No. 19-875

In the
Supreme Court of the United States

OTO, L.L.C.,
Petitioner,

v.

KEN KHO, ET AL.,
Respondents.

On Petition for Writ of Certiorari to the Supreme Court of California

BRIEF OF THE CIVIL JUSTICE ASSOCIATION OF CALIFORNIA AS *AMICUS CURIAE* IN SUPPORT OF PETITIONER

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QUESTION PRESENTED

Does the California Supreme Court's decision holding an employment arbitration agreement unconscionable because it substitutes a "more procedurally protective" arbitral hearing for an administrative agency hearing create conflicts with the Federal Arbitration Act and relevant decisions of this Court?

TABLE OF CONTENTS

TABLE OF AUTHORITIES

CASES

STATUTES

OTHER AUTHORITIES

INTEREST OF AMICUS[1]

The Civil Justice Association of California ("CJAC") is a nonprofit organization whose members are businesses, professional associations and financial institutions. CJAC's principal purpose is to educate the public and its governing bodies about how to make laws determining who gets paid, how much, and by whom when the conduct of some occasions harm to others – more fair, certain, and economical. Toward this end, CJAC regularly appears as amicus curiae in numerous cases of interest to its members, including those that concern the scope and application of the Federal Arbitration Act ("FAA").

CJAC's members collectively employ thousands of people in California and hundreds of thousands nationally to provide various products and services. Most of CJAC's members have elected, as have many employers throughout the country,[2] to resolve disputes with their employees over employment matters, including wage disputes, through binding arbitration.

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[1] Counsel of record for the parties received timely notice of the intent to file this brief and consented to its filing. No counsel for any party in this case authored this brief in whole or in part. No person or entity aside from *amicus*, its members, or their respective counsel made a monetary contribution to the preparation or submission of this brief.

[2] According to one study, approximately 55 percent of the workforce, or 60 million employees, are covered by employment arbitration agreements. Alexander J.S. Colvin, *Economic Policy Institute* (Sept. 27, 2017), available at https://www.epi.org/publication/the-growing-use-of-mandatory-arbitration/.

CJAC applauds this Court's consistent line of opinions upholding the FAA's broad preemptive sweep requiring that agreements to decide disputes by arbitration be placed on an "equal footing" with other contracts and enforced accordingly. The opinion at issue here, however, thwarts contractual arbitration by uniquely applying the state's unconscionability doctrine to void agreements that substitute an arbitral hearing with more procedural protections for the parties than an otherwise available and more informal administrative agency hearing. This constitutes a major roadblock to arbitration at odds with the FAA and sound precedents of this Court.

INTRODUCTION

The California Supreme Court decided, contrary to this Court's applicable precedents limning the FAA, that the arbitration agreement is unconscionable and unenforceable because it contained procedural rules and procedures akin to those in civil litigation, too much protection inconsistent with a simpler, more efficient administrative hearing before a state agency.

If left undisturbed, this opinion will place parties to existing employment arbitration agreements and those contemplating entering into such agreements between the "rock and the whirlpool"—confused and confounded over how much or how little procedural protections comparable to those available in civil litigation must be included or omitted from an arbitration agreement for it to pass constitutional muster under the FAA's broad preemptive sweep. Courts and counsel will also be flummoxed by the likely litigation influx the decision spawns as to "how many" and "what kinds" of

procedural protections (singly or in what combination) it will take for an employment arbitration agreement to be valid and enforceable.

The court found protections provided by the agreement fatal to its validity because they "created expense and delay" greater than what the parties would encounter if they were to avail themselves of the informal administrative agency hearing provided by a state statute. Appendix 6a ("App."). Those "rules and procedures" the court deemed objectionable provide the parties "full discovery" in preparation for a hearing before "a retired superior court judge" that conforms to "all the rules of evidence." *Id.* at 4a.

Though the allocation of arbitration expenses is "not addressed explicitly," the agreement specifies that "controlling case law" applies and prevails "over Code of Civil Procedure section 1284.2 if there is a conflict." *Id.* at 5a. Thus, while section 1284.2 provides that parties to arbitration shall bear their own costs, the "controlling case law" of *Armendariz v. Foundation Health Psychcare Services, Inc.*, 6 P.3d 669 (Cal. 2000) requires the employer to pay all costs unique to arbitration. The appellate court interpreted this provision in the agreement as requiring the employer to "pay both the costs of arbitration and a successful claimant's reasonable attorney fees." App. 7a.

This decision disregards the clear terms of the agreement by foisting upon the parties an administrative agency hearing they expressly waived in favor of the arbitral hearing. Though the administrative process is "optional" for both claimants and the agency [*i.e.*, the state Labor Commissioner], it

cannot be dispensed with unless the employee gains "in return any of the efficiencies or cost savings often associated with arbitration." App. 27a. The decision reaches this result by preferring the administrative hearing – called a "Berman hearing" after the legislator who authored the statute providing for it – over the arbitral hearing it bizarrely admits "anticipates a proceeding . . . no more complex than will often be required to resolve a wage claim under the Berman procedures." App. 7a.

Judging by the record of what occurred, however, it is highly doubtful the Berman hearing route the court prefers, and was taken here over the objection of the employer, is speedier and less costly than that prescribed by the arbitration agreement. The Berman hearing permits either party to appeal from it to the superior court, which reviews the claim de novo, and from there to further judicial appeals. *Id.* at 9a. The arbitration hearing, in contrast, is binding and final. Here the respondent got his Berman hearing nine months after he filed his complaint with the administrative agency. Respondent then appealed the agency decision to the superior court; and after that there was an appeal to the intermediate appellate court, where respondent prevailed, and next the petition to the state supreme court. Altogether this process took four years at an expense to the parties the record does not reveal, but no one can deny was substantial and likely greater than the time and cost of the arbitral hearing.

That the court's decision ultimately comes down to its preference for the administrative hearing over the

arbitral one cannot be gainsaid. Though the court found the agreement *procedurally* unconscionable given its adhesive nature (the size of its print and other factors), the "tipping point" persuading the court it was unconscionable was the substitution of the arbitral proceeding for the Berman hearing. This, the opinion tells us, satisfies the second component for finding overall unconscionability, "substantive unconscionability," through the employee's surrender of "Berman procedures . . . in return [for] access to a formal and highly structured arbitration process that closely resemble[s] civil litigation . . .." App. 33a.

Finally, the decision admits that the arbitration agreement with its "process closely resembling civil litigation, can be as advantageous for the employee as for the employer." As an example, the opinion cites to "wrongful discharge claims" where there "is no Berman-like administrative process." *Id.* This equal advantage cannot apply here, however, as the court exclaims it has "taken a different approach in evaluating the compelled arbitration of *wage claims*, as compared to the arbitration of other types of disputes." *Id.*; italics added.

The dissent by Justice Chin pointed out that the majority opinion used the "cloak of unconscionability" to cover its arbitration-specific rule for agreements covering wage disputes. *Id.* at 85a. He explained this violated the FAA's "equal treatment" principle. He also reasoned that the result of the majority opinion was to erect a "preliminary litigation hurdle" that frustrated the "purposes and objective" of the FAA, especially the

"prospect of speedy resolution" of disputes that arbitration is "meant to secure." App. 87a.

SUMMARY OF ARGUMENT

The California Supreme Court's decision lacks due regard for the FAA and numerous opinions of this Court discussing that Act's scope and application. As Justice Chin's dissent states, the majority's insistence that the arbitration agreement is unconscionable because it adopts more procedural protections for arbitration than those available from a state agency procedure it displaces, frustrates "the FAA's purpose to ensure that private arbitration agreements are enforced according to their terms." App. 89a.

The majority opinion adopts important but erroneous rules of law at odds with this Court's analyses of what the FAA requires and prohibits. In addition to petitioner's analysis, amicus presents complementary points for consideration. To begin with, once parties agree to arbitrate all disputes arising under a contract, state law lodging primary jurisdiction in another forum, judicial or administrative, are superseded by the FAA.

Nor may the opinion bolster its "unconscionability" determination by reference to the employee's interest in vindicating his rights under the administrative procedure rather than the agreed upon arbitral one. Those "rights" are based exclusively on a state statute, and this Court's "effective vindication" rule comes into play only when a federal, not a state, statute is implicated with the FAA.

Neither does the opinion comport with the FAA's "equal treatment" principle, which requires courts to place arbitration agreements on an "equal footing" with other contracts. In fact, the decision plainly does not treat contracts in general the same as it does this wage-claim arbitration agreement. This difference in the court's treatment between contracts in general and arbitration agreements stands as a prohibited and preempted obstacle to the accomplishment of the FAA's objectives.

Finally, the decision frustrates the "principal purpose" of the FAA to ensure that private arbitration agreements are enforced according to their terms, by subordinating that purpose to the secondary objective of a speedy and economical resolution of the dispute. For these reasons and others explained in the petition, the Court's review and corrective guidance about the decision is sorely needed.

REASONS TO GRANT THE WRIT

I. THE DECISION TO BAR ENFORCEMENT OF A PRE-DISPUTE ARBITRATION AGREEMENT BECAUSE IT SUBSTITUTES A MORE PROCEDURALLY PROTECTIVE ARBITRAL HEARING FOR AN AGENCY HEARING CONFLICTS WITH THE FAA AND THIS COURT'S PRECEDENTS.

"Here we come, right back where we started from."[3] Where we "started from" is this Court's consistent line

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[3] Buddy DeSylva, Al Jolson & Joseph Meyer, *California Here We Come* (1924).

of opinions for the past 35 years overruling California's hostile decisions and enactments invalidating arbitration agreements.

Things did not start out this way. In fact, California jurisprudence bristles with opinions praising contractual binding arbitration as a viable alternative to more expensive and protracted civil litigation. *E.g.*, *Madden v. Kaiser Foundation Hospitals* (1976) 17 Cal.3d 699, 706-707 ("arbitration has become an accepted and favored method of resolving disputes, praised by the courts as an expeditions and economical method of relieving overburdened civil calendars . . .."). Even the decision in this case pays lip-service to the value of contractual arbitration (App. 13a), though honoring it more in the breach than the observance.

But once arbitration agreements "caught on" and came to be widely used, opposition to them arose. Most of that opposition came from plaintiff attorneys and emphasized that arbitration lacked rights comparable to those available in judicial or administrative fora. "[C]ritic[s] of the widespread use of mandatory arbitration . . . complain that arbitration offers fewer procedural protections than litigation and extremely limited appellate review."[4] California succumbed to this criticism of arbitration and leaped to the forefront of states hostile toward it; the one state "more likely to hold contracts to arbitrate unconscionable than other

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[4] Richard Frankel, *What We Lose in Sales, We Make up in Volume: The Faulty Logic of the Financial Services Industry's Response to the Consumer Financial Protection Bureau's Proposed Rule Prohibiting Class Action Bans in Arbitration Clauses*, 48 ST. MARY'S L.J. 283, 311-312 (2016).

contracts." *AT&T Mobility LLC v. Concepcion*, 563 U.S. 333, 342 (2011) ("*Concepcion*").[5]

A case resolving a conflict between California law and the FAA that is analogous to the issue presented here is *Preston v. Ferrer*, 552 U.S. 346 (2008). There, a state law rule requiring exhaustion of administrative remedies *before* arbitration could occur was held to unconstitutionally conflict with the FAA's preemptive sweep to "achieve streamlined proceedings and expeditious results." *Id*. at 357. This objective, *Preston* observed, would be "frustrated" by requiring a dispute to be first heard by an administrative agency. "[W]hen parties agree to arbitrate all questions arising under a contract, state laws lodging primary jurisdiction in *another* forum, whether *judicial* or *administrative*, are superseded by the FAA." *Id*. at 349-350; italics added.

What *Preston* held a statute could not require of an arbitration agreement, the decision here requires the opposite of for all agreements that cover employment wage-claims. Courts and counsel need and deserve clarification from the Court as to whether, despite the authority of *Preston* and its cognates, the opinion permits a state to strike down agreements to arbitrate disputes if the parties substitute the arbitral hearing for one available before an administrative agency.

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[5] "Courts applying California law are most likely discriminating against arbitration agreements in a manner that is preempted by the interpretation of the FAA advanced by the Supreme Court." Paul Thomas, *Conscionable Judging: A Case Study of California Courts' Grapple with Challenges to Mandatory Arbitration Agreements*, 62 HASTINGS L.J. 1065, 1084 (2011).

Similarly, a state statute, Cal. Lab. C. § 229, authorizing lawsuits for unpaid wages "without regard to the existence of any private agreement to arbitrate," was held preempted because it conflicted with the FAA. *Perry v. Thomas,* 482 U.S. 483, 490 (1987).

Holding as *Perry* and *Preston* did that a state cannot require an arbitration agreement to take a back seat to an administrative agency hearing or a specific state statutory remedy for unpaid wages, is tantamount to permitting parties to waive state administrative or judicial remedies in favor of arbitration. Indeed, waiving one's right to either a judicial or administrative proceeding is not only sanctioned by the FAA, but banning or preventing such a waiver is contrary to it. *Southland Corp. v. Keating*, 465 U.S. 1 (1984), for instance, decided this when it considered if California's franchise investment statute voiding any contract to arbitrate claims in which a party waived any provision of that statute comported with the FAA. The court held it did not: "The California Supreme Court interpreted this statute to require judicial consideration of claims brought under [it] . . . and accordingly refused to enforce the parties' contract to arbitrate such claims. So interpreted the California . . . law directly conflicts with § 2 of the [FAA] and violates the Supremacy Clause." *Id*. at 10. "In enacting § 2 . . ., Congress declared a national policy favoring arbitration and *withdrew the power of the states to require a judicial [or administrative] forum . . ..*" *Id*.; italics added.

Section 2 reflects a "liberal federal policy favoring arbitration," *Moses H. Cone Memorial Hospital v.*

Mercury Constr. Corp., 460 U.S. 1, 24 (1983) and the "fundamental principle that arbitration is a matter of contract." *Rent-A-Center, West, Inc. v. Jackson,* 561 U.S. 63, 67 (2010).

Another opinion that poses serious constitutional concerns about this decision is *Concepcion*, *supra*, 563 U.S. at 333, which holds that the FAA preempts a California rule that invalidated most class action waivers in adhesion contracts, including arbitration agreements, as unconscionable. Of particular significance to this case is *Concepcion*'s statement 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." *Id*. at 341. The opinion here did what *Concepcion* prohibits; it declared the agreement unconscionable because it provided more procedural safeguards for the parties in arbitration than the administrative agency hearing displaced by the agreement.

A. The Decision Rests on the Erroneous Ground that an Arbitration Agreement is Unconscionable if it does not Provide a Party "Effective Vindication" of a State Statutory Right.

The decision declares the arbitration agreement unconscionable because it constitutes a "barrier to the vindication of [respondent's] statutory rights." App. 27a. Those statutory rights are set forth in state law, Cal. Labor Code § 98 et. seq., a "Berman hearing" "designed to provide a speedy, informal, and affordable method of resolving wage claims." App. 8a. The right consists of a wage claimant filing a complaint with the

Labor Commissioner, receiving an answer from the employer, dispensing with all discovery and technical rules of evidence, and receiving a decision within 15 days after the informal hearing. Either party may appeal the decision to the superior court, which then reviews the claim de novo; but if the employer appeals, a bond in the amount of the award must be posted. *Id*.

Assume *arguendo* that procedural rights afforded by the arbitration agreement akin to those in civil litigation are, as the decision here states, a barrier to respondent's more informal rights under the "Berman hearing." No matter; it is of no legal consequence and cannot be used to bolster a state court's unconscionability finding. *American Express Co. v. Italian Colors Restaurant*, 570 U.S. 228 (2013) ("*Amex*") teaches that a class action waiver is enforceable even though it violates an "unconscionability" rule based on a "vindication rationale" originating, as here, in *state* as opposed to *federal* law. *Id*. at 235-239; italics added.

As Justice Kagan's dissent in *Amex* clarifies, the effective vindication doctrine is confined to federal, not state law, claims. An arbitration agreement "may not thwart federal law, irrespective of exactly how it does so," and the effective vindication principle must be reconciled with the FAA and "all the rest of *federal* law." 570 U.S. at 240. "Our effective-vindication rule comes into play *only* when the FAA is alleged to conflict with another *federal* law . . .." *Id*. at 252; italics added. "We have no earthly interest (quite the contrary) in vindicating [a state] law" that is inconsistent with the FAA, so the state law must "automatically bow" to federal law; any effective-vindication exception that

might possibly exist would "come into play only when the FAA is alleged to conflict with another federal law." *Ibid.*

B. The Decision Fails to Give Due Regard to the FAA's Requirement that State Courts cannot use "Unconscionability" to Discriminate Against Arbitration Agreements.

To remedy the problem of state judicial hostility to contractual arbitration, Congress built an "equal-treatment principle" into the FAA, requiring courts to "place arbitration agreements on an equal footing with other contracts." *Kindred Nursing Centers L. P. v. Clark*, 137 S. Ct. 1421 (2017). Any state rule treating arbitration agreements worse than other contracts "stand[s] as an obstacle" to achieving the Act's purposes—and is preempted. *Concepcion*, *supra*, 563 U.S. at 343. That means the FAA displaces any state rule discriminating on its face against arbitration. See *id.* at 341.

And the FAA likewise preempts any more subtle law "disfavoring contracts that (oh so coincidentally) have the defining features of arbitration agreements." *Kindred Nursing*, 137 S. Ct. at 1427. Those "defining features" or "fundamental attributes" include "limiting . . . issues subject to arbitration," agreeing to "arbitrate according to specific rules and to limit with whom a party will arbitrate its disputes." *Concepcion, supra*, 563 U.S. at 343. What matters is whether the state law in question "target[s]" arbitration agreements, blatantly or covertly, for substandard treatment. *Epic Systems Corp. v. Lewis,* 138 S. Ct. 1612, 1622 (2018).

Here, the California Supreme Court fashioned a new rule of unconscionability focused solely on arbitration agreements governing employee wage claims. That rule deems these agreements unconscionable if they provide for procedures not as "streamlined" as the administrative proceeding the agreements displace for the arbitral one. It does not place arbitration contracts "on equal footing with all other contracts," *Buckeye Check Cashing, Inc. v. Cardegna,* 546 U.S. 440, 443 (2006), because California courts would not interpret contracts other than arbitration contracts the same way. Indeed, the language the court uses to frame the issue it decides focuses only on arbitration, and wage-claim arbitration at that.

The "equal treatment" principle extends beyond overt discrimination, "displac[ing] any [state] rule [of unconscionability] that covertly accomplishes the same objective." *Kindred Nursing*, *supra*, 137 S. Ct. at 1426. Although the FAA's "saving clause preserves generally applicable contract defenses," it does not "preserve state-law rules that stand as an obstacle to the accomplishment of the FAA's objectives." *Concepcion, supra*, 563 U.S. at 343. Nor does it permit state courts, in addressing the concerns that attend contracts of adhesion, "to take steps" under the rubric of unconscionability that "conflict with the FAA or frustrate its purpose to ensure that private arbitration agreements are enforced according to their terms." *Id.* at 347, fn. 6; App. 88a.

C. The Decision Erroneously Elevates the FAA's Encouragement of Efficient and Speedy Dispute Resolution Over the Enforcement of Private Agreements to Arbitrate.

The decision reverses the primary purpose of the FAA (to uphold the terms of private agreements to arbitrate) and elevates in its place a secondary purpose – the speedy, efficient and economical resolution of the dispute. This switching of the order of importance of two purposes the FAA seeks to further that can be consistent or occasionally conflicting is significant. When a statute is susceptible of either of two opposed interpretations, courts must read "it in the manner which effectuates rather than frustrates the *major purpose* of the legislative draftsmen." *Shapiro v. U.S.*, 335 U.S. 1, 31 (1948); italics added.

And there is no doubt about the "major" or "principal" purpose of the FAA. "The 'principal purpose' of the FAA is to ensur[e] that private arbitration agreements are enforced according to their terms." *Volt Information Sciences, Inc. v. Board of Trustees of Leland Stanford Junior Univ.,* 489 U.S. 468, 478 (1989) ("*Volt*").

Dean Witter Reynolds, Inc. v. Byrd, 470 U.S. 213, 219 (1985) illustrates that when the terms of an arbitration agreement result in a procedure that is not "streamlined and inexpensive," the agreement should still be enforced. Acknowledging that a goal of contractual arbitration is to expedite the resolution of disputes, *Dean Witter* clarified what courts should do when that secondary goal of "efficiency and economy"

is not ideally or fully achieved by an arbitration agreement: "[W]e reject the suggestion that the overriding goal of the Arbitration Act was to promote the expeditious resolution of claims"; *id.* at 219, 217. "[T]he intent of Congress requires us to apply the *terms of the Act without regard to whether the result would be "possibly inefficient*"; cf. *id.* at 220; italics added.

Since "[t]he thrust of the federal law is that arbitration is strictly a matter of contract," the parties to an arbitration agreement should be "at liberty to choose the terms under which they will arbitrate." *Volt*, *supra*, 489 U.S. at 473.

CONCLUSION

For all the aforementioned reasons, amicus urges the Court grant the petition for a writ of certiorari.

Respectfully submitted,

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