Legal Update Article

# U.S. Supreme Court Asked to Review California's Perceived Hostility to Arbitration Agreements

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Not surprisingly, OTO, LLC, the employer in *OTO, L.L.C. v. Kho,* 8 Cal. 5th 111 (2019), on January 13, 2020, petitioned the U.S. Supreme Court to review a 2019 California Supreme Court decision not to enforce an arbitration agreement. Employers with California arbitration agreements should watch closely whether the U.S. Supreme Court takes the case and provides much-needed guidance.

### California Supreme Court Decision

In *Kho,* a divided California Supreme Court declined to enforce an employment arbitration agreement on unconscionability grounds where the agreement was presented to the employee in person.

The Court held the agreement was procedurally unconscionable because, among other reasons, the employee did not have a fair opportunity to review the agreement before being asked to sign it and the agreement was not in the employee's native language.

The Court then held the agreement was substantively unconscionable and "shocked the conscience" because it:

1. Did not explain how to initiate arbitration;
2. Required arbitration procedures that were similar to the state's civil litigation procedures, but not easier or more advantageous to the employee than a "Berman hearing" (an informal administrative proceeding overseen by the state Labor Commissioner for resolving certain alleged wage and hour violations); and
3. Likely required the employee to hire a lawyer and, therefore, generally made arbitration unnecessarily expensive for someone pursuing a wage claim.

### Petition for Review

In its petition for review, OTO argued that the ruling in *Kho,* and in "other[] [cases] emanating from the California Supreme Court in recent years," is plainly inconsistent with the U.S. Supreme Court's decisions mandating that the Federal Arbitration Act (FAA) preempts any state rule that puts arbitration agreements on unequal footing with other agreements.

In deciding whether to enforce an arbitration agreement, California courts examine whether the agreement's terms are both procedurally and substantively unconscionable. Procedural unconscionability focuses on oppression or unfair surprise; substantive unconscionability focuses on overly harsh or one-sided terms. The two are analyzed on a sliding scale: the more substantively oppressive the term, the less evidence of procedural unconscionability is required for a court to invalidate an agreement based on unconscionability.

In its petition, OTO maintained that the California Supreme Court failed to apply California's general test for substantive unconscionability in contract cases, *i.e.,* whether

there was a substantial degree of unfairness that "shocks the conscience." Instead, it:

> fashioned a new rule of unconscionability applicable only to certain arbitration agreements: the court deemed the agreement substantively unconscionable because the contemplated arbitration procedures were not as streamlined as the administrative proceeding that would be available to resolve wage disputes under state law absent the agreement.

According to OTO, the new rule "discriminates against arbitration" and is "flatly inconsistent with the FAA's equal-treatment principle" because the new rule requires arbitration agreements to pass a fact-intensive inquiry regarding the benefits of arbitration (and the specific arbitration procedures) to the employee in order to be enforceable, and not invalidated on substantive unconsionability grounds. This is a significantly higher hurdle than the straightforward fairness test applied to other types of contracts.

OTO also argued that the U.S. Supreme Court should hear this case because:

1. The California Supreme Court is a "serial offender" that has "repeatedly refused to apply the [FAA's] equal-treatment principal that [the U.S. Supreme Court] has affirmed time and again";
2. The California State Legislature recently passed a law (Assembly Bill 51) that purports to bar arbitration agreements in contravention of the FAA (for more on the law, see our articles, Court Grants Preliminary Injunction on Enforcement of California Ban on Employment Arbitration Agreements; Court Hears Challenges to California Bar on Mandatory Arbitration Agreements in Employment; California Bar on Mandatory Arbitration Agreements in Employment Temporarily Enjoined; California Bar on Mandatory Arbitration Agreements in Employment Challenged, Injunction Sought; and New California Law Attacks Mandatory Arbitration Again … But Is It More Bark Than Bite?); and
3. California's economy is so large, and arbitration agreements are so ubiquitous, that the state's refusal to comply with the FAA and U.S. Supreme Court's rulings can no longer be tolerated.

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OTO's petition will be followed closely to see if the U.S. Supreme Court takes this case as another opportunity to reaffirm FAA preemption. Jackson Lewis attorneys will continue to monitor this petition and will report on significant developments. Please contact a Jackson Lewis attorney with any questions.