Big News in Arbitration: *Sonic-Calabasas v. Moreno* and *AT&T Mobility v. Concepcion*

By Joel M. Grossman

Joel Grossman is a mediator and arbitrator with JAMS in Los Angeles. His practice focuses on employment, entertainment and other business disputes. He has twice been selected as one of California's Top 40 Neutrals by the Daily Journal. For more information please visit www.grossmanmediation.com.

In the landmark 2000 case of *Armendariz v. Foundation Health Psychcare Services, Inc.*[1] the California Supreme Court made it clear that employers could require employees to submit statutory claims to arbitration, provided certain minimal standards of fairness were met. The court specifically ruled that a claim of violation of the Fair Employment and Housing Act (FEHA) could be the subject of a mandatory arbitration provision, so long as there was no waiver of statutory rights and the terms of the arbitration agreement were not otherwise unconscionable.

Although the court in *Armendariz* recognized that an employer may require its employees to arbitrate statutory claims, it recently held in *Sonic-Calabasas, Inc., v. Moreno*[2] that despite a valid arbitration clause, an employee cannot be compelled to waive an informal hearing over unpaid wages before the Labor Commissioner, known as a "Berman hearing."[3] In *Sonic*, the employee filed an administrative claim with the Labor Commissioner, seeking unpaid vacation pay. Before the Berman hearing was held, the employer sought a judicial ruling compelling arbitration of the wage dispute, and dismissing the pending Berman hearing. The employer asserted that, by signing the arbitration agreement, the employee waived his right to a Berman hearing, since the arbitration clause required all disputes to be submitted to arbitration.[4] The court held that while the employee ultimately would be compelled to arbitrate the wage claim should either party seek a *de novo* review of the Labor Commissioner's decision, he could not be deprived of the right to have an informal Berman hearing first.

Before discussing the court's reasoning, a short summary of Berman hearings is in order. Under the Labor Code, employees who believe they are owed wages may either file an action directly in court, or may file an administrative claim with the Labor Commissioner. The claim is assigned to a Deputy Labor Commissioner, who may dismiss the claim or set it for hearing. There is no opportunity for pre-hearing discovery. The hearing is conducted without formal rules of evidence, and the Deputy Labor Commissioner may assist a party in cross-examining witnesses or explaining the issues. After the award is rendered, either side may appeal to the trial court for a *de novo* review. Should the employer appeal, it is required to post a bond equal to the award. Employees who prevail are entitled to attorneys' fees. The Labor Commissioner is required to represent employees who cannot afford counsel at the trial.[5]

In *Sonic-Calabasas*, the court of appeal had determined that the arbitration agreement was not unconscionable because the employee could litigate his right to vacation pay in the arbitration. However, because of all the protections that employees obtain through Berman hearings, the California Supreme Court rejected the appellate court's view, holding that an employee's right to a Berman hearing is "an unwaivable right that an employee cannot be compelled to relinquish as a condition of employment."[6] The court went on to explain that claims for wages are given special treatment under the law:

> It has long been recognized that wages are not ordinary debts, that they may be preferred over other claims, and that, because of the economic position of the average worker and, in particular, his dependence on wages for the necessities of life for himself and his family, it is essential to the public welfare that he receive his pay when it is due.[7]

The court held that the Legislature had created the Berman hearing and appeal process as a means of affording an employee with a meritorious wage claim certain advantages, chiefly designed to reduce the costs and risks of pursuing a wage claim, recognizing that such costs and risks could prevent a theoretical right from becoming a reality.[8] The court thus concluded that "permitting employers to require employees, as a condition of employment, to waive their right to a Berman hearing would seriously undermine the efficacy of the Berman hearing statutes and hence thwart the public purpose behind the statutes."[9]

Justice Chin, in a dissenting opinion, pointed out that the majority opinion referred to Berman hearings

Because it viewed the Discover Bank *rule as an obstacle to the FAA's objectives, the U.S. Supreme Court invalidated it.*

as a "speedy, informal, and affordable method of resolving wage claims,"[10] and yet California public policy favors arbitration "precisely because it is a speedy, informal, and relatively inexpensive means of dispute resolution."[11] Justice Chin's dissent concluded that while a Berman hearing may have some advantages for an employee, that did not mean that arbitration would, in the words of *Armendariz,* deprive employees of the ability to "vindicate" their statutory right to vacation pay. Nonetheless, the majority opinion clearly held that an arbitration agreement may not deprive an employee of the opportunity to bring a wage claim to a Berman hearing.

Two months after the opinion in *Sonic-Calabasas* was issued, the United States Supreme Court decided *AT&T Mobility LLC v. Concepcion*,[12] holding that class action waivers in arbitration agreements, requiring all disputes to be submitted to arbitration individually, and not as representative or class actions, are enforceable. This case will have a major impact on arbitration law in California, as discussed below, and could potentially affect the holding of *Sonic-Calabasas* and other California Supreme Court decisions regarding arbitration of employment claims.

The facts of *AT&T Mobility* were simple and undisputed. AT&T advertised a free cell phone for customers who signed up for new service. In order to sign up for service, new customers had to agree to submit any disputes to binding arbitration, with a class action waiver. The customers who signed up for service were given a free phone, but were required to pay the sales tax, usually between $20 and $30, far less than the cost of the phone, but not totally free. Mr. Concepcion was the lead plaintiff in a class action against AT&T for false advertising and fraud. AT&T moved to compel arbitration, the federal district court denied the motion, and the Ninth Circuit Court of Appeals affirmed, relying on *Discover Bank v. Superior Court.*[13]

In *Discover Bank*, the California Supreme Court held that class action waivers in consumer arbitration agreements are unconscionable and therefore unenforceable. The California Supreme Court extended that holding to wage and hour class actions in *Gentry v. Superior Court.*[14] Thus, the state of California law prior to the issuance of the U.S. Supreme Court's *AT&T Mobility* decision was that, provided certain conditions were met, an employer could not enforce an arbitration clause that required employees to prosecute wage claims individually rather than as a class.

In *AT&T Mobility*, the U.S. Supreme Court held that arbitration—including the class action waiver—should be compelled. The Court held that the Federal Arbitration Act (FAA)[15] preempts the rule enunciated in *Discover Bank* because that case's holding "stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress."[16] The Court rested its analysis on the so-called "savings clause" in § 2 of the FAA, which states that agreements to arbitrate "shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract."[17] Paradoxically, the California Supreme Court rested its holding in *Discover Bank* on this very clause, holding that the unconscionability doctrine applies generally to the revocation of all contracts, not just agreements to arbitrate. Because any contract can be rejected as unconscionable, not just agreements to arbitrate, the California Supreme Court held in *Discover Bank* that it could invalidate all arbitration agreements with class action waivers without violating the terms of § 2 of the FAA.

In *AT&T Mobility,* the U.S. Supreme Court strongly rejected this explanation. The Court stated that "[w]hen state law prohibits outright the arbitration of a particular type of claim, the analysis is straightforward: The conflicting rule is displaced by the FAA." The Court elaborated: "[a]lthough § 2's saving clause preserves generally applicable contract defenses, nothing in it suggests an intent to

preserve state-law rules that stand as an obstacle to the accomplishment of the FAA's objectives."[18] Because it viewed the *Discover Bank* rule as an obstacle to the FAA's objectives, the U.S. Supreme Court invalidated it.

The U.S. Supreme Court also explained that class arbitrations can be inefficient and unwieldy. It stated:

> Classwide arbitration includes absent parties, necessitating additional and different procedures and involving higher stakes. Confidentiality becomes more difficult. And while it is theoretically possible to select an arbitrator with some expertise relevant to the class-certification question, arbitrators are not generally knowledgeable in the often-dominant procedural aspects of certification, such as the protection of absent parties. The conclusion follows that class arbitration, to the extent it is manufactured by *Discover Bank*, rather than consensual, is inconsistent with the FAA.[19]

It is unclear how the *AT&T Mobility* decision will affect the law of arbitration in California. However, it seems relatively certain that *Gentry,* which relied on *Discover Bank* in holding that class action waivers are not enforceable in the context of a wage and hour claim, cannot survive *AT&T Mobility.* Thus, it seems unlikely that a California trial court judge would invalidate a class action waiver in the wage and hour context. Indeed, many employers may add class action waivers to their arbitration agreements for the sole purpose of avoiding wage and hour or other employment-related class actions.

But what of other California cases that have invalidated arbitration clauses deemed unconscionable? Take, for instance, the *Sonic-Calabasas* decision discussed in the first part of this article. Does the U.S. Supreme Court's strongly pro-arbitration ruling in *AT&T Mobility*—which flatly rejects the unconscionability argument of *Discover Bank*—mean that an arbitration clause can in fact require the waiver of a Berman hearing, just as it can require the waiver of a class action? Indeed, are all of the rules of fairness and public policy articulated in *Armendariz* at risk in a post- *AT&T Mobility* world, in which doctrines that are deemed "obstacles" to enforcing the purpose of the FAA must be jettisoned?

While these are hugely important and complex issues which will surely be litigated in the trial and appellate courts over the next few years, the answer should be no, not all California rulings are at risk in light of *AT&T Mobility.* First, the U.S. Supreme Court made it clear that the savings clause in § 2 of the FAA generally means that a court may invalidate an arbitration agreement on the same grounds that it may invalidate other contracts under state law. Clearly, California state courts may invalidate contracts that are unconscionable. Second, the Court in *AT&T Mobility* spent a great deal of time focusing on class actions and why they are particularly unsuited for arbitration. This could well provide a basis for distinguishing cases such as *Sonic-Calabasas* and *Armendariz*, which do not involve class arbitrations. While it is impossible to predict whether these California Supreme Court cases will survive *AT&T Mobility,* there is certainly good reason to think that they can.

[Sonic Calabasas] clearly held that an arbitration agreement may not deprive an employee of the opportunity to bring a wage claim to a Berman hearing.

ENDNOTES

1. *Armendariz v. Foundation Health Psychcare Servs., Inc.*, 24 Cal. 4th 83 (2000).
2. *Sonic-Calabasas, Inc. v. Moreno*, 51 Cal. 4th 659 (2011).
3. Cal. Lab. Code § 98.
4. *Sonic,* 51 Cal. 4th at 670.
5. *Id.* at 672-74.
6. *Id.* at 678.
7. *Id.* at 679, quoting *In Re Trombley*, 31 Cal. 2d 801, 809 (1948).
8. *Id.*
9. *Id.*
10. *Id.* at 672.
11. *Id.* at 699.
12. *AT&T Mobility LLC v Concepcion*, 179 L. Ed. 2d 742 (2011).
13. *Discover Bank v. Superior Court*, 36 Cal. 4th 148 (2005).
14. *Gentry v. Superior Court*, 42 Cal. 4th 443 (2007).
15. 9 U.S.C. §§ 1–16.
16. *AT&T Mobility*, 179 L. Ed. 2d at 747.
17. 9 U.S.C. § 2.
18. *AT&T Mobility*, 179 L. Ed. 2d at 752-53.
19. *Id.* at 756.