

HOSPITALITY ALERT

PRE-EMPLOYMENT ARBITRATION AGREEMENTS THAT PREVENT EMPLOYEES FROM FILING CLAIMS FOR UNPAID WAGES WITH THE CALIFORNIA LABOR COMMISSIONER ARE UNENFORCEABLE

On February 24, 2011, a divided California Supreme Court ruled in *Sonic Calabasas A, Inc. v. Moreno*, S174475, that a worker who signs an otherwise valid pre-employment arbitration agreement does not give up his statutory right to seek administrative relief through Labor Commissioner hearings. In other words, even if that worker signed a mandatory arbitration agreement, that worker is still free to file and pursue a claim with the Labor Commissioner for unpaid wages and/or other benefits allegedly due.

The Facts of the Moreno Case

Frank Moreno was a former employee of Sonic Calabasas A, Inc. ("Sonic"), the owner and operator of an automobile dealership. As a condition of his employment with Sonic, Mr. Moreno signed an arbitration agreement that required both Sonic and Mr. Moreno to submit employment disputes to "binding arbitration under the Federal Arbitration Act, in conformity with the procedures of the California Arbitration Act."

However, the arbitration agreement used by Sonic specifically excluded National Labor Relations Act claims, and Worker's Compensation Act claims, from the arbitration mandate. The arbitration agreement also stated explicitly that employees were not prohibited from "filing and pursuing administrative proceedings only before the California Department of Fair Employment and Housing or the U.S. Equal Opportunity Commission." But Sonic's arbitration agreement was silent as to Labor Commissioner claims; they were specifically neither excluded nor included.

After leaving his position with Sonic, Mr. Moreno filed an administrative wage claim with the California Labor Commissioner for unpaid vacation pay pursuant to California Labor Code Section 98 *et seq.* In response, Sonic petitioned the Superior Court to compel arbitration of Mr. Moreno's claim and to dismiss entirely the Labor Commissioner proceeding. The Superior Court denied Sonic's petition. Sonic appealed.

While Sonic's appeal was pending, the U.S. Supreme Court decided *Preston v. Ferrer*, 552 U.S. 346 (2008). In *Preston*, the U.S. Supreme Court held that the Labor Commissioner's exclusive jurisdiction California's Talent Agencies Act was preempted by the Federal Arbitration Act ("FAA") because the parties signed a commercial contract that contained an arbitration agreement governed by the FAA.

After ruling that *Preston* was not controlling, the Court of Appeal reached the same result and upheld the parties' arbitration agreement. The Court ruled that Mr. Moreno was barred from pursuing his administrative claim with the Labor Commissioner's office because that claim did not fall under one of the specifically enumerated exceptions in the arbitration agreement.

Mr. Moreno then appealed to the California Supreme Court claiming the appellate court decided the case incorrectly. Sonic claimed that the appellate court was correct and reiterated its position that, in light of the *Preston* decision, the FAA preempted the case and mandated that Mr. Moreno's claims be arbitrated rather than pursued before the Labor Commissioner.

The Moreno Court's Analysis and Ruling

The first question before the California Supreme Court in *Moreno* was whether a pre-employment arbitration

agreement that compelled arbitration of administrative wage claims was contrary to California public policy or unconscionable. On that question, the Court held that the language in Sonic's arbitration agreement was both in violation of public policy and unconscionable. Therefore, the Court concluded that the Sonic arbitration agreement could not be used to prohibit Mr. Moreno from pursuing his pre-litigation administrative action with the Labor Commissioner's office. The legislature conveyed too many important, fundamental benefits on employees when it created the Labor Commissioner framework. To ask workers to waive those intended benefits, held the Court, violated California public policy and was unconscionable.

However, the Court ruled that the Sonic arbitration agreement could be enforced after the Labor Commissioner's process had concluded. For example, if the Labor Commissioner ruled against Mr. Moreno, and if Mr. Moreno sought to appeal that decision, the Sonic arbitration agreement could be used by the employer to force Mr. Moreno's appeal to be heard before an arbitrator rather than in court.

The second question before the *Moreno* Court was whether, based on the U.S. Supreme Court's decision in *Preston*, the FAA mandated a different outcome. The Court ruled that it did not. According to *Moreno*, *Preston* does not pre-empt a state's authority to impose "preliminary proceedings" that may delay arbitration provided that those preliminary proceedings pursue important state goals. The Labor Commissioner process is one such proceeding. Although it delays arbitration, it does not prevent it, and it furthers the crucial state interest of "serving as a gateway to obtaining special protections that enable the protection of [workers'] claims." Therefore, the California Supreme Court held that the FAA did not mandate arbitration of Mr. Moreno's administrative claims before the Labor Commissioner.

Impact on California Employers

As a result of *Moreno*, employers can no longer attempt to use a signed arbitration agreement to prevent an employee from pursuing claims for unpaid wages through the Labor Commissioner's office. Those administrative claims will be allowed to proceed. At the conclusion of the administrative process, however, the terms of an otherwise valid arbitration agreement will control. The employer can then use its arbitration agreement to compel arbitration of post-hearing

litigation (including appeals) provided that the arbitration agreement is written properly to include such litigation (and appeals) in the definition of claims which must be arbitrated.

Interestingly, *Moreno* is likely not the final word on federal FAA preemption in California. The U.S. Supreme Court is expected soon to issue its decision in *AT&T Mobility v. Concepcion*, 130 S. Ct. 3322 (2010), which addresses whether states like California may subject arbitration agreements to "unconscionability" or other tests that thwart the purpose of the FAA.

In *AT&T Mobility*, the issue was whether an arbitration clause in a cell phone service contract that effectively bans class action litigation is unconscionable. If the answer to that question from the business-friendly U.S. Supreme Court is "No," as many predict, then companies can force individual consumers into individual arbitration actions and, in the process, take away their collective class action litigation rights. The *AT&T Mobility* case was argued before the U.S. Supreme Court in November 2010, so a decision is expected soon.

Depending on how the U.S. Supreme Court rules in *AT&T Mobility*, and depending on how broadly or narrowly the Court writes its opinion, we may find that the California Supreme Court's *Moreno* decision is no longer good law in California for arbitration agreements governed by the FAA. Stay tuned!

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