SUPREME COURT
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Case No. S244630

IN THE SUPREME COURT
OF THE STATE OF CALIFORNIA

OTO, LLC an Arizona Limited Liability Company, dba
ONE TOYOTA OF OAKLAND, ONE SCION OF OAKLAND,
Plaintiff and Respondent,

v.

KEN KHO,
Real Party in Interest and Appellant,

JULIE A. SU IN HER OFFICIAL CAPACITY AS THE STATE OF CALIFORNIA LABOR COMMISSIONER, DIVISION OF LABOR STANDARDS ENFORCEMENT, DEPARTMENT OF INDUSTRIAL RELATIONS, STATE OF CALIFORNIA

Intervener and Appellant

After a Decision of the Court of Appeal, Case No. A147564,
First Appellate District, One

Appeal from the Superior Court of Alameda County
Case No. RG15781961, The Honorable Evelio Grillo, Judge

OPENING BRIEF ON THE MERITS

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STATEMENT OF ISSUES

A. Issue Stated By Ken Kho

Whether, in light of the Court's decision in *Sonic-Calabasas A, Inc. v. Moreno* (2013) 57 Cal.4th 1109 (*Sonic II*) holding that any arbitration agreement must be "accessible and affordable," a procedurally unconscionable arbitration provision is also substantively unconscionable where it removes the protections and advantages of the Berman hearings and also imposes all heightened obligations of civil litigation that significantly burden individual wage claimants?

B. Issues Stated By the Labor Commissioner

(1) Whether an arbitration agreement that not only evidences an "extraordinarily high" degree of procedural unconscionability, but also eliminates the Labor Code's free, informal Berman process and forces a *pro per* worker to advance his wage claim instead in an arbitral forum similar in complexity to regular civil litigation in superior court, yet neither provides nor incentivizes affordable counsel, satisfies the "affordable and accessible" mandate established by this Court in *Sonic II*?

(2) Whether mere notice of an arbitration agreement on the same day the Berman process is to commence divests the Labor Commissioner's jurisdiction to proceed with the Berman process?

C. Issues Stated By OTO, LLC

(1) Whether an arbitration agreement that requires that the rules and procedures of a California Superior Court be applied in arbitration as if it were in Superior Court makes the arbitration agreement unconscionable if it is still affordable as a Superior Court action?

(2) Whether the Labor Commissioner should stay the Berman proceedings once it gets notice and copies of the filings where a Superior Court action has been commenced to determine whether the matter should proceed to arbitration; or should the Labor Commissioner be permitted to hold a Berman hearing where it would not be allowed to do so under Code of Civil Procedure section 1281.4 if it were a trial court?

(3) Whether the Labor Commissioner violated OTO's right to a fair administrative hearing, as determined by the Superior Court, where the Labor Commissioner conducted the Berman hearing in the absence of the employer, after the employer had given the Labor Commissioner notice of the pending petition to compel arbitration?

INTRODUCTION

In *Sonic II*, this Court considered the enforceability of arbitration agreements that waive statutory protections afforded to wage claimants in

the State's "Berman" administrative hearing process.[1] The Court concluded that an arbitration agreement could be substantively unconscionable if it failed to provide wage claimants with a forum that is "accessible and affordable." (*Sonic II*, *supra*, 57 Cal. 4th at p. 1146.) As this Court instructed, "in the context of a standard contract of adhesion setting forth conditions of employment, the unconscionability inquiry focuses on whether the arbitral scheme imposes costs and risks on a wage claimant that make the resolution of the wage dispute inaccessible and unaffordable, and thereby 'effectively block[s] every forum for redress of wage disputes, including arbitration itself.'" (*Id.* at p. 1148 [citation omitted].)

Here, it is undisputed that OTO's arbitration agreement bars Kho from redressing his wage claims not only in the civil courts, but also through the Berman process. The question in the present case, then, is whether the arbitration agreement "effectively blocks" Kho from redressing his wage claims in arbitration.

For Kho, a low-wage worker with no legal sophistication, who sought to quickly resolve a claim for unpaid wages after being fired from

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[1] The Berman process "is designed to provide a speedy, informal, and affordable method of resolving wage claims."[1] (*Cuadra v. Millan* (1998) 17 Cal.4th 855, 858.) By utilizing this process, parties may avoid recourse to costly and time-consuming judicial proceedings in all but the most complex of wage claims. (*Id.* at p. 869.)

his job, the answer is "yes." The agreement strips Kho of benefits from the Berman process that are intended to "level[] a playing field that generally favors employers with greater resources and bargaining power." (*Sonic II*, *supra*, 57 Cal.4th at p. 1134.) While the waiver of the Berman protections "does not necessarily render an arbitration agreement unenforceable" (*Sonic II*, *supra*, 57 Cal.4th at p. 1146), the arbitration agreement here is nonetheless unenforceable because the waiver is coupled with rules that force Kho to redress his wage claims in an opaque, costly, and formal forum akin to civil litigation. The resulting playing field is so overtly tilted in OTO's favor that Kho is left without an accessible and affordable forum in which he can effectively redress his wage claims. The Court of Appeal misconstrued and misapplied this Court's holding in *Sonic II*, and thereby reached the erroneous conclusion that OTO's arbitration agreement was enforceable against Kho.

The other issue presented by this case is no less critical – whether the mere filing and notice of petition to compel arbitration operates in effect as an automatic stay so as to prohibit the Labor Commissioner from moving forward with the Berman hearing and issuing an Order, Decision, or Award (ODA). There is nothing in the Federal Arbitration Act, the California Arbitration Act, or the Code of Civil Procedure that would require the Labor Commissioner to stay proceedings absent a court order. Treating the mere filing of a petition to compel arbitration as an automatic stay of the

Berman proceeding encourages employer delay, fosters misuse of the Labor Commissioner's scarce resources, and is contrary to policies favoring the prompt resolution of disputes.

STATEMENT OF FACTS AND PROCEDURAL HISTORY

A. The Arbitration Agreement

Kho began working for OTO as an auto mechanic in early 2010. (CT 109:3-5.)[2] Three years later, in early 2013, a low-level human resources employee approached him while he was working at his station. (CT 109:9-15.) She handed him several documents, asked that he sign them, and waited at his workstation until he did. (*Ibid.*) She did not tell Kho anything about the nature of the documents. (CT 109:18-20.) Nor did she tell Kho that he could take time to review the documents. (CT 109:12-14.)

The first document was titled "Automotive Technician Compensation Plan," so Kho believed the documents pertained to his compensation. (CT 115-116.) Pages three and four of that document were titled "Comprehensive Agreement Employment At-Will and Arbitration." (CT 117-118.) The bulk of the arbitration provision is a densely-packed, single spaced paragraph consisting of more than 1,000 words in tiny 7 point font

[2] CT refers herein to the Clerk's Transcript, followed by the Bates page number and (if applicable) line numbers. RT refers to the Reporter's Transcript, followed by page and line numbers.

that takes up approximately 7/8th of an 8.5 by 11 inch page. (CT 117; *OTO v. Kho* (2017) 14 Cal.App.5th 691, 709, fn. 3.)

With OTO's representative standing by, waiting for him to sign documents that he thought pertained to compensation, Kho signed and returned the papers without reviewing, much less negotiating, the terms. According to OTO's manager, the arbitration agreement "is presented to all persons who seek or seek to maintain employment with [OTO]." (CT 21:1-5.) "[A]ll personnel who commence or continue employment at [OTO] are required to comply with the company's alternative dispute resolution policy." (CT 21:6-7.) This, however, was never explained to Kho. Nor did OTO explain to Kho that he had signed an arbitration agreement, waiving his right to bring a wage claim before the Labor Commissioner. (CT 109:21-22.) OTO never provided Kho with a copy of any applicable rules of arbitration, nor did OTO ever inform Kho how he could initiate arbitration or how the arbitration procedures would work. (CT 109:18-27.) The Court of Appeal found the degree of procedural unconscionability associated with OTO's arbitration agreement to be "extraordinarily high." (*OTO*, *supra*, 14 Cal.App.5th at p. 709.)

The agreement provides that "all disputes which may arise out of the employment context" are to be resolved in binding arbitration. (CT 5.) The stated purpose of the agreement is to "reduce[] expense and increase[] efficiency." (*Ibid.*) Despite this, the agreement adopts technical civil

litigation-like procedures, mandating use of rules applicable to civil actions in California courts, including "all rules of pleading (including the right of demurrer), all rules of evidence, all rights to resolution of the dispute by means of motions for summary judgment, judgment on the pleadings, and judgment under Code of Civil Procedure Section 631.8." (*Ibid.*) The agreement also states that it "shall be controlled by the Federal Arbitration Act, in conformity with the procedures of the California Arbitration Act . . . including section 1283.05 and all the Act's other mandatory and permissive rights to discovery." (*Ibid.*)

Though the agreement specifies that "any arbitrator herein shall be a retired California Superior Court Judge," the agreement is silent on how such a person may be found or selected, let alone how an arbitration may be initiated. (CT 5-6.) The agreement is also silent regarding potential liability for attorneys' fees and costs and who will pay the arbitration costs and fees. The agreement only states, "[i]f CCP § 1284.2 conflicts with other substantive statutory provisions or controlling case law, the allocation of costs and fees shall be governed by said statutory provisions or controlling case law instead of CCP § 1284.2." (CT 5.)

B. <u>The Proceedings Before the Labor Commissioner</u>

After signing the arbitration agreement, Kho continued to work for OTO for another year until OTO terminated him in April 2014. (CT 110:4-5.) Kho subsequently filed a wage claim with the Labor Commissioner on

October 9, 2014, seeking unpaid wages for: (1) hours during which he attended mandatory meetings with no compensation; (2) hours during which he performed mandatory multi-point inspections with no compensation; and (3) standby time with no compensation. (CT 9.) Kho also sought liquidated damages, waiting time penalties, and statutory interest. (CT 9.)

On October 17, 2014, the Labor Commissioner notified OTO and Kho that a settlement conference was scheduled for November 10, 2014. (CT 123:9-11, 127.) OTO appeared at that conference with counsel; Kho appeared *in pro per*. (CT 123:12-14.) The conference proceeded, but the parties were unable to reach a settlement. (CT 123:12-14.) Though OTO asserts that it provided a copy of the arbitration agreement to Kho during this settlement conference, there is no written record reflecting this interaction and both Kho and the deputy who conducted the conference deny that the issue of arbitration was ever raised. (CT 172:8-21.)

The Labor Commissioner subsequently notified OTO on January 30, 2015, that Kho had requested a Berman hearing. In the notice, the Labor Commissioner informed OTO that "although we have been unsuccessful in the settlement of the dispute, lines of communications remain open if you wish to resolve this matter prior to the hearing." (CT 131.) Having not heard anything from OTO, the Labor Commissioner set the hearing for August 17, 2015. (CT 133-136.)

On Friday, August 14, 2015—one court day before the scheduled hearing—OTO filed a petition to compel arbitration in Alameda Superior Court. (CT 1.) In that petition, OTO sought an order compelling Kho to "arbitrate all claims against [OTO] arising from or associated with his employment at [OTO], including but not limited to those claims currently before the [Labor Commissioner]." (CT 3:11-14.) OTO also requested that the Berman hearing the following Monday be stayed. The hearing on the petition to compel and request for a stay was scheduled for October 14, 2015. (CT 42.)

Though OTO filed its petition on Friday, August 14, 2015, it delayed serving that petition on the Labor Commissioner until the following Monday—the day of the hearing. (CT 41, 61.) In a letter accompanying the faxed petition, OTO demanded that the administrative hearing scheduled for 1:00 p.m. that day be taken off calendar "until the completion of arbitration under the signed agreement between the parties." (CT 41.) At approximately 11:09 a.m., the Labor Commissioner responded to OTO, stating that the Berman hearing would proceed that afternoon as scheduled months earlier. (CT 63-64.)

The Berman hearing proceeded as scheduled. (CT 68:25.) Kho appeared *in pro per*. OTO appeared through counsel, but only to serve Kho with the petition to compel arbitration. OTO's counsel then left. (CT 68:27, 69:23-27, fn. 1.) The afternoon of the Berman hearing was the first

time since Kho filed his wage claim that he learned that OTO intended to enforce the arbitration agreement. (CT 110:16-19.)

Following the Berman hearing, on August 25, 2015, the Labor Commissioner issued her order, decision, or award ("ODA") as required by Labor Code section 98.1. (CT 66-75.) In it, the Labor Commissioner awarded Kho $158,546.21 for unpaid wages, liquidated damages, interest, and waiting time penalties. (CT 67, 75:10-16.)

C. The Civil Proceedings

On September 15, 2015, OTO filed an appeal of the ODA. (RJN Ex. 1, at 1-12.)[3] One day later, OTO filed a motion to vacate the ODA under the same case number as OTO's petition to compel arbitration. (CT 1, 81.) The Labor Commissioner filed a Notice of Representation of Kho in the de novo appeal. (RJN Ex. 4, at 16-17.) OTO stipulated that the Labor Commissioner could intervene in the proceeding on the petition to compel arbitration to protect her jurisdiction over Kho's wage claims. (CT 86.) The trial court consolidated the hearings on OTO's petition to compel arbitration and motion to vacate the ODA. (CT 194-199.)

On December 11, 2015, the trial court issued an order finding the arbitration agreement procedurally unconscionable because Kho was:

[3] RJN refers to the Labor Commissioner's Request for Judicial Notice, filed with the Court on March 2, 2018. The exhibit number is followed by the Bates stamped page number(s).

(1) presented with the documents at his work station and asked to sign and return them immediately; (2) given no explanation of the nature of the documents; (3) not provided with a copy of the documents after he signed them; and (4) given no information in the agreement about the rules governing the arbitration and how to initiate arbitration. (CT 212.) According to the court, "[t]hese facts are all consistent with the conclusion that the arbitration provision was imposed on [Kho] under circumstances that created oppression or surprise due to unequal bargaining power." (*Ibid.*)

The trial court also found the arbitration agreement substantively unconscionable because it: (1) adopts complex civil litigation-like rules of procedure and evidence; (2) "fails to provide a speedy, informal and affordable method of resolving wage claims and has virtually none of the benefits afforded by the Berman hearing procedure;" (3) "does not include an attorney's fees clause;" (4) is "intended to have the effect of eviscerating the protections provided by the Berman procedure . . . [and] seeks, in large part, to restore the procedural rules and procedures that create expense and delay in civil litigation;" and (5) "is also unconscionable as a deprivation of the rights to speedy resolution of employee claims for wages." (CT 220-222.)

As to OTO's motion to vacate the ODA, the trial court noted that "[OTO] had provided notice prior to the hearing of the existence of the

arbitration agreement and its petition to compel arbitration." (CT 204.) The court further noted that though there was no court order finding the arbitration agreement to be enforceable or any order staying the proceeding, OTO was nonetheless substantially justified under the circumstances in refusing to participate in the hearing. (*Ibid.*)

OTO appealed the trial court's order denying its petition to compel arbitration. (CT 296). The Labor Commissioner cross-appealed the order vacating the ODA. (CT 301.)

On August 21, 2017, the Court of Appeal issued a decision. It acknowledged that the circumstances surrounding the arbitration agreement's execution presented an "extraordinarily high" degree of procedural unconscionability. (*OTO*, *supra*, 14 Cal.App.5th at p. 709.) Specifically, the agreement was "presented on a take-it-or-leave-it basis" under circumstances "intended to thwart, rather than promote, voluntary and informed consent." (*Id.* at p. 708.) The court characterized the agreement as "a parody of the classic adhesion contract," noting that the tiny font and lack of separate paragraphs "challenged the limits of legibility," with technical language that "require a specialist's legal training to understand." (*Id.* at pp. 708-09.)

The court nonetheless found the arbitration agreement not to be substantively unconscionable. (*OTO*, *supra*, 14 Cal.App.5th at p. 709.) It concluded that because the Berman process may end in a de novo civil trial

if the employer appeals the ODA, arbitral procedures that track what might happen in that de novo proceeding are "presumably not inaccessible for purposes of *Sonic II.*" (*Id.* at p. 710.)

In justifying this conclusion, the court found that the loss of the right to free representation by the Labor Commissioner in an employer-filed de novo appeal following a Berman hearing, and its replacement by an arbitral procedure under which the claimant must either represent himself or bear the cost of paying for counsel, does not make arbitration unaffordable for purposes of *Sonic II.* (*OTO, supra,* 14 Cal.App.5th at p. 711.) The court also determined that the arbitration agreement was not substantively unconscionable because of its silence regarding how claims should be initiated, whether one party could recover attorney's fees from another, and who would be liable for all arbitration fees and costs. (*Id.* at pp. 709-13.)

Finally, the court denied the Labor Commissioner's cross-appeal of the order vacating the ODA on the ground that it was moot. (*OTO, supra,* 14 Cal.App.5th at p. 715.)

STANDARD OF REVIEW

Generally, a trial court's denial of a petition to compel arbitration is reviewed under an abuse of discretion standard, but where the court's denial presents a pure question of law, the order is reviewed de novo. (*Rebolledo v. Tilly's, Inc.* (2014) 228 Cal.App.4th 900, 912; *Mendez v.*

Mid-Wilshire Health Center (2013) 220 Cal.App.4th 534, 541.) Where, as is the case here, there are no meaningful factual disputes as to the evidence, unconscionability is a question of law subject to de novo review. (*Ontiveros v. DHL Express (USA), Inc.* (2008) 164 Cal.App.4th 494, 502.)

ARGUMENT

I. OTO'S ARBITRATION AGREEMENT IS UNCONSCIONABLE BECAUSE IT IS ADHESIVE AND IT ELIMINATES THE PROTECTIONS OF THE BERMAN PROCESS THAT REDUCE THE COSTS, RISKS AND DIFFICULTIES OF PURSUING WAGE CLAIMS, AND REPLACES THEM WITH A PROCESS THAT IS NEITHER ACCESSIBLE NOR AFFORDABLE

To determine whether an arbitration agreement that substitutes binding arbitration for the Berman process is substantively unconscionable, courts must examine and compare the dispute resolution procedures eliminated by the agreement with those established by the agreement. (*Sonic II*, *supra*, 57 Cal.4th at p. 1146.) This comparison is central to determining whether the arbitration process "imposes costs and risks on a wage claimant that make resolution of the wage dispute inaccessible and unaffordable," thereby blocking every forum for redress of disputes, including arbitration. (*Id.* at p. 1148.)

The Court of Appeal misapplied this test. Specifically, the Court of Appeal failed to evaluate the accessibility and affordability of the dispute resolution procedures of the challenged arbitration agreement against the

accessibility and affordability of the Berman process that the arbitration agreement displaces. Instead, the Court largely assessed the accessibility and affordability of OTO's arbitral procedures by reference to ordinary civil litigation, reasoning that because an appeal of an ODA results in a de novo proceeding in the superior court, an arbitration agreement that mandates use of the same formal procedures is presumably not inaccessible. (*Id.* at p. 712.)

In reasoning this way, the Court of Appeal discounted protective features of the Berman process that exist in a de novo proceeding, features specifically "designed to lower the costs and risks for employees in pursuing wage claims." (*Sonic II*, *supra*, 57 Cal.4th. at p. 1146.) The absence of these protections effectively block Kho from redressing his wage claims, even in arbitration. And there is no legitimate commercial need furthered by arbitral rules that effectively require the same level of cost and complexity as civil litigation, while removing the statutory protections that alleviate these burdens to wage claimants. Those terms operate in a fundamentally lopsided manner to dramatically favor OTO in wage disputes.[4] (See *Armendariz v. Foundation Health Psychcare*

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[4] Supplanting the informality of a Berman hearing with the rigors of civil litigation procedures is entirely inconsistent with the promotion of the "fundamental attributes of arbitration," particularly where there is no legitimate commercial need to do so. (See *Stolt-Nielsen S.A. v. AnimalFeeds International Corp.* (2010) 559 U.S. 662, 685 [fundamental

Services, Inc. (2000) 24 Cal.4th 83, 117.) Accordingly, this Court should reverse the Court of Appeal and find OTO's arbitration agreement unconscionable and unenforceable against Kho.

A. The Court of Appeal Erred by Comparing the Accessibility and Affordability of the Arbitral Procedures with Civil Litigation Rather than the Berman Process

In evaluating the accessibility and affordability of an arbitration scheme that displaces the Berman process, the arbitral rules should not be measured against the requirements of formal civil litigation. As this Court instructed in *Sonic II*, courts must consider the "features of dispute resolution the [arbitration] agreement eliminates." (*Sonic II*, *supra*, 57 Cal.4th at p. 1146.) Accordingly, the Berman process should serve as the touchstone for determining whether OTO's arbitration agreement meets *Sonic II's* test for accessibility and affordability, not the formal procedures of civil litigation. (*Sonic II*, *supra*, 57 Cal.4th at p. 1146.)

This is not a trivial command. It gives weight to the settled premise that the Legislature created the Berman processes because the formal requirements of ordinary civil litigation are ill-suited for resolving wage

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goal of arbitration is to provide a forum that provides for greater informality, lower costs, greater efficiency and speed, and expert adjudicators].)

disputes for workers like Kho.[5] For those disputes, a forum akin to ordinary civil litigation can be inaccessible and unaffordable, effectively blocking workers from redressing their wage disputes, contrary to the State's public policy.

Commentators have recognized that "Americans who cannot afford legal representation in court routinely forfeit basic rights, not due to the facts of their case or the governing law, but due to the absence of counsel." (*Access to Justice – Civil Right to Counsel – California Establishes Pilot Programs to Expand Access to Counsel for Low-Income Parties*, 123 Harv. L. Rev. 1532 (April 2010).) "[I]n most situations, enforcing or defending a legal right requires the assistance of an attorney. Complex legal rules, stringent procedural requirements, and an adversarial system that functions best when both sides are represented by competent attorneys leave the unrepresented at a substantial, and in most situations insurmountable, disadvantage." (Robert R. Kuehn, *Undermining Justice: The Legal*

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[5] As this Court stated: "[g]iven the dependence of the average worker on prompt payment of wages, the Legislature has devised the Berman hearing and posthearing process as a means of affording an employee with a meritorious wage claim certain advantages, chiefly designed to reduce the costs and risks of pursuing a wage claim, recognizing that such costs and risks could prevent a theoretical right from becoming a reality." (*Sonic II*, *supra*, 57 Cal. 4th at p. 1131.)

Profession's Role in Restricting Access to Legal Representation (2006) 2006 Utah L. Rev. 1039.)

Recognizing these barriers, the Legislature guaranteed free counsel under Labor Code section 98.4, to those wage claimants unable to afford counsel. This guarantee was both the means of ameliorating the "justice gap" that makes wealth a prerequisite for access to justice, and a reflection of the State's long-standing policy affording the highest priority to wage claims.[6] That OTO has wielded its power to prevent access to counsel compels "the need to protect access, at least at a level commensurate with that available [under section 98.4], otherwise arbitration becomes a tool to thwart legal claiming." (*Nothing for Something? Denying Legal Assistance to Those Compelled to Participate In ADR Proceedings*, 37 Fordham Urb. L.J. 273, 283 (2010).)

As detailed above, the arbitration agreement here expressly mandates use of all rules of pleading including the right of demurrer, all rules of evidence, and preserves the right to bring motions for summary judgment, judgment on the pleadings, and judgment under Code of Civil

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[6] "It has long been recognized that wages are not ordinary debts, that they may be preferred over other claims, and that, because of the economic position of the average worker, and in particular, his dependence on wages for the necessities of life for himself and his family, it is essential to the public welfare that he receive his pay when it is due." (*In re Trombley* (1948) 31 Cal.2d 801, 809.)

Procedure Section 638.1. Where an arbitration agreement imposes the daunting technical pleading, discovery, evidentiary, and motion practice rules of civil litigation, it creates a barrier to claimants. But, the relaxed administrative procedures in Berman hearings remove that barrier. Pleadings are limited to an informal complaint and an answer. (Lab. Code, § 98, subd. (d).) Hearings are to be held within 90 days of the filing, but prior to that the Commissioner's staff assist to help settle claims. (Lab. Code, § 98, subd. (a).) There is no discovery before hearing. The hearings themselves are not governed by technical rules of evidence; any relevant evidence is admitted if it is the sort of evidence on which reasonable persons are accustomed to rely on in the conduct of serious affairs. The hearing officer is authorized to assist parties in cross-examining witnesses and to explain issues and terms not understood by the parties. (*Sonic II, supra,* 57 Cal.4th at p. 1128, citing DLSE Policies and Procedures for Wage Claim Processing.) And the Commissioner provides qualified interpreters to assist the parties. (Lab. Code, § 105.) In total, these features effectively remove the barriers inherent in formal civil litigation for workers who lack legal expertise, English-language ability, or the means to pay for representatives and translators, in seeking and obtaining a quick, impartial resolution of their wage disputes.

In addition, the Berman statutes remove not only key barriers to pursuing one's claims in the first place; they also remove barriers in the de