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CALIFORNIA COURTS BREATHE RENEWED LIFE INTO UNCONSCIONABILITY ARGUMENTS AGAINST THE ENFORCEMENT OF EMPLOYMENT ARBITRATION AGREEMENTS

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The California Supreme Court recently issued its first ruling interpreting the U.S. Supreme Court's 2011 decision in *AT&T Mobility v. Concepcion*. *Concepcion,* in a broad statement of the Federal Arbitration Act (FAA)'s preemptive effect on state-court rules and state statutes which act to deter the FAA's stated preference for arbitration, overturned a California Supreme Court decision finding unconscionable and unenforceable a consumer arbitration agreement which waived the ability to seek class-wide relief. In *Moreno v. Sonic-Calabasis A, Inc*., No. S174475 (Cal., Oct. 17, 2013),(*Sonic II*, as this marks the second time the California Supreme Court has heard this case), the Court recognized, but narrowly interpreted, the impact of the *Concepcion* decision on its jurisprudence.

In *Sonic II*, the issue before the Court was the enforceability of an arbitration agreement which waived the employee's right to a hearing before the California Labor Commission. While admitting its prior opinion (in *Sonic I*), which held the arbitration agreement per-se unenforceable, was preempted by the FAA under the reasoning of *Concepcion*, the Court explained that notwithstanding *Concepcion,* "unconscionability remains a valid defense to a petition to compel arbitration" in California. The *Sonic II* Court reiterated its general hostility toward arbitration agreements in the employment context, noting its "concern with the impermissible waiver of certain rights and protections as a condition of employment before a dispute has arisen."

The *Sonic II* decision arguably lessens the standard for finding employment arbitration agreements unconscionable. In defining what makes an arbitration agreement unconscionable, the Court explained that unconscionable agreements are those whose terms are: "overly harsh," or "unduly oppressive," or "so one-sided as to shock the conscience," or "unfairly one-sided," or "unreasonably favorable to the more powerful party." Ultimately, the Court did not resolve the question of whether the arbitration agreement at issue in *Sonic II* is unconscionable, sending the case back to the trial court to hear evidence and argument on the issue based on its guidance.

However, it is *Sonic II* Court's description of unconscionable agreements as those with terms "unreasonably favorable to the more powerful party"

that is worrying to employers who wish to enforce arbitration agreements in California. Employers are certainly the "more powerful" party in employment arbitration agreements and, as the *Sonic II* dissent pointed out, finding an arbitration agreement "unreasonably favorable" suggests the Court is setting a considerably lower bar for unconscionability that the previous "shocks the conscience" standard.

California courts have already begun rigorously analyzing employment arbitration agreements, focusing on employees' unconscionability defenses. Earlier this year, a California Court of Appeals refused to compel arbitration in an employment dispute where the agreement allowed the employer to take trade secret claims to court while requiring the employee to submit her employment-related claims to arbitration. In *Compton v. American Management Services, LLC,* No. B236669, (Cal. Ct. App., Mar. 19, 2013), the Court found that the reservation by the employer of the right to access the courts while depriving employees of that right was unconscionably one-sided. Additionally, the arbitration agreement shortened to one year the time period for the employee to raise disputes and suggested, contrary to the statutory protections provided employees, that the employee would not be entitled to an award of attorneys' fees even if she prevailed at the arbitration. These provisions, the California Court of Appeals held, rendered the arbitration agreement unconscionably one-sided and thus not a valid, enforceable agreement to arbitrate.

Last week, the U.S. Court of Appeals for the Ninth Circuit weighed in on California's unconscionability standards. In *Chavarria v. Ralphs Grocery Co.,* No. 11-56673 (9th Cir. Oct. 28, 2013), the court refused to enforce an employment arbitration agreement, finding the agreement procedurally and substantively unconscionable. The Court found the arbitration agreement in *Chavarria* to be procedurally unconscionable because it was provided to the employee on a "take it or leave it" basis at the time she applied for employment and because the terms of the arbitration agreement were not provided to her until three weeks after she signed the agreement. The Court also found the arbitration agreement to be substantively unconscionable due to an arbitrator selection process which it believed would always favor the employer's choice of arbitrator. Additionally, because the agreement left open the manner in which costs and fees might be apportioned between the employer and employee, the Court found the agreement to unconscionably "price the employee" out of the arbitration process.

What do these developments mean for employers? The takeaway for employers is that employment arbitration agreements are going to receive heightened scrutiny and continue to be viewed with hostility in California courts. Accordingly, employers who wish to utilize arbitration agreements should ensure the agreements are as fair as possible to their employees. What that practically means is that, to have the best chance of being enforced by California courts, arbitration agreements should not substantially remove or alter the protections available to those employees who can bring their employment-related disputes in court. For example, employers should remove the following provisions if they are currently within their arbitration agreements:

- Provisions which significantly reduce the time period when claims must be brought by the employee;
- Provisions which reserve the right to bring employer-specific claims, *i.e.,* claims concerning alleged trade secret or non-solicitation violations, in court while requiring all employee-specific claims be arbitrated;
- Arbitration procedures which provide for significantly reduced discovery;

- Any provisions which appear – or could be construed – to give the employer an upper hand in the arbitration process; or
- Any provisions which require the employee to incur additional costs beyond what would be incurred in court.

Taking the guidance of these recent California cases to heart, some employers may choose to forego arbitration agreements altogether. Whether employers will want to enact arbitration programs which attempt to comply with the heightened, and currently in flux, California standards of "fairness" will depend upon their assessment of their employment litigation risks. While the bar on drafting enforceable arbitration agreements for California employers has been raised by these recent court decisions, arbitration agreements may still be a viable risk management tool for many California employers.

If California employers do believe arbitration agreements are worth pursuing with their employees, they should go further in shoring up their agreements by approaching them as contracts, rather than employment policies. For example, employers should consider adopting some or all of the following practices:

- Removing arbitration agreements from employment applications and employee handbooks;
- Creating a separate arbitration agreement which both the employee and employer must sign;
- Ensuring the employee has access to the terms and conditions of the arbitration process before requiring the employee's agreement to arbitrate;
- Allowing new employees a period of time and advising new employees to seek the advice of counsel before requiring the employee to an arbitration agreement;
- Actively inviting discussion with the employee about the terms of the agreement; and
- Providing additional consideration, usually monetary, to current employees they wish to bind to arbitration agreements.

Finally, the *Sonic II* decision did not shed light on how the Court will rule on the specific question of the enforceability of class action waivers in employee arbitration agreements – perhaps the biggest question for employers trying to protect themselves against expensive wage/hour class and collective actions. The California Supreme Court will address that issue in another case currently before it, *Iskanian v. CLS Transportation Los Angeles.* But certainly California courts have indicated their intention to continue to seek ways to avoid enforcement of employment arbitration agreements and to limit the scope of *Concepcion* and other recent pro-arbitration decisions of the U.S. Supreme Court. While the law is still developing on these issues, employers who wish to have the possibility of avoiding California courts in their employment disputes have at least now been provided some guidance on what arbitration agreements will pass muster in California and those which will be denied enforcement as unconscionable.
