April 29, 2011

California courts will no longer enforce arbitration agreements to the extent that they require employees to waive the option of an administrative hearing (known as a "Berman" hearing) before the California Labor Commissioner. In an important opinion on February 24, 2011, the California Supreme Court ruled in *Sonic-Calabasas A, Inc. v. Moreno* that a Berman waiver in an arbitration agreement is "contrary to public policy and unconscionable."[1]

Background on Berman hearings

A California employee with a wage claim may seek judicial relief by filing a civil action in court. Or the employee may seek administrative relief by filing his or her wage claim with the Labor Commissioner. If the Labor Commissioner decides to accept the matter, it may hold a Berman hearing for the recovery of wages, penalties, and other demands for compensation.[2]

Berman hearings afford several advantages to prevailing employees. First, the decision is almost immediately enforceable as a judgment, and the Labor Commissioner is required to expend best efforts in enforcing the award. Second, if the employer appeals, it must post a bond equal to the amount of the award. Third, attorney fees are imposed on employers who unsuccessfully appeal but not on employees who unsuccessfully defend the award. Fourth, if the employer appeals, the Labor Commissioner must represent the employee if he or she cannot afford an attorney.[3]

The *Sonic-Calabasas* decision

As a condition of his employment with Sonic-Calabasas, Frank Moreno signed an arbitration agreement that required both parties to arbitrate all employment disputes "which would otherwise require or allow resort to any court or other governmental dispute resolution forum."[4] Later, Moreno filed a claim for unpaid vacation time and "waiting time" penalties with the Labor Commissioner. Sonic unsuccessfully petitioned the trial court to compel arbitration and dismiss the pending administrative action. The appellate court reversed, holding that the arbitration agreement constituted a waiver of Moreno's right to seek a Berman hearing.

In a 4-3 decision, the California Supreme Court upheld the trial court's holding that the arbitration agreement was contrary to public policy and unconscionable. The majority rejected the Court of Appeal's framework for determining whether the absence of a Berman hearing significantly impairs an employee's statutory right to recover unpaid wages. "Rather, the question is whether the employee's statutory right to seek a Berman hearing, with all the possible protections that follow from it, is itself an unwaivable right…. We conclude that it is."[5]

The Court ruled that the waiver was contrary to public policy because the Legislature designed the Berman procedures to encourage the pursuit of meritorious wage claims and discourage frivolous employer appeals. Unlike arbitration, which "bears the hallmark" of formal legal proceedings, Berman hearings are relatively informal, and employees can pursue their claims without the need of counsel.[6] Further, successful claimants are afforded the above-mentioned procedural advantages if the employer decides to appeal.

The majority opinion found the waiver was procedurally and substantively unconscionable. First, it was procedurally unconscionable because the arbitration agreement—imposed as a condition of employment—was a contract of adhesion. Second, the waiver was

substantively unconscionable because only the employer benefits from eliminating the employee-friendly Berman procedures.

The Court also found that the Federal Arbitration Act (FAA) did not preempt its holding. Under section 2 of the FAA, state courts may refuse to enforce an arbitration agreement based on generally applicable contract defenses, such as unconscionability.[7] State courts may not, however, apply these defenses in a manner that discriminates against arbitration. Because Berman waivers in non-arbitration agreements are equally unenforceable, the Court reasoned that its holding does not violate the FAA.[8]

Practical considerations

The California Supreme Court's decision in *Sonic-Calabasas* does not preclude arbitration of employment disputes. Rather, an employer's arbitration agreement must permit employees the option of filing a wage claim with the Labor Commissioner. The employer may then appeal any decision by the Labor Commissioner to an arbitrator pursuant to the arbitration agreement.

If the employer appeals the Labor Commissioner's award, the post-Berman procedures will apply in the arbitration. Thus, employers who appeal must post a bond equal to the amount of the award, employers who unsuccessfully appeal must pay the employee's attorney fees, and the Labor Commissioner must represent employees who cannot afford counsel for the arbitration.[9]

As a practical matter, employers may consider redrafting their standard arbitration agreements to account for this important change in California law in order to ensure that all procedures subsequent to a Berman hearing proceed in arbitration. Our attorneys have deep counseling and litigation experience on these arbitration issues. If you would like to discuss these issues further or have questions about this *Alert*, please contact one of the attorneys listed above.

Notes

1 51 Cal. 4th 659, 669 (2011).

2 Cal. Labor Code § 98(a).

3 Id. §§ 98–98.4.

4 *Sonic-Calabasas,* 51 Cal. 4th at 670.

5 *Id.* at 678.

6 *Id.* at 680.

7 9 U.S.C. § 2.

8 *Sonic-Calabasas*, 51 Cal. 4th at 688–89.

9 *Id.* at 676.

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