Supreme Court Copy

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The Honorable Ronald M. George, Chief Justice
and the Honorable Associate Justices of the California Supreme Court
350 McAllister Street
San Francisco, CA 94102

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

Honorable Chief Justice and Associate Justices:

This letter is filed by Frank B. Moreno ("Moreno") in reply to the supplemental letter brief filed on October 29, 2010 by Sonic-Calabasas A, Inc. ("Sonic") in response to this Court's question: Was the Berman waiver contained in the arbitration agreement between the parties unconscionable? For all of the reasons set forth below, we urge this Court to reject Sonic's argument that this is not a proper question for the Court to consider, and to reject Sonic's assertion that the record is devoid of evidence of "actual unconscionability." Quite the contrary – the undisputed facts in the record amply support a finding of procedural and substantive unconscionability. And this unconscionability that is evident in the record makes the Berman waiver contained in the parties' arbitration agreement unenforceable, as a matter of law.

Sonic contends that the issue of unconscionability was never raised below. That contention is a misrepresentation. Moreno's Response to the Petition to Compel Arbitration, filed with the Los Angeles Superior Court on May 15, 2007, raises the issue of unconscionability as an affirmative defense: "If the arbitration agreement between the parties is construed as absolutely prohibiting Respondent from exercising her [sic] statutory right to initially invoke the non-binding administrative remedy afforded by the Labor Commissioner, then the arbitral scheme crafted by Petitioner fails to provide an arbitral forum in which employees can fully and effectively vindicate their statutory rights to recover unpaid wages, and is thus contrary to public policy, unconscionable, and unenforceable." (Clerk's Transcript, hereinafter "CT," at 40-44.)

To be sure, much of the following briefing, at all stages in this litigation, has focused on the issue of whether the Berman waiver violates public policy. But the defense that all or part of a contract violates public policy is subsumed within the defense of unconscionability. The defense

of unconscionability necessarily and implicitly arises from a public policy challenge to a provision in a contract. As this Court noted in *Discover Bank v. Superior Court* (2005) 36 Cal.4th 148, 160-161:

> [W]hen a consumer is given an amendment to its cardholder agreement in the form of a 'bill stuffer' that he would be deemed to accept if he did not close his account, an element of procedural unconscionability is present. Moreover, although adhesive contracts are generally enforced, class action waivers found in such contracts may also be substantively unconscionable as they may operate effectively as exculpatory clauses that are contrary to public policy. [internal citations omitted.]

Likewise, in *Szetela v. Discover Bank* (2002) 97 Cal.App.4th 1094, 1101, in analyzing a class action waiver, the court intertwined the issues of unconscionability and violation of public policy:

> While the advantages to Discover are obvious, such a practice contradicts the California Legislature's stated policy of discouraging unfair and unlawful business practices. . . . It provides the customer with no benefit whatsoever; to the contrary, it seriously jeopardizes customers' consumer rights by prohibiting any effective means of litigating Discover's business practices. This is not only substantively unconscionable, it violates public policy by granting Discover a 'get out of jail free' card while compromising important consumer rights.

The import of *Discover Bank* and *Szetela* is clear -- the defense that enforcement of a provision in an arbitration agreement would impair the weaker party's ability to vindicate statutory rights that are founded upon public policy necessarily implicates both the defenses of unconscionability and violation of public policy.

Moreover, even in cases where the parties failed to raise a determinative issue in the proceedings below, this Court has the authority, and when appropriate, has not hesitated to exercise that authority, to consider and resolve that issue. The circumstances under which such authority will be exercised were explained in *Cedars-Sinai Medical Center v. Superior Court* (1998) 18 Cal.4th 1, 6:

> This is not the first occasion on which we have addressed a dispositive issue not raised by the parties below. In *Fisher v. City of Berkeley,* we decided a potentially dispositive threshold issue raised for the first time in this court by an amicus curiae (the validity under federal antitrust law of Berkeley's rent control ordinance) because it was an issue of law not turning on disputed facts and

> because it was an important question of public policy. (*Fisher v. City of Berkeley* (1984) 37 Cal.3d 644, 654, fn. 3, 209 Cal.Rptr, 682, 693 P.2d 261 ["parties may advance bew theories on appeal when the issue posed is purely a question of law based on undisputed facts, and involves important questions of public policy]; see also *Ford v. Gouin* (1992) 3 Cal.4th 339, 346-350, fn. 2, 11 Cal.Rptr.2d 30, 834 P.2d 724 (plur. opn. of Arabian, J.) [deciding case by applying Harbors and Navigation Code section 658, a ground never raised in the trial court, appellate court, or this court]; 3 Cal.4th at pp. 364-369, 11 Cal.Rptr.2d 30, 834 P.2d 724 (conc. and dis. opn. of George, J., joined by Lucas, C.J..) [same]; *id.* at p. 369, 11 Cal.Rptr.2d 30, 834 P.2d 724 (dis. opn. of Mosk, J.) [same].)

In summary, the Court observed: "There are sound policy reasons supporting our discretion to consider all of the issues presented by a case, and we have used this discretion in the past to resolve issues of public importance." *Cedars-Sinai Medical Center, supra,* 18 Cal.4th at p. 7, fn. 2. Indeed, as acknowledged by Sonic in its supplemental letter brief, "the Court has discretion to address issues not contested below where they present pure issues of law on undisputed facts (see, e.g., *Neumann v. Melgar* (2004) 121 Cal.App.4th 152)." But, according to Sonic, "this is clearly not the case here." To the contrary, this is precisely the case here. The issue of whether the Berman waiver contained in the parties' arbitration agreement was unconscionable is an issue that can and should be decided by applying controlling legal principles to the undisputed facts that are in the record.

These are the undisputed facts sufficient to support a determination of a high level of procedural unconscionability: 1) Sonic conceded, in its petition to compel arbitration, that the arbitration agreement was a contract of adhesion, as it was imposed as a condition of employment.[1] (CT 006–007), and 2) the arbitration agreement, which was attached to the petition to compel arbitration, is set out in an absurdly small type size that is densely packed and barely readable.

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[1] This fact alone is sufficient to establish procedural unconscionability. "Ordinary contracts of adhesion, although they are indispensable facts of modern life that are generally enforced (see *Graham v. Scissor-Tail, Inc.* (1981) 28 Cal.3d 807, 817-818, 171 Cal.Rptr. 604, 623 P.2d 165), contain a degree of procedural unconscionability even without any notable surprises, and 'bear with them the clear danger of oppression and overreaching.' (*Id.*, at p. 818, 171 Cal.Rptr. 604, 623 P.2d 165.)" (*Gentry v. Superior Court* (2007) 42 Cal.4th 443, 469.) Seeking to minimize this certain finding of procedural unconscionability, Sonic now argues that it "should have the opportunity to put on evidence that Respondent signed multiple arbitration agreements throughout his employment, blunting any argument that the agreement was forced upon him." This argument is bereft of logic and utterly fails to overcome the admission in its petition that "all employees of Sonic-Calabasas A, Inc, are subject to the company's arbitration program by accepting or continuing employment with the company." (CT 007.)

These are the undisputed facts sufficient to support a determination of a high level of substantive unconscionability: 1) the arbitration agreement provides for mandatory binding arbitration of all disputes arising out of employment that would otherwise allow resort to any court or governmental dispute resolution forum, with the sole exception of certain identified administrative claims, none of which exempt wage claims or the Berman wage adjudication process from the scope of mandatory arbitration, 2) the arbitration agreement requires that all claims subject to arbitration be heard "in conformity with the procedures of the California Arbitration Act ... including section 1283.05 and all of the Act's other mandatory and permissive rights to discovery," and 3) the arbitration agreement mandates the application of "all rules of pleading (including the right of demurrer), all rules of evidence, all right to resolution of the dispute by means of motion for summary judgment, judgment on the pleadings, and judgment under Code of Civil Procedure Section 631.8."

Substantive unconscionability is also a function of what has been omitted from the parties' arbitration agreement. The following provisions – all central to the Berman process and vitally necessary for wage earners to vindicate their claims for unpaid wages – are notably absent from the arbitration agreement: 1) a provision ensuring that Moreno will not be subject to liability for Sonic's attorneys' fees, 2) a provision ensuring that Moreno will be provided with all necessary assistance in prosecuting his claim for unpaid wages, including assistance in identifying potential claims and drafting his claim, and any necessary language assistance, 3) a provision ensuring that Moreno will be provided with assistance in collecting the amount found owed on his claim, 4) a provision ensuring that Moreno will incur no filing fees or administrative fees in connection with the processing of his claim, and no fees payable to the person(s) hearing his claim, 5) a provision ensuring that Moreno will be provided with an attorney at no cost if he is unable to afford private counsel, to represent him in connection with any employer-initiated proceedings that are procedurally more complex than the streamlined proceedings of an administrative hearing in the Berman process, 6) a provision ensuring that Moreno will recover attorneys' fees from Sonic in the event that Moreno prevails in any employer-initiated proceeding that is more complex than the streamlined proceedings of an administrative hearing in the Berman process, and 7) a provision ensuring that Sonic will post a bond or cash undertaking in an amount sufficient to guarantee payment to Moreno of any amount ultimately found due.

All of the undisputed facts required for a determination of substantive unconscionability are based upon a reading of the terms of the arbitration agreement that Sonic placed into the record with its petition to compel arbitration. That is because "substantive unconscionability focuses on overly harsh or one-sided terms." (*Olvera v. El Pollo Loço, Inc.* (2009) 173 Cal.App.4th 447, 456.) The subject of this focus is the arbitration agreement itself. "[A] finding of procedural unconscionability does not mean that a contract will not be enforced, but rather that courts will scrutinize the substantive terms of the contract to ensure they are not manifestly unfair or one-sided." (*Gentry v. Superior Court, supra,* 42 Cal.4th at p. 469.)

Yet, incomprehensibly, Sonic urges this Court to decline to decide this issue because "the parties did not have the opportunity to submit evidence on the issue of substantive unconscionability." But the only evidence that is needs to be considered is the arbitration agreement that Sonic is seeking to enforce, and that is in the record. Evidence of events subsequent to the execution of that agreement would be irrelevant. "Generally, unconscionability is determined as of the time the contract was entered into, not in light of subsequent events. Civil Code section 1670.5, subdivision (a) permits a court to refuse to enforce a contract '[i]f the court as a matter of law finds the contract or any clause of the contract to have been unconscionable at the time it was made...." (*Parada v. Superior Court* (2009) 176 Cal.App.4th 1554, 1583 [internal quotes and citations omitted].) "The [drafter] is saddled with the consequences of the provision *as drafted.* If the provision, as drafted, would deter potential litigants, then it is unenforceable...." (*Id.*, at p. 1584.)

Sonic urges this Court to find that the because the Berman waiver has no substantive effect on the final forum where the merits will be decided, the waiver is not unconscionable. Initially, we note that it is a matter of pure speculation to opine as to the "final forum" where the merits of this dispute would be decided if the Berman waiver contained in the arbitration agreement were held to be unconscionable. The overwhelming majority of wage claims adjudicated by the Labor Commissioner are not appealed, and there is no reason to believe that substituting *de novo* arbitration for *de novo* superior court proceedings would make the parties to a Berman hearing any more or less likely to file for *de novo* review – provided, of course, that the panoply of remedial tools and protections that are provided to employees pursuant to the Berman process remain equally available regardless of whether the route for *de novo* review is through the courts or through arbitration.

But the Berman waiver, at least in the context of an arbitration agreement that utterly fails to provide employees with equivalent remedial tools and protections, is designed and intended to deprive employees of the ability to vindicate their rights to payment of wages. Any doubt that this was precisely Sonic's intention is belied by its assertion, at page 5 of its supplemental letter brief, that "the Berman process sees the matter submitted first to the Labor Commissioner, an entity whose pro-employee leanings disadvantage the employer." Here we have it – at last some honesty about what Sonic hopes to accomplish by its Berman waiver – as evidenced by its undisguised hostility to the protections and remedial tools that were created by the Legislature, and nurtured by this Court, to enable and encourage employees to vindicate their rights to payment of wages. Displacement of these Berman protections is not a matter of merely substituting the arbitral forum for that of the Labor Commissioner. Perhaps that could be accomplished through an arbitration agreement that carefully replicated the vital protections that stem from the Berman process. But that is most decidedly not what would occur under this arbitration agreement, which was unquestionably designed to make the adjudicatory forum far less friendly to employees and far more likely to produce results that favor this employer. How?

Far fewer employees would file wage claims, as a result of the complexity of these arbitral procedures, the need for attorney representation to effectively proceed in this arbitral arena, and the exposure to costs and fees that they would not face under the Berman process. Employees who do file wage claims would likely abandon them at an early stage, when faced with pleading requirements, the need to respond to demurrers, motions for judgment on the pleadings, motions for summary judgment, employer-filed discovery, motions for sanctions for failure to adequately respond to those discovery demands, and concerns about mounting exposure to costs and fees. And those few employees who stay the course and reach an arbitration hearing, if not represented by counsel, would be at a pronounced disadvantage with the application of "all rules of evidence" to these arbitral proceedings, with the inevitable result that lack of familiarity with these rules and how to present a case under these rules will translate into a lower rate of success in prosecuting claims when compared to the Berman process.[2]

In short, the Berman waiver, together with arbitration agreement's failure to replicate the vitally necessary Berman protections and remedial tools, "indicate[s] a systematic effort to impose arbitration on an employee not simply as an alternative to [the Berman process], but as an inferior forum that works to the employer's advantage." (*Gentry v. Superior Court, supra,* 42 Cal.4th at p. 466.) The complete displacement of these Berman protections and remedial tools makes the Berman waiver contained in this arbitration agreement highly substantively unconscionable, and unenforceable.

Ignoring the overwhelming tilt in the playing field that inexorably results from this Berman waiver, Sonic cites to *Green Tree Financial Corp.-Alabama v. Randolph* (2000) 531 U.S. 79, in support of its assertion that "unsubstantiated speculation" regarding the consequences of the Berman waiver is not enough to dislodge the strong public policy favoring enforcement of arbitration agreements. Instead, Sonic argues that under *Green Tree,* it is necessary to prove that the costs that would have to be borne by Moreno as a result of the Berman waiver are prohibitively expensive, and that this is an analysis that must be done on a case by case basis, looking at the specific employee's ability to bear these costs.

Of course, the applicability of *Green Tree* to state law has already been argued, and soundly rejected, by this Court in *Little v. Auto Stiegler, Inc.* (2003) 29 Cal.4th 1064, a case which involved an unconscionability challenge to an arbitration agreement virtually identical, except in

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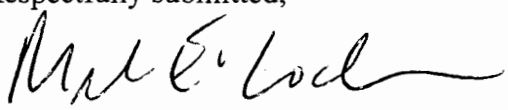
[2] Berman hearing procedural rules state: "Proceedings need not be conducted according to technical rules relating to evidence and witnesses. Any relevant evidence shall be admitted if it is the sort of evidence on which responsible persons are accustomed to rely in the conduct of serious affairs, regardless of the existence of any common law or statutory rule which might make improper the admission of such evidence over objection in civil actions." (Title 8, Cal. Code of Regulations § 13502.)

some minor respects, to the agreement at issue herein. In its decision, this Court acknowledged that *Green Tree* took an opposite approach from *Armendariz v. Foundation Health Psychcare Services, Inc.* (2000) 24 Cal.4th 83, which applied a so-called categorical approach under which *any* cost unique to the arbitral forum is prohibited when the employee is seeking to vindicate an unwaivable statutory right, regardless of the specific employee's ability to pay the cost. In rejecting the *Green Tree* approach, this Court explained: "[W]e do not believe that the FAA requires state courts to adopt precisely the same means as federal courts to ensure that the vindication of public rights will not be stymied by burdensome arbitration costs." (*Little v. Auto Stiegler, supra,* at p. 1085.)

Insofar as Moreno's vacation pay claim presents an unwaivable statutory right, we believe that *Armendariz* and *Little* controls as to this issue. But to be sure, even if Moreno's claim was not based on an unwaivable statutory right, the staggering disparity between the relatively low value of his claim and his enormous exposure to costs and fees under Sonic's arbitral process (costs and fees he would face no exposure to under the Berman process), not to mention all of the other ways in which he is terribly disadvantaged, vis-à-vis the Berman process, in prosecuting his claim, tells us all that we need to know about the unconscionability of this Berman waiver. Sonic's suggestion that the unconscionability of the Berman waiver might somehow be dependent on Moreno's (or any other wage claimant's) financial status should be soundly rejected. It is a suggestion that has no basis in existing law, and as we have discussed in earlier briefing, adoption of a requirement that any wage claimant opposing enforcement of a Berman waiver must prove financial inability to vindicate his or her wage rights in the arbitral forum would create an insurmountable barrier to the employees least able to afford to litigate this question.

Respectfully submitted,



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PROOF OF SERVICE AND DELIVERY

I, the undersigned, hereby certify that I am a citizen of the United States, over the age of 18 years, and am not a party to the within action. I am employed in the City and County of San Francisco, California, and my business address is 235 Montgomery Street, Suite 835, San Francisco, California 94104. I am readily familiar with my business practice for collection and processing of correspondence for mailing with the United States Postal Service. On the date listed below, following ordinary business practice, I served the following document(s):

REPLY TO SONIC CALABASAS A, INC'S SUPPLEMENTAL LETTER BRIEF RE: UNCONSCIONABILITY

on the party(ies) in this action, through his/her/their attorneys of record, by placing true and correct copies thereof in sealed envelope(s), addressed as shown on the attached Service List for service as designated below:

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(X) (By First Class Mail) I placed, on the date shown below, at my place of business, a true copy thereof, enclosed in a sealed envelope, with postage fully pre-paid, for collection and mailing with the United States Postal Service where it would be deposited with the United States Postal Service that same day in the ordinary course of business, addressed to those listed on the attached Service List.

( ) (By Personal Service) Following ordinary business practice, I caused each such envelope, with courier charges prepaid, to be delivered to a courier employed by Western Messenger Attorney Services, who personally delivered each such envelope to the offices of each addressee.

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I declare under penalty of perjury under the laws of the State of California that the foregoing is true and correct and that this Proof of Service was executed on November 5, 2010 at San Francisco, California.

Cherie A. Miljevich-Moore