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Employment Law Alert

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California Supreme Court Clarifies Interplay Between the Federal Arbitration Act and California Law on Unconscionability

The California Supreme Court has just added another chapter to the story about the preemptive effect of the Federal Arbitration Act (FAA) on California law regarding the doctrine of unconscionability as applied to arbitration agreements. The new case is Sanchez v. Valencia Holding Co., LLC (No. S199119, Aug. 3, 2015). Although *Sanchez* arose in a consumer context, some of its holdings will shape the arguments for and against a finding that an arbitration agreement in an employment contract is unconscionable.

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Sanchez involved a dispute, pled as a class action, between the purchaser of a used luxury automobile and the automobile dealer. The complaint contained a cause of action based on the Consumer Legal Remedies Act (CLRA). The dealer moved to enforce the arbitration provision in the sales contract that included these features: (1) a class action waiver, contrary to the CLRA's anti-waiver provision; (2) an "appeal," or right to a second arbitration, if the award was for $0 or exceeded $100,000, or if the arbitrator ordered injunctive relief; (3) the "appealing" party would be responsible for the "appeal" costs, subject to apportionment by the arbitrators; and (4) self-help remedies and small claims court actions were not subject to arbitration. The trial court and Court of Appeal denied enforcement of the arbitration provision, with the appellate court holding that it was procedurally and substantively unconscionable for several reasons even though the FAA required enforcement of the class action waiver.

The California Supreme Court reversed. At the outset, the court reviewed the California cases that have articulated varying definitions for an unconscionable contract, including "overly harsh," "unduly oppressive," or "so one-sided as to shock the conscience." The court held that there was no conceptual difference among these terms -- they all require something more than a showing the deal was a bad bargain that favored one side over the other. Next, the court made clear that under the U.S. Supreme Court's decision in *AT&T Mobility LLC v. Concepcion*, the standard for finding unconscionability "must be as rigorous and demanding for arbitration clauses as for any other contract clause." The FAA preempts state laws that facially or as applied single out arbitration provisions that interfere

with the federal policy favoring arbitration. However, this analysis is "highly dependent on context," including the provision's commercial purposes and effect.

Turning to the arbitration provision in question, the Supreme Court noted that its adhesive nature gave rise to some procedural unconscionability. However, the court upheld the provisions that the Court of Appeal had found to be substantively unconscionable. First, the appeal provisions did not obviously favor the dealer and served valid commercial purposes. In particular, the requirement that the appealing party initially pay the costs of the appeal is consistent with the statutes that enact an ability-to-pay approach for arbitrations in a consumer context and that there was no evidence that the appeal costs would have a substantial deterrent effect on the plaintiff's ability to appeal. The court observed that this statutory approach differs from the rule stated in *Armendariz v. Foundation Health Psychare Services, Inc.*, which requires the employer to pay all costs of arbitration for claims based on the Fair Housing and Employment Act. Second, the provision that exempted self-help remedies, while favorable to the dealer, was not unduly one-sided. By definition, self-help remedies occur outside the litigation process and meet a "legitimate commercial need." Finally, the court agreed with the Court of Appeal that, under *Concepcion*, the FAA preempted the CLRA's anti-waiver rule for class actions.

For employers in California, *Armendariz* will continue to be the gold standard regarding the provisions an arbitration provision must include to enforceable. *Sanchez*'s primary significance may lie in its holdings that an unconscionability analysis is context-dependent but that it must be as rigorous and demanding for arbitration provisions as for any other contract clause. The former holding leaves room for employees to emphasize their lack of bargaining power and need for employment. However, the latter holding delivers a clear message that a court may refuse to enforce an arbitration provision in an employment contract if, and only if, its terms are unconscionable for reasons that apply to all contracts.

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