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eAlert - California Courts Continue Restriction and Refinement of Arbitration Agreement Enforceability

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On February 24, 2011, the California Supreme Court issued its decision in Sonic-Calabasas A, Inc. v. Moreno (Case No. S174475). In a contentious 4 – 3 decision, the Court's 37-page majority opinion held that an arbitration agreement cannot mandate a bypassing of the Division of Labor Standards Enforcement ("DLSE") Berman hearing process. The Court held that a provision that purports to waive an employee's right to an evidentiary hearing before the DLSE is unconscionable and against public policy of California.

The basic facts of the case are simple. As a condition of his employment with an automobile dealership, Plaintiff Frank Moreno signed a pre-dispute arbitration agreement pursuant to the Federal Arbitration Act, requiring both parties to submit to binding arbitration "all disputes that may arise out of the employment context . . . that either [party] may have against the other which would otherwise require or allow resort to any court or other governmental dispute resolution forum."

The agreement also included three exceptions to the "all disputes" coverage: "claims arising under the National Labor Relations Act which are brought before the National Labor Relations Board, claims for medical and disability benefits under the California Workers Compensation Act and Employment Development claims."

After Moreno's employment ended, he filed an administrative wage claim with the California Labor Commissioner for alleged unpaid vacation pay. In response, the employer filed a motion with the Superior Court to compel arbitration of the claim and dismiss the pending administrative action before the Labor Commissioner (referred to as a "Berman proceeding"). The trial court denied the employer's motion, finding that under California law the arbitration provision was unenforceable as a matter of public policy. The employer appealed.

The appellate court reversed. Based on the agreement's clear language, the Court determined that, other than the administrative remedies expressly listed as exceptions to the waiver, the plaintiff must arbitrate all employment claims. The agreement contained no exception for administrative proceedings before the Labor Commissioner.

The California Supreme Court reviewed the following two questions: 1) Whether a mandatory employment arbitration agreement may operate to waive wage claim administrative proceedings before the Labor Commissioner concerning an employee's statutory wage claim? (2) Whether the California Labor Commissioner's jurisdiction over employee statutory wage claims is divested by the Federal Arbitration Act under Preston v. Ferrer, 552 U.S. 346 (2008)?

The answer to both questions was a resounding "no." First, the Court observed that the entire statutory scheme establishing the DLSE process for pursuing wage claims contains important rights and protections that are "designed to assist employees" through the process and "deter frivolous employer defenses." The Court held that an arbitration agreement that required an employee to waive these rights and protections was unconscionable and against California's declared public policy. On the second question, the Court determined that where a term in a contract is unconscionable and violates public policy it is simply "beyond the scope of F[ederal ]A[rbitration ]A[ct] preemption."

In a noteworthy 29-page dissent, three justices opined that the broad equating of administrative process "advantages" with fundamental public policy would lead to many other opportunities for ignoring the parties' original contractual intent to arbitrate, as there are many other statutes offering arguably "advantageous" agency procedures. This would be directly contrary to the state policy favoring arbitration, and to U.S. Supreme Court precedent concerning the preemptive force of the Federal Arbitration Act.

This decision puts an end to an employer's ability to compel Labor Commissioner wage claims into arbitration. The opportunity to arbitrate such claims will only come about in the event of an employer's appeal of an unfavorable agency decision, and will require the expense of a bond and possible court action to obtain an order compelling the arbitration. The promise and utility of arbitration, in California, has again suffered a diminishing blow.

Should you have any questions about the impact of this decision on your organization's arbitration agreement, please contact Kirstin E. Muller at kmuller@chklawyers.com or Glen E. Kraemer at gkraemer@chklawyers.com, both resident in our Santa Monica, CA office.