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July 19, 2013

Hon. Tani Cantil-Sakauye, Chief Justice
and the Honorable Associate Justices
Supreme Court of California
350 McAllister Street
San Francisco, CA 94102-4797

Re: ***Sonic-Calabasas A, Inc. v. Frank B. Moreno***
Case No. S174475
Reply Letter Brief

Honorable Chief Justice and Associate Justices:

This reply letter brief is filed by Frank B. Moreno ("Moreno") pursuant to the Court's order of June 21, 2013, requesting briefing from Moreno and his former employer, Sonic-Calabasas A, Inc. ("Sonic") on the significance, if any, of the United States Supreme Court's recent decision in *American Express Co. v. Italian Colors Restaurant* (June 20, 2013) ___ U.S. ___ , 133 S.Ct. 2304 ("*American Express*").

Sonic grossly inflates the scope of the holding of *American Express* by failing to tether the Court's analysis to the actual question it decided. That question decided was a rather narrow one: "whether the Federal Arbitration Act ["FAA'] permits courts ... to invalidate arbitration agreements on the ground that they do not permit class arbitration of a ... claim." (*American Express, supra,* 133 S.Ct. at 2308.) There is little that *American Express* added to what had already been decided in *AT&T Mobility, Inc. v. Concepcion* (2012) 563 U.S. ___ , 131 S.Ct. 1740. As the Court noted, "our decision in *AT&T Mobility* all but resolves this case. There we invalidated a law conditioning enforcement of arbitration on the availability of class procedure because that law 'interfere[d] with the fundamental attributes of arbitration.'" (*Amercan Express,* 133 S.Ct., at 2312.) Both cases identified bilateral proceedings, as opposed to class proceedings, as a core, fundamental attribute of arbitration. Neither case identified a single statutory remedy that would be lost to a claimant as a result of the enforcement of the arbitration agreements which precluded class proceedings. Rather, the Court explained: "The class action waiver merely limits arbitration to the two contracting parties." (*Id.,* at 2311.)

Here, in contrast, Sonic's arbitration agreement operates to deprive its employees of a panoply of statutory rights and remedies. Under the controlling statutes, these remedies are conditioned upon a determination, by the State Labor Commissioner, that the wage claim has

merit. The Berman adjudication itself is non-binding as it is subject to *de novo* review. (Labor Code § 98.2 (a).) But the rights and remedies that flow from the Berman process – the one way fee shifting, the no cost State appointed attorney to represent the wage claimant, etc. – carry forward from the Berman hearing to the *de novo* proceedings. By depriving its employees of the right to have their wage claims heard and preliminarily decided by the Labor Commissioner, Sonic's arbitration agreement ousts the State Labor Commissioner from her role in determining whether a wage claimant qualifies - by virtue of having a claim found to be meritorious by the Commissioner – for these statutory rights and remedies, and effectively deprives its employees of these rights and remedies. For this reason, there is no comparison between the Berman waiver in Sonic's arbitration agreement, and the class action waivers at issue in *American Express* and *AT&T Mobility,* under which there was no deprivation of rights or remedies.

As for the reason the U.S. Supreme Court majority identified bilateral proceedings, rather than class proceedings, as a "fundamental attribute of arbitration," the Court explained: "The switch from bilateral to class arbitration ... 'sacrifices the principle advantage of arbitration – its informality – and makes the process slower, more costly, and more likely to generate a procedural morass than final judgment." (*American Express,* 133 S.Ct., at 2312, citing *AT&T Mobility,* 131 S.Ct., at1751.) The incompatibility between class proceedings and arbitration as envisioned under the FAA arises because of the extent to which class proceedings alter the fundamental attributes of bilateral arbitration. The Court explained:

"[B]efore an arbitrator may decide the merits of a claim in classwide procedures, he must first decide, for example, whether the class itself my be certified, whether the named parties are sufficiently representative and typical, and how discovery for the class should be conducted." (*AT&T Mobility,* 131 S.Ct., at 1751.) "Second, class arbitration *requires* procedural formality.... If procedures are too informal, absent class members would not be bound by the arbitration.... [A]bsent members must be afforded notice, an opportunity to be heard, and a right to opt out of the class.... At least this amount of process would presumably be required for absent parties to be bound by the results of arbitration." (*Id.*) "Third, class arbitration greatly increases the risks to defendants.... [W]hen damages allegedly owed to tens of thousands of potential claimants are aggregated and decided at once, the error of risk becomes unacceptable. Faced with even a small chance of a devastating loss, defendants will be pressured into settling questionable claims." (*Id.,* at 1752.)

In contrast, a brief delay[1] of bilateral arbitration to allow an employee to have his wage claim heard by the Labor Commissioner for a preliminary, non-binding determination of the merits pursuant to the Berman process simply has no effect on the fundamental attributes of that

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[1] Under Labor Code §§ 98(a) and 98.1(a), the Labor Commissioner must decide whether to hold a Berman hearing within 30 days of the filing of the wage claim; must hold the Berman hearing within 90 days thereafter; and must issue the order, decision or award as to the merits of the claim within 15 days of the hearing. The contrast between class proceedings that drag on for years and an expedited Berman process that is finished in four and a half months could not be more stark.

bilateral arbitration. Initial resort to the Berman proceedings does not change the way that the arbitration is conducted; does not impose any new duties on the arbitrator; does not have any effect on the level of formality of the arbitration proceedings; and does not expose the employer to liability for any claims other than those brought by the individual wage claimant. And because the Labor Commissioner's determination of the merits of the claim is non-binding, with an absolute right to *de novo* review, the employer can choose to defend the claim without any participation in the Berman process. The law is clear and well-settled: the employer has no obligation to file an answer to the wage claim that is filed with the Labor Commissioner, and no obligation to appear at the Berman hearing, as the failure to answer or appear does not deprive the employer of the right to seek *de novo* review under Labor Code § 98.2. (*Jones v. Basich* (1986) 176 Cal.App.3d 513.) An employer that chooses not to participate in proceedings before the Labor Commissioner need only wait for the Labor Commissioner to hear the wage claimant's evidence, and issue her decision on the merits of the claim, before filing its *de novo* appeal. Where the wage claim, as here, is subject to resolution under a binding arbitration agreement, the claim would then be heard, *de novo,* by an arbitrator, *exactly as specified by the arbitration agreement* – i.e., bilaterally, and with whatever level of formality is set out in the parties' agreement.

Unless enforcement of an arbitration agreement is delayed until the employee has had the opportunity to avail himself of the Berman process, the employee will be deprived of rights and remedies that are only made available under California law through the Berman process. In order for employees to secure these rights and pursue these statutory remedies, the Labor Commissioner must be allowed the short time provided by statute to hear and decide the wage claim, regardless of the existence of an arbitration agreement that was imposed as a condition of employment. This inconsequential delay of arbitration proceedings – in order to prevent an actual deprivation of statutory rights and remedies – does not trigger FAA preemption under any case decided by the United States Supreme Court.

In *Preston v. Ferrer* (2008) 552 U.S. 346, 359, the Court decried a delay occasioned by state administrative proceedings under the Talent Agencies Act ("TAA") where, if compelled to arbitrate under the parties' agreement, the performer "relinquishes no substantive rights the TAA (or other California law) may accord him." There was no Section 2 unconscionability defense in *Preston,* presumably because there was no adhesion contract and because the Labor Commissioner's initial jurisdiction under the TAA is nothing more than a forum preference, as no rights or remedies are forfeited by waiving the right to have the Labor Commissioner hear a case under the TAA. "Finally, it bears repeating that Preston's petition presents precisely and only a question concerning the forum in which the parties' dispute will be heard." (*Id.*) Delay cannot be justified under the FAA when the delay stems only from a state law's forum preference, and the state forum provides no additional rights or remedies that are not equally available in the arbitral forum.

In contrast, the statutory remedy of one-way fee shifting, the right to no-cost legal counsel provided by the State, and the right to Labor Commissioner enforcement of any judgment in the wage claimant's favor are substantive rights that are deprived by denying an employee access to

the Berman process. And there is nothing in *Preston,* or *AT&T Mobility,* or *American Express* that commands the enforcement of an arbitration agreement that deprives a party of substantive rights and remedies. Quite the opposite - in all of these cases, the Court was careful to note that enforcement of the arbitration agreement at issue would not result in a deprivation of any rights and remedies. This is not surprising, as there has never been a single U.S. Supreme Court decision that upheld the enforcement of an arbitration agreement that deprived a party of substantive statutory rights and remedies.

Sonic places undue importance on the penultimate paragraph in the majority decision in *American Express.* This paragraph cannot be read in isolation, but must be understood as tied to the key issue in that case – whether a class action waiver contained in an arbitration clause in an agreement between a merchant and a credit card issuer was unenforceable, on the ground that the extraordinarily high cost of proving the alleged antitrust claims (through expensive expert economist analysis and testimony) as compared to the low value of these claims make it unaffordable to bring these claims in any manner other than by class proceeding. The merchant argued that the "effective vindication" principle should apply to preclude enforcement of a class action waiver because of the discrepancy between the cost of proving the claims and the value of any individual recovery. The Court held that the "effective vindication" defense to enforcement of the arbitration agreement there is "effective vindication" regardless of how much it may cost to litigate a claim and secure a remedy, so long as the arbitration agreement does not "eliminat[e] the *right to pursue* that remedy." (*American Express*, 133 S.Ct., at 2310-2311.) The Supreme Court thus reversed the Court of Appeals, which in a series of three decisions over a two year period, consistently had found that "because the merchants had established that 'they would incur prohibitive costs if compelled to arbitrate under the class action waiver,' the waiver was unenforceable and the arbitration could not proceed." (*Id.*, at 2308.)

The paragraph on which Sonic places such great reliance is not in the least bit applicable to the issue now facing this Court – the enforceability, under the FAA, of a provision in an arbitration agreement imposed as a condition of employment that denies employees the right to have their wage claims heard by the Labor Commissioner, so as to deprive those employees of the substantive rights and remedies that are only available through the Berman process. The paragraph reads as follows:

> The regime established by the Court of Appeals' decision would require – before a plaintiff can be held to contractually agreed bilateral arbitration – that a federal court determine (and the parties litigate) the legal requirements for success on the merits claim-by-claim and theory-by-theory, the evidence necessary to meet those requirements, the cost of developing that evidence, and the damages that would be recovered in the event of success. Such a preliminary litigating hurdle would undoubtedly destroy the prospect of speedy resolution that arbitration in general and bilateral arbitration on particular was meant to secure. The FAA does not sanction such a judicially created superstructure. (*American Express,* 133 S.Ct., at 2312.)

These determinations would enable a federal court to decide whether the disparity between litigation costs and potential recovery was sufficient, under the Court of Appeals' interpretation of the "effective vindication" principle, to deny enforcement of the arbitration agreement and instead, allow the matter to proceed on a class-wide basis. No such judicial determinations are required under the state law rule that was adopted by this Court in its prior decision in this matter. These determinations are not required because denial of the right to access the Berman process – unlike a class action waiver – necessarily results in a deprivation of statutory right and remedies. No analysis of litigation costs versus the value of wage claims is needed, because deprivation of access to the Berman process necessarily results in deprivation of the remedy of one-way fee shifting, deprivation of the right to appointment of a State attorney to represent the wage claimant at no cost to the claimant, deprivation of the right to have the Labor Commissioner take responsibility for enforcing a judgment in the claimant's favor, etc. The deprivation of these statutory rights and remedies is substantively unconscionable regardless of the value of the wage claim or the potential cost to the claimant of proving the claim. Coupled with procedural unconscionability, which stems from the fact that Sonic's arbitration agreement is conceded by Sonic to be a contract of adhesion that is imposed as a condition of employment, we have unconscionability as a matter of law, without the need for a fact intensive judicial proceeding that weighs the value of the claim against the potential costs of proving the claim.

To be sure, even if such a judicial proceeding were required for each and every wage claimant opposing the enforcement of a Berman waiver contained within a mandatory arbitration agreement on the ground of unconscionability, the proceeding would no more of a "litigation hurdle" than a proceeding challenging the enforcement of an arbitration agreement on the ground of duress or fraud. As duress, fraud and unconscionability are all grounds expressly listed in the FAA's § 2 savings clause as defenses to the enforceability of an arbitration agreement, it cannot be said that the "FAA does not sanction such a judicially created superstructure." No, the FAA expressly provides for judicial proceedings to determine whether an arbitration agreement is enforceable when such a defense to enforceability is raised. This all makes clear that the penultimate paragraph of the majority decision has no applicability whatsoever to a challenge to the enforcement of an arbitration agreement when the challenge, as here, is based on the defense of unconscionability. What Sonic conveniently forgets is that the defense of unconscionabilty was not raised or considered in *American Express.* Hence, Justice Thomas' statement in his concurrence: "Because Italian Colors has not furnished 'grounds for the revocation of any contract,' 29 U.S.C. § 2, the arbitration agreement must be enforced." (*American Express,* 133 S.Ct., at 2312-2313.)

The question now before this Court, pursuant to the U.S. Supreme Court's grant, vacate and remand order ("GVR") on the petition for certiorari filed by Sonic, is whether *AT&T Mobility* requires modification of the prior decision in *Sonic.* With the recent decision in *American Express,* the question has become whether either of these two U.S. Supreme Court cases requires a change in this Court's prior holding that the FAA does not preempt a state law rule prohibiting enforcement of arbitration until the employee has been afforded the opportunity to have the Labor Commissioner to hear and decide the employee's wage claim under the Berman process.

"A GVR order does not necessarily imply that the Supreme Court has in mind a different result in the case, nor does it suggest that [the] prior decision was erroneous. The GVR order is not equivalent to a reversal on the merits, *Tyler v. Cain,* 533 U.S. 656, 666 fn. 6 (2001); *Henry v. City of Rock Hill*, 376 U.S. 776, 777 (1964), nor is it 'an invitation to reverse,' *Gonzalez v. Justices of the Mun. Court of Boston*, 420 F.3d 5, 7 (1st Cir. 2005)." (*In re Whirlpool Corp. Front-Loading Washer Products Liability Litigation* (6th Cir., July 18, 2013) ___ F.3d ___, 2013 WL 3746205 at * 1.) It simply requires the Court to determine whether its original decision was correct in light of subsequent authority. (*Id.*)

We respectfully urge this Court to resist any impulse to overreact to this GVR. We are not blind to the fact that *AT&T Mobility* and *American Express* were significant decisions that have a significant impact on the enforceability of class action waivers contained within arbitration agreements. But the holdings of both of these cases should not be extended beyond the issues that were actually decided, and neither case should be read to permit an arbitration agreement to be used as a weapon for depriving a party of statutory remedies and substantive rights. With four justices dissenting in *AT&T Mobility,* and with Justice Thomas of the opinion that the FAA "does not apply to proceedings in state courts .... [and] cannot displace a state law that delays arbitration until administrative proceedings are completed" (*Preston v. Ferrer, supra,* J. Thomas dissent, 552 U.S. at 363), and in the absence of even a single High Court decision – from the enactment of the FAA to the present – enforcing an arbitration agreement that deprives a party of substantive rights and statutory remedies, we do not believe the U.S. Supreme Court is prepared to construe the FAA in such a manner, and neither should this Court.

Respectfully submitted,

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PROOF OF SERVICE

I, Miles E. Locker, hereby declare and state:

1. I am a partner with the law firm of Locker Folberg LLP, whose address is 71 Stevenson Street, Suite 422, San Francisco, CA 94105, and I am not a party to the cause. I am over the age of eighteen years. I am an attorney licensed to practice law in the State of California.

2. On the date hereof, I caused to be served the following document:

RESPONDENT'S REPLY LETTER BRIEF RE: SIGNIFICANCE OF AMERICAN EXPRESS COMPANY V. ITALIAN COLORS RESTAURANT

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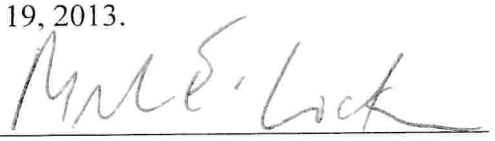
By First Class Mail: I am readily familiar with the firm's business practice of collection and processing of correspondence for mailing with the United States Postal Service and said correspondence is deposited with the United States Postal Service the same day, postage-prepaid, in a sealed envelope.

I declare under the penalty of perjury under the laws of the State of California that the above is true and correct.

Executed at San Francisco, California on July 19, 2013.



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