-dispute mandatory arbitration provision. The arbitration agreement's key provision reads as follows:

> I . . . acknowledge that [Sonic] utilizes a system of alternative dispute resolution that involves binding arbitration to resolve all disputes that may arise out of the employment context. Because of the mutual benefits (such as reduced expense and increased efficiency) which

Littler
Employment & Labor Law Solutions Worldwide

> private binding arbitration can provide both [Sonic] and myself, both [Sonic] and I agree that any claim, dispute, and/or controversy (including, but not limited to, any claims of discrimination and harassment . . .) that either I or [Sonic] . . . may have against the other which would otherwise require or allow resort to any court or other governmental dispute resolution forum arising from, related to, or having any relationship or connection whatsoever with my seeking employment with, employment by, or other association with [Sonic], whether based on tort, contract, statutory, or equitable law, or otherwise, (with the sole exception of claims arising under the National Labor Relations Act . . . , claims for medical and disability benefits under the California Workers Compensation Act, and Employment Development Department claims) shall be submitted to and determined exclusively by binding arbitration under the Federal Arbitration Act, in conformity with the procedures of the California Arbitration Act (Cal. Code Civ. Proc. sec. 1280 et seq., including section 1283.05 and all of the Act's other mandatory and permissive rights to discovery). However, nothing herein shall prevent me from filing and pursuing administrative proceedings only before the California Department of Fair Employment and Housing, or the U.S. Equal Opportunity Commission.

Moreno voluntarily terminated his employment. After quitting, Moreno filed a claim in December 2006 with the Labor Commissioner for over $18,000 in accrued but unpaid vacation. Sonic responded by filing a petition to compel the arbitration of Moreno's wage claim.

The trial court denied the petition, concluding that the agreement's arbitration provision required arbitration of Labor Commissioner claims under Labor Code sections 98 to 98.8 (the so-called "Berman hearing" before the Labor Commissioner), that the requirement was against public policy, and held the provision unconscionable.

On appeal from the trial court by Sonic, the court of appeal reversed the trial court's judgment, holding that the arbitration clause was valid in requiring the employee to waive the right to a Berman hearing. The court of appeal reasoned that Moreno had failed to show how proceeding in an arbitral forum, instead of before the Labor Commissioner, would be a disadvantage to him. In turn, Moreno then appealed that decision to the California Supreme Court.

The California Supreme Court's Decision

In the California Supreme Court, the majority opinion[2] reversed the result of the court of appeal, and affirmed the trial court's determination, that the arbitration agreement was invalid as contrary to public policy, because it required the arbitration of claims that an employee could bring in a Berman hearing. Parting company from the court of appeal on this issue, the California Supreme Court said that the key question was whether the employee's statutory right to seek a Berman hearing is in itself an unwaivable right. The court concluded that it was.

The court majority observed that if an employee elects to recover wages by a Labor Commissioner claim, the employee enjoys several significant advantages absent from the arbitration process. The advantages include a speedy administrative hearing, the assistance of a deputy labor commissioner in attempting to resolve the claim before the Berman hearing, an informal hearing, priority in enforcement of any award, the possible award of attorneys' fees in the employee's favor only, the undertaking (bonding) requirement of an award for unsuccessful employers seeking to appeal a Labor Commissioner award in favor of an employee, and no need for attorney assistance. In contrast, the court noted, if the wage claim were subject to the arbitration process described in the Sonic agreement's provision, the arbitration would be presided over by a retired state court judge, the one-way attorney-fee-shifting provision would not apply, and the statutory rules of evidence and civil procedure would apply, meaning that the employee would require the costly assistance of an attorney. The court also noted the strong public policy, not limited to individuals, in favor of prompt payment of wages. Based on the foregoing, the majority concluded that the Berman waiver was contrary to public policy.[3]

The majority also concluded that the agreement was a contract of adhesion, was oppressive and one-sided, and was both procedurally and substantively unconscionable. The majority invalidated the agreement on that alternative basis.

Lastly, the majority considered the employer's argument that a holding by the California Supreme Court that the arbitration provision is contrary to public policy, and unconscionable, would be preempted by the FAA. The court maintained that its analysis of the agreement at issue in the case neither favored nor disfavored arbitration. On this issue, the majority agreed with the court of appeal's conclusion

that the holding of *Preston* was distinguishable from this case. In *Preston*, the plaintiff had made no challenge to the validity of the agreement's arbitration clause – only to the entire employment agreement.[4]

In a spirited dissent, Justice Chin, joined by two other justices, argued that the majority's conclusion was irreconcilable with the holding of *Preston*. The dissent maintained that *Preston* held that the FAA superseded any state laws that lodge primary jurisdiction over a dispute the parties have agreed to arbitrate in an administrative forum. Under this holding, the dissent insisted, the FAA preempts the state law at issue (the Berman hearings). Finally, Justice Chin declared that, as the parties had not raised or briefed the issue of the possible unconscionability of the agreement in either the trial court or the court of appeal, that issue should not now be considered by the California Supreme Court.

Going Forward

The employer in this case may decide to seek review of this decision by the U.S. Supreme Court to determine whether that court's view of the non-application of the holding in Preston is the same as the California Supreme Court's, and whether the Labor Commissioner's jurisdiction over wage claims is divested by the FAA.

In addition, with one-party control of the California Legislature and governorship into 2012, it is quite possible that legislation may be pursued in Sacramento prohibiting employers from using pre-dispute mandatory arbitration agreements at all, or even only eliminating the possible use of the arbitration process for appeals from Labor Commissioner awards. Such legislation, not to mention the *Sonic-Calabasas* case itself, could run headlong into the United States Supreme Court's ruling in *Perry v. Thomas*, in which the high court held that California Labor Code Section 229 was preempted by the FAA insofar as it purported to cover arbitration agreements governed by the federal law. Section 229 states that administrative actions by an individual "for the collection of due and unpaid wages . . . may be maintained without regard to the existence of any private agreement to arbitrate."

Finally, federal courts are not bound by the California Supreme Court's views of the applicability of federal preemption, and it is possible that federal courts will simply decline to follow the California Supreme Court's lead.

Pending these possible developments, California employers may wish to reconsider whether to use a judicial referee as an alternative dispute resolution device in employment agreements.[5] However, there is no certainty whether this approach would divest the state Labor Commissioner of any authority at all, particularly in light of the California Supreme Court's ruling earlier in February 2011 in *Tarrant Bell Property, LLC v. Superior Court* that trial courts retain discretion to refuse to enforce those delegations.

Henry Lederman is a Shareholder in Littler Mendelson's Walnut Creek office, and Christopher E. Cobey is Special Counsel in the San Jose office. If you would like further information, please contact your Littler attorney at 1.888.Littler, info@littler.com, Mr. Lederman at hlederman@littler.com, or Mr. Cobey at ccobey@littler.com.

---

1 *See* Douglas A. Wickham, Steven A. Groode and Robert P. Hennessy, *Federal Arbitration Act Trumps State Laws Lodging Primary Jurisdiction in State Administrative Forums*, LITTLER ASAP (Mar. 2008).

2 The four-justice majority included the opinion's author, Justice Moreno (no relation to the plaintiff-employee), who had previously announced his intention to retire from the court at the end of February 2011, and retired Chief Justice Ronald George. Retired Chief Justice George's replacement did not participate in the court's decision.

3 In a footnote, the majority noted that it was not deciding whether it was contrary to public policy for an employee to knowingly and voluntarily waive the right to seek a Berman hearing "as part of a freely negotiated, nonstandard contract, such as may exist between an employer and a *highly compensated executive employee*." (Emphasis added)

4 The majority noted that this was not a case in which the employer maintained that the arbitration provision in dispute reserved to the arbitrator, not the court, the determination of unconscionability, thus finding unnecessary to decide the applicability of the 2010 U.S. Supreme Court decision of *Rent-A-Center v. Jackson*. *See* Henry Lederman, *U.S. Supreme Court Rules Arbitration Clause Delegating Contract Enforceability Issues to Arbitrator Is Enforceable*, LITTLER ASAP (June 2010).

5 *See* Marlene S. Muraco, *Agreements to Submit Disputes to a Judicial Referee May Allow Employers to Avoid the Pitfalls of Jury Trials and Arbitration,* LITTLER INSIGHT (Aug. 2006).