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COMMENTS

CIRCUIT CITY MEETS THE CALIFORNIA LABOR COMMISSIONER: DOES THE FAA PREEMPT ADMINISTRATIVE CLAIMS?

I. INTRODUCTION

Carlos¹ was a day laborer, standing on a busy street corner in southern California.² When a man pulled up in his car and asked him if he wanted work as a janitor, he quickly agreed and jumped in. The day job turned into something more permanent: Carlos worked for that employer for three years. However, the employer never paid him overtime, despite the fact that Carlos regularly worked nine and ten-hour days. After Carlos was laid off, he heard that he could file a claim with the California Labor Commission for the overtime pay he should have received. He filed the claim, and appeared for a pre-hearing conference at the Labor Commission. At the conference, the Deputy Commissioner informed the employer that he had violated the California Labor Code by not paying overtime, and that if he went forward to a hearing, he risked being ordered to pay the full amount of back wages due plus statutory penalties and interest. The employer consulted with his attorney and after several rounds of negotiation, he and Carlos agreed to a settlement. Carlos received a check for \$9,000. The entire process had taken only three months and had cost Carlos nothing but his time. His statutory rights were enforced, and both he and the employer could move on with their lives. The employer was now on notice regarding his statutory obligation to pay overtime, and while he had to pay Carlos and his own attorney, the costs were minimal when compared to a court proceeding.³

1. Carlos is not his real name, but his story is based on an actual case brought before the California Labor Commission in 2003.

2. In many communities of southern California, Hispanic men wait on street corners to be picked up for day labor. Employers drive up, let them know what they need, and one or more men hop into the car.

3. Both parties may represent themselves or have counsel. Division of Labor Standards Enforcement, *Policies and Procedures for Wage Claim Processing*, at www.dir.ca.gov/dlse/Policies.htm (last revised May 2001). In many cases, the workers are represented by public interest organizations such as Legal Aid Society, California Rural Legal Assistance, or the Employee Rights Center. Employers typically have private counsel. Telephone Interview with Michael Jackman, Counsel, California Labor Commission (Aug. 4, 2003).

When non-union workers⁴ in California have a dispute with their employer over wages, hours or related issues, the Department of Labor Standards Enforcement (DLSE) (also referred to as the Labor Commission) provides a powerful resource to protect their rights under the California Labor Code.⁵ After receiving a claim from a worker, the Labor Commission holds a pre-hearing conference, in an attempt to settle the dispute informally.⁶ If the parties cannot reach a settlement, they proceed to an administrative hearing, where a Deputy Labor Commissioner determines the validity of the worker's claim.⁷ If the Commissioner finds the employer liable for Labor Code violations, he can award back pay, penalties and interest to the employee.⁸ Workers can also bring certain discrimination claims to the Labor Commission and the agency will investigate those claims and issue a decision.⁹ In both cases, decisions of the Labor Commission are binding, subject to appeal in Superior Court, and if the employer does not comply with a finding against him, the Labor Commissioner can proceed to court to have it enforced.¹⁰

What if Carlos had signed an employment agreement with a mandatory arbitration clause?¹¹ Would he still have been able to pursue his claim before the Labor Commission? Should he be able to? Many employers today require new employees to sign mandatory arbitration clauses as a condition of employment, in order to avoid the costs of litigation.¹² Does a worker who signs such an agreement waive his right to take a claim, not just to court, but

4. The Labor Commission handles primarily claims by non-union workers. However, if a union worker has a claim that is not covered by the collective bargaining agreement, he may file with the Labor Commissioner as well. *Livadas v. Bradshaw*, 512 U.S. 107 (1994) (when employer refused to pay a unionized employee promptly on her discharge, she was free to bring a claim to the Labor Commissioner because the collective bargaining agreement was irrelevant to the dispute at hand).

5. CAL. LAB. CODE § 79-107 (West 2003).

6. LEGAL AID SOC'Y EMP. LAW CTR., *WAGE CLAIMS: A GUIDE FOR ADVOCATES* 56 (2001).

7. CAL. LAB. CODE § 98 (West 2003).

8. *Id.* §§ 98.1, 203, 558.

9. *Id.* §§ 98.6-98.7. "Any person who believes that he or she has been discharged or otherwise discriminated against in violation of any law under the jurisdiction of the Labor Commissioner may file a complaint with the division within six months after the occurrence of the violation." *Id.* § 98.7(a). Examples include discrimination or discharge for filing or threatening to file a claim with the Labor Commissioner, *id.* § 98.6(c)(1); taking time off to seek relief from domestic violence, *id.* § 230(c); engaging in political activity of the employee's choice, *id.* §§ 1101, 1102; complaining about safety or health practices, *id.* § 6310; or refusing to work hours in excess of those permitted by law, *id.* § 1198.3(b).

10. *Id.* § 98.2.

11. It is probably unlikely that a day laborer would be presented with such a contract, but many low wage workers at least fill out an application, which may contain an arbitration agreement.

12. It is estimated that eight to ten percent of U.S. workers are currently covered by arbitration agreements. Eighty-five percent of those have been created since 1991. Laura Kaplan Plourde, Comment, *Analysis of Circuit City Stores, Inc. v. Adams in Light of Previous Supreme Court Decisions: an Inconsistent Interpretation of the Scope and Exemption Provisions of the Federal Arbitration Act*, 7 J. SMALL & EMERGING BUS. L. 145, 172 (2003).

to the Labor Commission as well? This Comment explores these questions in light of recent Supreme Court decisions regarding arbitration clauses in employment contracts. This is an especially contentious and unsettled area of law in California. This Comment examines recent California cases and developing legal theories bearing on the right of workers to take statutory claims to the Labor Commissioner (or to court) when they have signed arbitration agreements with their employer. The Comment argues that while employers are often defeated in their attempts to compel workers to arbitrate, the process is time-consuming, costly and unpredictable; resulting in wasteful litigation and uncertainty for employers and workers alike.

Part II describes the background of the current debate, including a brief history of the Federal Arbitration Act (FAA),¹³ and Supreme Court decisions that have expanded its scope in recent years to cover statutory employment claims brought by most employees. Part II also summarizes the arguments made by the proponents and opponents of arbitration clauses in employment contracts.

Part III discusses the law as it has developed in California since two watershed U.S. Supreme Court decisions: *Circuit City v. Adams*¹⁴ and *EEOC v. Waffle House*.¹⁵ This part explores the California (and Ninth Circuit) courts' approach to arbitration clauses in employment contracts. It focuses on the California Supreme Court's guidelines for evaluating arbitration clauses, laid down in *Armendariz v. Foundation Health Psychcare Services, Inc.*¹⁶ and the case law that applied those guidelines. It discusses the position of the California Labor Commissioner on its jurisdiction where an arbitration clause exists. In addition to Labor Commission cases, Part III looks at the fate of statutory employment claims in the California courts as well.

Part IV argues that because of the unsettled nature of the law in California, workers' rights to pursue a claim with the Labor Commissioner or in court are decided on a case-by-case basis. As a result, both employers and employees are uncertain as to the scope of an arbitration clause. This leads to increased litigation and a weakening of the effectiveness of workers' statutory rights. These outcomes undermine important policy goals of efficiency, consistency and fairness in the legal system. This is particularly true when workers are prevented from taking claims to the Labor Commission, which provides an efficient, low cost method of dispute resolution. Part IV discusses a new legal theory being developed by Labor Commission attorneys, which attempts to resolve the current dilemma by arguing for a new interpretation of the scope of the FAA: that the FAA does not cover administrative proceedings.

13. 9 U.S.C.A. (1999 & Supp. 2003).

14. 532 U.S. 105 (2001).

15. 534 U.S. 279 (2002).

16. 6 P.3d 669 (2000).

Part V concludes with a discussion of possible solutions to the problem, including the Labor Commission attorneys' approach. This part assesses the promise and limitations of their argument, as well as other possibilities. Ultimately, the Comment concludes that the FAA should not preempt administrative claims by workers, but that without Congressional action, a satisfactory solution is unlikely.

II. BACKGROUND

In recent years, increasing numbers of employers have made use of mandatory arbitration clauses in job applications and employment contracts.¹⁷ They are mandatory in the sense that they must be signed as a condition of employment, and if a dispute arises between employer and employee it must be resolved by binding arbitration, rather than in court.¹⁸ Arbitration is a faster and less formal process than litigation.¹⁹ The parties are not required to adhere to procedural and evidentiary rules, and judicial review is quite limited.²⁰ To understand the increase in mandatory arbitration clauses in employment contracts, it is necessary to look at the history of arbitration in the United States, focusing in particular on the FAA.

A. *The Federal Arbitration Act*

In 1925, Congress passed the Federal Arbitration Act, which gave arbitration agreements the same legal standing as any contract.²¹ Merchants and trade associations since colonial times had used arbitration, because it provided a relatively fast, informal, private and inexpensive means of dispute resolution.²² However, English and American common law had always been hostile to arbitration, and Congress intended to change that. Its goal was to create a "liberal federal policy favoring arbitration agreements."²³ The FAA states that "a contract evidencing a transaction involving commerce to settle by arbitration a controversy thereafter arising out of such contract or transac-

17. See *supra* note 12.

18. Mandatory arbitration can be distinguished from voluntary arbitration, in which, once a dispute arises, the parties can mutually agree to arbitration. Voluntary arbitration is beyond the scope of this Comment, except to note that many of the critics of mandatory arbitration advocate voluntary arbitration as an alternative. See Michael Rubin, *Point Counterpoint: Voluntary ADR is Preferable to Mandatory Arbitration Agreements Which are Sure to Result in More Litigation*, California Bar Journal, <http://www.calbar.ca.gov/calbar/2cbj/01may/page10-1.htm> (May 2001).

19. LAURA J. COOPER ET AL., ADR IN THE WORKPLACE 546-48 (2000).

20. *Id.*

21. Brandon L. Peak, Note, *EEOC v. Waffle House, Inc.: Employers Beware—the EEOC is Now the "Master of its own Case,"* 54 MERCER L. REV. 1235, 1238 (2003).

22. *Id.* at 1237.

23. *Id.* at 1238 (quoting *Moses H. Cone Mem'l Hosp. v. Mercury Constr. Corp.*, 460 U.S. 1 (1983)).

tion . . . shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity."²⁴ Section 3 of the FAA provides that when parties have a written arbitration agreement, one of the parties can stay a judicial proceeding over a dispute covered by that agreement.²⁵

For decades after the enactment of the FAA, the Supreme Court interpreted it narrowly. It was held to apply only to admiralty cases or commerce cases brought in federal court based on federal question or diversity jurisdiction.²⁶ In addition, the Court was hostile to the FAA in cases where federal statutes were involved.²⁷ However, in the 1980s, "the FAA was virtually rewritten by the Supreme Court, ushering in a new era in arbitration law."²⁸ In a series of cases, the Court held that: 1) the FAA applies in state as well as federal courts and preempts conflicting state law;²⁹ 2) the FAA establishes a presumption of arbitrability, i.e., "as a matter of federal law, any doubts concerning the scope of arbitrable issues should be resolved in favor of arbitration;"³⁰ and 3) the FAA applies to statutory claims.³¹

Employment disputes frequently involve statutory claims, especially civil rights claims. Despite its general approval of arbitration for statutory claims after 1985, however, the Court granted special protection to claims brought under Title VII of the Civil Rights Act of 1964 (Title VII).³² A few years earlier, the Court had unanimously held in *Alexander v. Gardner-Denver Co.*,³³ that anti-discrimination policy is of such high priority that "there can be no prospective waiver of an employee's rights under Title VII."³⁴ The Court viewed arbitration as "well suited to the resolution of contractual disputes . . . [but] inappropriate . . . for the . . . resolution of rights created by Title VII."³⁵ The Court reasoned that arbitrators "effectuate the intent of the parties rather than the requirements of enacted legislation,"³⁶

24. Hai Jiang, Note, *Do We Allow Contract Law to Administer Civil Rights Remedies? Casenote on Haskins v. Prudential Insurance Co.*, 2003 L. REV. MICH. ST. U. - DETROIT C. L. 251, 254 (quoting 9 U.S.C. § 2 (2000)).

25. 9 U.S.C.A. § 3 (West 1999).

26. Katherine Van Wezel Stone, *Rustic Justice: Community and Coercion Under the Federal Arbitration Act*, 77 N.C. L. REV. 931, 944 (1999).

27. Jiang, *supra* note 24, at 255.

28. Stone, *supra* note 26, at 943.

29. *Southland Corp. v. Keating*, 465 U.S. 1 (1984).

30. *Moses H. Cone Mem'l Hosp. v. Mercury Constr. Corp.*, 460 U.S. 1, 24-25 (1983).

31. *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*, 473 U.S. 614 (1985). *Mitsubishi* was an international commercial law case, but it provided a strong signal that the Court was now willing to allow arbitration of statutory claims. In addition, the Court made it clear that arbitration was now a favored approach to dispute resolution: "[W]e are well past the time when judicial suspicion of the desirability of arbitration and of the competence of arbitral tribunals inhibited the development of arbitration as an alternative means of dispute resolution." *Id.* at 626-27.

32. 42 U.S.C.A. § 2000e (West 1999 & Supp. 2003)

33. 415 U.S. 36 (1974).

34. *Id.* at 51.

35. *Id.* at 56.

that arbitration produces a less complete record, does not employ the usual reasons of evidence or civil procedure, and does not require arbitrators to give reasons for an award.³⁷

In surprising contrast to this strong stand against arbitration of employment discrimination claims in 1974, in 1991 the Supreme Court ruled in *Gilmer v. Interstate/Johnson Lane Corp.*,³⁸ that an employee could be forced to arbitrate an age discrimination claim under the Age Discrimination in Employment Act.³⁹ In *Gilmer*, the court distinguished *Gardner-Denver* because the latter involved a collective bargaining agreement.⁴⁰ The Court went further, however, stating that *Gardner-Denver* reflected “[t]he view that arbitration was inferior to the judicial process for resolving statutory claims . . . [a view that] has been undermined by our recent arbitration decisions.”⁴¹ The Court concluded, “by agreeing to arbitrate a statutory claim, a party does not forgo the substantive rights afforded by the statute; it only submits to their resolution in an arbitral, rather than a judicial, forum.”⁴²

The tide had turned. Not only did the Court endorse mandatory arbitration of statutory claims, it was now willing to extend its approval to civil rights claims arising out of employment disputes. The *Gilmer* decision was narrow in its effect, however. The arbitration clause at issue was not in an employment contract, but part of an application to register with the New York Stock Exchange, which *Gilmer* was required by his employer to fill out.⁴³ The Court did not rule on the broader question of whether the FAA applied to employment contracts generally.⁴⁴

Why would the Court have to answer such a question? As discussed below, the question was created in 1925, in the wording of the FAA itself. It was only in 1991, however, that the question came to the forefront. Because employment disputes so often involve statutory—and especially civil rights—claims, and because the *Gilmer* Court had broadly embraced arbitration of statutory claims, it became important to know whether the FAA cov-

37. *Id.* at 57-58.

38. 500 U.S. 20 (1991).

39. 29 U.S.C.A. §§ 621-634 (West 2002 & Supp. 2003). It is of interest to note that the Court in 1991 had only four members who had participated in the *Gardner-Denver* decision (Justices Rehnquist, Marshall, Blackmun and White). The other members were new (Justices Souter, Scalia, Stevens, Kennedy and O'Connor) and for the most part more conservative than the justices they replaced. Supreme Court Historical Society, *Timeline of the Justices*, at http://www.supremecourthistory.org/02_history/subs_timeline/02_a.html (last visited Feb. 19, 2004); Supreme Court Historical Society, *The Current Court*, at http://www.supremecourthistory.org/02history/subs_current/02_b.html (last visited Feb. 19, 2004).

40. *Gilmer*, 500 U.S. at 34-35.

41. *Id.* at 34 n.5.

42. *Id.* at 26 (quoting *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*, 473 U.S. 614, 628 (1985)).

43. *Id.* at 23.

44. Edward A. Marshall, *Title VII's Participation Clause and Circuit City Stores v. Adams: Making the Foxes Guardians of the Chickens*, 1 BERKELEY J. EMP. & LAB. L. 71, 80

ered employment contracts. Unfortunately, the text of the FAA contains no clear answer to the question.⁴⁵

B. *The Question of Employment Contracts in the FAA*

The FAA excludes some employment contracts from its coverage, but does not make clear which ones. Excluded are “contracts of employment of seamen, railroad employees, or any other class of workers engaged in foreign or interstate commerce.”⁴⁶ Just who are these other workers? The statute does not tell us. This ambiguity has led to considerable conflict in the courts in the wake of the *Gilmer* decision.

Why should employment contracts be different than any others? Those who argue that employment contracts should be excluded from the FAA point out that arbitration developed as an arrangement between merchants to settle their disputes.⁴⁷ Commercial arbitration agreements are voluntarily “arrived at after arms length bargaining and a determination by each party that the agreement is in its best interests.”⁴⁸ In contrast, unequal bargaining power permeates the employment relationship.⁴⁹ When a job is at stake, an agreement to arbitrate is not the result of a bargained-for exchange. The employee needs the job and is unlikely to challenge or even question the clause.⁵⁰ Moreover, the employee has little knowledge of the likelihood that he may end up in a dispute with his new employer.⁵¹

The terms of the arbitration agreement are designed and controlled by the employer, and are imposed unilaterally on the employee.⁵² Employers may also benefit as “repeat players” in the arbitration process, where they may have undue influence with the arbitrators who benefit from their continuing business.⁵³ Limits on discovery may hinder the employee in building a case against his employer, and even if he prevails in arbitration, the remedies available to him may be more limited than those provided by statute.⁵⁴ For example, he may not be able to win punitive damages, attorney fees, or reinstatement.⁵⁵

45. *Id.* at 81-82.

46. 9 U.S.C.A. § 1 (West 1999 & Supp. 2003) (emphasis added).

47. Jiang, *supra* note 24, at 273.

48. Martin H. Malin, *Privatizing Justice—But by How Much? Questions Gilmer Did Not Answer*, 16 OHIO ST. J. ON DISP. RESOL. 589, 595 (2001).

49. Jiang, *supra* note 24, at 273.

50. Malin, *supra* note 48, at 596.

51. *Id.*

52. *Id.* at 598. An exception is the case of a highly paid executive, who is able to negotiate the terms of his employment, including an agreement to arbitrate. *Id.* The vast majority of employees, however, hold no such bargaining power.

53. Lisa Bingham, *On Repeat Players, Adhesive Contracts and the Use of Statistics in Judicial Review of Employment Arbitration Awards*, 29 MCGEORGE L. REV. 223, 224 (1998).

54. Malin, *supra* note 48, at 599-600.

Arbitrators are not bound to follow case precedent or statutes, and have “wide latitude in their interpretation of laws.”⁵⁶ Thus, the employee may lose, even though he has the law on his side. If he loses, it is highly unlikely that he will succeed in having the ruling vacated by a judge. The FAA requires corruption, fraud, or misconduct in the arbitration process in order for a court to vacate an arbitration award.⁵⁷ Most courts have held that mere errors of law are not sufficient to vacate an award. Instead, there must be “manifest disregard of law,” which generally requires a finding that the arbitrator “deliberately disregarded what [he] knew to be the law.”⁵⁸ This standard is especially difficult to achieve because arbitrators are generally not required to provide written explanations of their opinions.⁵⁹

Because of these problems, many commentators have argued that employment agreements should not be subject to the FAA, and employees should retain full access to the courts to resolve employment disputes.⁶⁰ However, others argue that arbitration agreements are advantageous to employees. For example, one commentator points out that in a litigation-based system, the only employees who reap lucrative jury verdicts or settlements are those with high enough salaries to attract competent attorneys and to withstand the costs and risks of a lawsuit.⁶¹ He argues that arbitration provides “accessible justice for average claimants . . . [who] will benefit [from] lower costs . . . [and] a prompt resolution more suitable for claims by incumbent employees or even former employees truly desiring reinstatement.”⁶² Others note that in arbitration there is generally no summary judgment, so the employee will always be sure to have his case heard on the merits.⁶³ The debate goes on, but in the meantime the Supreme Court stepped

56. Jiang, *supra* note 24, at 273.

57. 9 U.S.C.A. § 10 (West 1999 & Supp. 2003).

58. Steven J. Ware, *Default Rules from Mandatory Rules: Privatizing Law Through Arbitration*, 83 MINN. L. REV. 703, 724 (1999). See *Moncharsh v. Heily & Blasé*, 832 P.2d 899, 904, 919 (1992) (“[W]ith narrow exceptions, an arbitrator’s decision cannot be reviewed for errors of fact or law. . . . Further, the existence of an error of law apparent on the face of the award that causes substantial injustice does not provide grounds for judicial review.”).

59. Ware, *supra* note 58, at 721.

60. Russell D. Feingold, *Mandatory Arbitration: What Process is Due?*, 39 HARV. J. ON LEGIS. 281 (2002). Senator Feingold (D-Wis.) and Representative Dennis Kucinich (D-Ohio) have separately authored (unsuccessful) legislation to amend the FAA to exempt all employment contracts. *Id.* at 293-94. Compare Marshall, *supra* note 44, at 107 (advocating that Congress provide protection from employer retaliation to employees covered by arbitration agreements who seek to arbitrate a statutory claim) with David S. Schwartz, *Enforcing Small Print to Protect Big Business: Employee and Consumer Rights Claims in an Age of Compelled Arbitration*, 1997 WIS. L. REV. 33 (calling on the courts to stop enforcing arbitration contracts in employment) and Jiang, *supra* note 24, at 276-77 (advocating a heightened standard of judicial scrutiny in civil rights employment cases).

61. Samuel Estreicher, *Saturns for Rickshaws: The Stakes in the Debate over Predispute Employment Arbitration Agreements*, 16 OHIO ST. J. ON DISP. RESOL. 559, 563-64 (2001).

62. *Id.* See also Charity Robl, *Recent Development: Circuit City Stores, Inc. v. Adams*, 17 OHIO ST. J. ON DISP. RESOL. 219, 227 (2001) (making many of the same arguments).

up to the plate in 2001, and decided what the FAA meant by its exclusion of “any other class of workers engaged in foreign or interstate commerce.”⁶⁴

C. Circuit City Stores v. Adams

By 2001, all of the federal courts of appeal had interpreted the FAA’s statement of exclusion in narrow terms, and held that the FAA applied to most employment contracts—all, that is, except the Ninth Circuit Court of Appeals.⁶⁵ Moreover, the other federal courts saw nothing in the “text, legislative history, or purposes underlying Title VII mandating an exception for the civil rights statute.”⁶⁶ Only the Ninth Circuit held that the FAA’s exclusion of employment contracts of “any other class of workers engaged in foreign or interstate commerce” meant that all contracts of employment fell outside the scope of the statute.⁶⁷ In *Circuit City Stores, Inc. v. Adams*,⁶⁸ the Supreme Court, in a five to four ruling, reversed the Ninth Circuit and held that “Section 1 [of the FAA] exempts . . . *only contracts of employment of transportation workers.*”⁶⁹ The Court did not specifically address the issue of a Title VII exception, because the case before it involved claims brought under California law. The following year the Court reaffirmed its ruling in a Title VII case, *EEOC v. Waffle House, Inc.*⁷⁰ In this case, all nine justices endorsed the idea that the FAA applies to employment contracts.⁷¹ However, the majority also held that the Equal Employment Opportunity Commission (EEOC) was free to pursue a claim on behalf of an individual, despite the existence of an arbitration agreement.⁷² This ruling will have limited effect on employment disputes, considering that the EEOC brings suit in a very small number of cases each year.⁷³ However, the EEOC’s ability to pursue statutory claims notwithstanding an arbitration clause has important implications for the California Labor Commission, as shown below.

64. Marshall, *supra* note 44, at 80-81 (quoting 9 U.S.C § 1 (1999)).

65. *Id.* at 72.

66. *Id.*

67. *Id.* See also *Craft v. Campbell Soup Co.*, 177 F.3d 1083 (9th Cir. 1999); *Duffield v. Robertson Stephens & Co.*, 144 F.3d 1182 (9th Cir. 1998).

68. 532 U.S. 105 (2001).

69. *Id.* at 119 (emphasis added).

70. 534 U.S. 279 (2002).

71. Peak, *supra* note 21, at 1250. The Ninth Circuit Court of Appeals acknowledged this reality in September 2003, when it reheard en banc a case decided in 2002. On rehearing, the court reaffirmed its earlier holding that *Duffield* was overruled, and that arbitration clauses cannot be barred in Title VII employment cases. *EEOC v. Luce, Forward, Hamilton & Scripps*, 345 F.3d 742 (9th Cir. 2003).

72. *Waffle House*, 534 U.S. at 297-98.

73. Peak, *supra* note 21, at 1250.

III. LAW

As a result of *Circuit City*, *Waffle House*, and earlier decisions holding that the FAA preempts state law,⁷⁴ states can no longer declare the FAA inapplicable to employment contracts, even where statutory claims are involved.⁷⁵ An arbitration clause can be challenged only under general state contract law doctrines,⁷⁶ in particular the doctrine of unconscionability.⁷⁷ This is what happened in *Circuit City v. Adams* on remand (*Adams III*),⁷⁸ where the Ninth Circuit held that the arbitration clause was unenforceable, because its terms were unconscionable.⁷⁹ Thus, state contract law provides a means of challenging arbitration clauses on a case-by-case basis. However, the unconscionability standard is traditionally difficult to meet, and some commentators argue that it will apply only to the most egregious cases.⁸⁰ Nevertheless, state courts have made use of the concept in developing guidelines for evaluating arbitration clauses.

The California Supreme Court provided guidelines for its lower courts to follow in *Armendariz v. Foundation Health Psychcare Services, Inc.*⁸¹ In this case, the plaintiff brought a claim for wrongful termination against her employer under the Fair Employment and Housing Act of California (FEHA),⁸² which is the state analogue to a Title VII claim.⁸³ The employer sued to compel arbitration, based on a mandatory agreement signed by the plaintiff.⁸⁴ The court found the arbitration clause unconscionable because it required the employee, but not the employer, to arbitrate disputes,⁸⁵ and because it provided for limited damages and remedies.⁸⁶ The court considered whether the offending provisions could be severed and the remainder of the

74. See, e.g., *Southland Corp. v. Keating*, 465 U.S. 1 (1984).

75. Plourde, *supra* note 12, at 171-72.

76. "The principles of contract law . . . require courts to enforce any arbitration contract unless there is a showing of fraud, duress, mistake, or other misconduct. . . ." Jiang, *supra* note 24, at 277.

77. Under California Civil Code § 1670.5, a court can refuse to enforce a contract provision which is unconscionable. CAL. CIV. CODE § 1670.5 (West 2003). Determining unconscionability involves a two-prong test: 1) procedural unconscionability (oppression or surprise due to unequal bargaining power) and 2) substantive unconscionability (harsh or one-sided results). Both must be present (though not in the same degree) in order for a court to void a provision or an entire contract. *Armendariz v. Found. Health Psychcare Servs., Inc.*, 6 P.3d 669, 690 (2000).

78. *Circuit City v. Adams* (*Adams III*), 279 F.3d 889 (2002).

79. Plourde, *supra* note 12, at 172-73 (discussing *Circuit City*).

80. *Id.* at 175.

81. 6 P.3d 669 (2000).

82. CAL. GOV'T CODE §§ 12900-12996 (West 1992 & Supp. 2004).

83. *Armendariz*, 6 P.3d at 674.

84. *Id.* at 675.

85. *Id.* at 692.

86. *Id.* at 694.

contract enforced.⁸⁷ It concluded that the lack of mutuality was not severable: the contract was “permeated by unconscionability,” and was thus invalid.⁸⁸

In its opinion, the California Supreme Court stated six requirements for a valid arbitration clause, based on contract law principles.⁸⁹ An agreement that requires an employee to arbitrate statutory claims: 1) cannot limit an employee’s statutory damages; 2) must allow the full range of discovery, unless there is an express agreement to the contrary; 3) must provide for a written arbitration decision to allow for judicial review; 4) must require a neutral arbitrator; 5) cannot require the employee to pay any expense that is unique to arbitration; and 6) must apply to the employer as well as the employee.⁹⁰

The focus on statutory claims reflects the California Supreme Court’s concern that employers might use arbitration agreements to contract out of their statutory obligations. The court quoted dicta from the U.S. Supreme Court’s opinion in *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*,⁹¹ pointing out that when a party agrees to arbitrate a statutory claim, it “does not forgo the substantive rights afforded by the statute [but] only submits to their resolution in an arbitral, rather than a judicial, forum.”⁹² Noting that this point is prescriptive as well as descriptive, the *Armendariz* court declared, “[I]t sets a standard by which arbitration agreements . . . are to be measured, and disallows forms of arbitration that in fact compel claimants to forfeit certain substantive statutory rights.”⁹³ The court stated that statutory rights created for a public purpose rather than for individual benefit cannot be waived and concluded, “An arbitration agreement cannot be made to serve as a vehicle for the waiver of statutory rights created by the FEHA.”⁹⁴

Thus, the California Supreme Court made clear in *Armendariz* that, while it endorses the concept that the FAA applies to employment contracts and to statutory claims, it intends to apply close scrutiny to the arbitration clauses in those contracts.⁹⁵ Recent California and Ninth Circuit cases have reaffirmed and extended *Armendariz* principles.⁹⁶

87. *Id.* at 695-99.

88. *Id.* at 698.

89. Bernard Finnegan, Note, *The California Supreme Court Framework for Mandatory Arbitration Agreements: Armendariz v. Foundation Health Psychcare Services, Inc.*, 36 U.S.F. L. REV. 571, 578-82 (2002).

90. *Id.*

91. 473 U.S. 614 (1985).

92. *Armendariz*, 6 P.3d at 679 (quoting *Mitsubishi Motors*, 473 U.S. at 628).

93. *Id.* at 680.

94. *Id.* at 681.

95. *Id.* at 679.

96. *Mercuro v. Countrywide Secs. Corp.*, 116 Cal. Rptr. 2d 671 (2002); *Little v. Auto Stiegler, Inc.*, 63 P.3d 979 (2003); *Ingle v. Circuit City Stores, Inc.*, 328 F.3d 1165 (9th Cir. 2003).

In *Mercuro v. Countrywide Securities Corp.*,⁹⁷ the Second District of the California Court of Appeal expanded the reach of *Armendariz*, declaring, “*Armendariz’s* ‘particular scrutiny’ of arbitration agreements should [not] be confined to claims under FEHA. Rather . . . such scrutiny should apply to the enforcement of rights under any statute enacted ‘for a public reason.’”⁹⁸ The court held that *Armendariz* principles therefore applied to claims brought under the California Labor Code as well.⁹⁹

In 2003, the California Supreme Court further broadened the reach of *Armendariz* in *Little v. Auto Steigler*.¹⁰⁰ The court extended *Armendariz* protections to cover a *non-statutory* employment claim: a *Tameny* claim for termination “in violation of public policy.”¹⁰¹ The court reasoned that employees’ public policy rights are as strong as statutory rights, and should therefore fall under *Armendariz* as well.¹⁰²

Most recently, in *Ingle v. Circuit City*,¹⁰³ the Ninth Circuit Court of Appeals declared that an arbitration clause in an employment contract “raises a rebuttable presumption of substantive unconscionability.”¹⁰⁴ “Unless the employer can demonstrate that the effect of a contract to arbitrate is bilateral . . . with respect to a particular employee, courts should presume such contracts substantively unconscionable.”¹⁰⁵ This means that employers will be required to make an initial showing that the duties, obligations and benefits of the agreement affect the employer and employee equally.¹⁰⁶

This is a holding of potentially broad scope, as it appears to apply *Armendariz* to all arbitration clauses in employment contracts, and to all types of claims.¹⁰⁷ Moreover, *Armendariz* implied that mandatory arbitration agreements in employment contracts are per se procedurally unconscionable, because they are “imposed on employees as a condition of employment . . . [with] no opportunity to negotiate.”¹⁰⁸ Add to this *Ingle’s* rebuttable pre-

97. 116 Cal. Rptr. 2d 671 (2002).

98. *Id.* at 680 (quoting *Armendariz*, 6 P.3d 669, 680 (Cal. 2000)).

99. *Id.*

100. 63 P.3d 979 (2003).

101. *Id.* at 987 (citing *Tameny v. Atl. Richfield Co.*, 610 P.2d 1330, 1336 (Cal. 1980)).

102. *Id.*

103. 328 F.3d 1167 (2003).

104. *Id.* at 1174.

105. *Id.*

106. Wendy Lazerson, et al., *California Employment Alert: An Obstacle to Arbitration Agreements*, at www.gsy.fi/Publications/newsletters.asp?ID=373 (May 15, 2003).

107. *Ingle* involved claims brought under FEHA and Title VII, but the court did not limit its conclusion to statutory claims. It appeared, rather, to be making a general statement about arbitration contracts between employers and employees, regardless of the type of claim involved.

108. *Armendariz v. Found. Health Psychcare Servs., Inc.*, 6 P.3d 669, 690 (2000). The court actually stated that the arbitration agreement before it was a contract of adhesion, which it appeared to equate with procedural unconscionability. *Id.* In *Stirlen v. Supercuts, Inc.*, 60 Cal. Rptr. 2d 138 (1997), the court noted that procedural unconscionability turns on adhesive-

sumption of substantive unconscionability, and the unconscionability standard may not be so difficult to meet after all. Employers may now be facing an uphill battle when they seek to compel arbitration in California courts.

Armendariz and its progeny show that the California (and Ninth Circuit) courts are prepared to closely scrutinize arbitration clauses in employment contracts whenever they come before them. Following the *Armendariz* guidelines, the courts have declared many such agreements unconscionable and void when employers have sought to compel arbitration.¹⁰⁹ Even in cases where the employee was highly skilled or in management, and presumably had more bargaining power than the average worker, the courts have found arbitration agreements unconscionable.¹¹⁰

In some cases where the arbitration agreement was enforced, one clause was nevertheless severed as unconscionable.¹¹¹ In only a few cases has the arbitration agreement been enforced in its entirety.¹¹²

Thus, while *Circuit City* and *Waffle House* declared arbitration clauses in employment contracts legal and binding, the California (and Ninth Circuit) courts appear more likely than not to find these agreements unconscionable. These courts recognize the inherently unequal nature of arbitration agreements in the employment context, and rightly scrutinize the agreements closely for fairness. This works to the benefit of the employees in these cases. However, as long as the fairness of arbitration agreements is

hesion, thereby establishing the necessary element of procedural unconscionability.” *Id.* at 145-46. The Ninth Circuit in *Ingle* read *Armendariz* to hold that “it is procedurally unconscionable to require employees, as a condition of employment, to waive their right to seek redress of grievances in a judicial forum.” *Ingle*, 328 F.3d at 1172.

109. In addition to *Armendariz* and *Mercurio*, the California courts have held that arbitration contracts were unconscionable and thus void in *Gonzalez v. Hughes Aircraft Employees Fed. Credit Union*, 83 Cal. Rptr. 2d 763 (1999); *Kinney v. United Health Care Servs., Inc.*, 83 Cal. Rptr. 2d 348 (1999); *Stirlen v. Supercuts, Inc.*, 60 Cal. Rptr. 2d 138 (1997) (the preceding three cases predated *Armendariz* and were relied on in part in that opinion); *Pitzen v. Veritas Software*, No. A100181, 2003 Cal. App. Unpub. LEXIS 8259 (Aug. 29, 2003); *O’Hare v. Mun. Res. Consultants*, 132 Cal. Rptr. 2d 116 (2003); *Wilson v. Bally Total Fitness*, No. D039355, 2003 Cal. App. Unpub. LEXIS 5892 (June 18, 2003); *Hendrix v. Countrywide Home Loans, Inc.*, No. B153848, 2002 Cal. App. Unpub. LEXIS 6598 (July 17, 2002); and *Packin v. Astra USA, Inc.*, No. G023345, 2002 Cal. App. Unpub. LEXIS 4483 (Jan. 29, 2002). The Ninth Circuit Court of Appeals has held arbitration agreements unconscionable in *Circuit City Stores, Inc. v. Mantor*, 335 F.3d 1101 (2003); *Circuit City Stores, Inc. v. Adams*, 279 F.3d 889 (2002); and *Ferguson v. Countrywide Credit Indus., Inc.*, 298 F.3d 778 (2002).

110. *Stirlen v. Supercuts, Inc.*, 60 Cal. Rptr. 2d 138 (1997) (*Stirlen* was vice-president and chief financial officer of Supercuts, yet the arbitration agreement between them was found to be unconscionable); *Graham v. Scissor-Tail, Inc.*, 623 P.2d 165 (Cal. 1981) (arbitration agreement enforced between concert promoter and the musical group that hired him, but one clause found unconscionable and severed).

111. See generally *Graham*, 623 P.2d 165, on which *Armendariz* relied in part; *Ingle v. Circuit City*, 328 F.3d 1167 (9th Cir. 2003); *McManus v. CIBC World Markets*, 134 Cal. Rptr. 2d 446 (2003).

112. *Kim v. Sonic Auto., Inc.*, No. H024386, 2003 Cal. App. Unpub. LEXIS 6516 (2003); *Martinez v. Univision Television Group*, No. A100780, 2003 Cal. App. Unpub. LEXIS 6227 (2003).

The Labor Commission represents a powerful resource for workers, and many make good use of it. Since 1976, workers have filed approximately 50,000 wage and hour claims each year.¹²⁴ The Labor Commission requires the parties to meet for a settlement conference before proceeding to a hearing, and most claims are settled there or soon after.¹²⁵ Approximately 16,000 claims go to a Berman hearing each year; 70% of those are decided in favor of the employee.¹²⁶ Employers file appeals in Superior Court in about 1,000 of those cases, and the Labor Commission typically represents the employee at the appeal.¹²⁷ The original decision is affirmed by the Superior Court in approximately 90% of the appeals.¹²⁸

Since 1986, the Labor Commission has also had the authority, under California Labor Code section 98.7, to investigate and resolve employee complaints of discrimination arising under various sections of the Labor Code.¹²⁹ These relate primarily to retaliation by the employer when the employee exercises his rights under the Labor Code.¹³⁰ The Labor Commissioner was originally charged with enforcing nine Labor Code statutes, and by 2001, the number had increased to twenty-eight.¹³¹ In 2001, 1003 such complaints were filed, 60% of which were for retaliation or discrimination against an employee as a result of "filing or intent to file a claim with the Labor Commissioner."¹³² The next largest group of claims (15%) alleged discrimination due to reporting safety and health violations at the workplace.¹³³ Seven hundred ninety-nine cases were closed in 2001.¹³⁴ Of these, 50 were decided in favor of the complainant, 98 were settled to the mutual satisfaction of both parties, 172 were dismissed, and the remaining 479 were withdrawn or abandoned by the complainant.¹³⁵

P.2d 704, 706 (1998)).

123. The only exception to the no-charge policy is that the Labor Commissioner may assess reasonable attorney's fees against a complainant where a discrimination complaint is found to be "frivolous, unreasonable, groundless, and brought in bad faith" and where the complaint has been dismissed after a hearing by the Labor Commissioner. CAL. LAB. CODE § 98.7(d)(1) (West 2003).

124. Locker Interview II, *supra* note 119.

125. *Id.*

126. *Id.*

127. *Id.*

128. *Id.*

129. ARTHUR S. LUJAN, DIV. OF LABOR STANDARDS ENFORCEMENT, 2001 DISCRIMINATION COMPLAINT REPORT, <http://www.dir.ca.gov/dlse/2001DiscriminationComplaintReport.htm> (Mar. 5, 2002).

130. See *supra* note 9 for examples.

131. LUJAN, *supra* note 129. "[T]he majority of these statutes are contained in the Labor Code . . . but the [DLSE] also enforces statutes contained in the Health and Welfare Code, the Unemployment Insurance Code, and the Industrial Welfare Commission Orders." *Id.*

132. *Id.* This is prohibited by CAL. LAB. CODE § 98.6 (West 2003).

133. LUJAN, *supra* note 129.

134. *Id.*

A centralized Discrimination Complaint Investigation Unit with thirteen full-time Deputy Labor Commissioners, well-trained in investigation and report writing and knowledgeable about the relevant statutes, handles discrimination complaints.¹³⁶ Similarly, the Deputy Labor Commissioners who handle wage and hours claims at eighteen statewide offices are full-time employees, and are well versed in the statutes under which complaints arise.¹³⁷

The strong protections provided by the DLSE to workers are especially important in the context of at-will employment, in which employers are free to hire and fire for any reason, or for no reason.¹³⁸ It has long been recognized that the employer-employee relationship is inherently unequal,¹³⁹ and laws and administrative proceedings that protect workers help to partially offset their weaker position vis-à-vis their employers. The Labor Commission, with its highly trained staff dedicated solely to enforcing the Labor Code, is a valuable part of the protections enjoyed by California workers.¹⁴⁰

B. Labor Commission Cases Involving Arbitration Agreements

One of the protections contained in the Labor Code is section 229, which provides, "Actions to enforce the provisions of this article for the collection of due and unpaid wages claimed by an individual may be maintained without regard to the existence of any private agreement to arbitrate."¹⁴¹

Notwithstanding the position of the U.S. Supreme Court that the FAA extends to most employee contracts and preempts state law, the California Labor Commissioner has taken an assertive stance regarding arbitration clauses. Senior Counsel Miles Locker states, "DLSE will not halt proceedings on a wage claim in response to an employer's assertion that the claim is covered by an arbitration 'agreement.'"¹⁴² If an employer wants to halt the

136. *Id.*

137. CAL. LAB. CODE § 81 (West 2003). See generally Div. of Labor Standards Enforcement, *District Offices*, at <http://www.dir.ca.gov/dlse/DistrictOffices.htm> (last visited Feb. 22, 2004).

138. 4 LABOR AND EMPLOYMENT LAW § 130.02 (Matthew Bender) (2003). "Outside of the discrimination laws . . . there is simply no general statutory law which alters this basic rule [of at-will employment]." *Id.*

139. Jiang, *supra* note 24, at 273.

140. The DLSE sees its mission as serving employers as well: "to protect employers who comply with the law from those who attempt to gain competitive advantage at the expense of their workers by failing to comply with minimum labor standards." Div. of Labor Standards Enforcement, *Homepage*, at <http://www.dir.ca.gov/DLSE/dlse.html> (last visited Feb. 22, 2004).

141. CAL. LAB. CODE § 229 (West 2003).

142. E-mail from Miles Locker, Senior Counsel, California Labor Commission, to employer representative (Feb. 19, 2002), quoted in John M. True, *Point of View: Some Recent—and Surprising—Developments in Mandatory Employment Arbitration*, at www.leonardarden.com/articles/RecentArbitrationDevelopments.htm (last modified Feb. 22, 2004).

proceeding, he must file a motion to compel arbitration in Superior Court.¹⁴³ The court will examine the arbitration agreement under *Armendariz* guidelines. If the court finds the agreement unconscionable, it will deny the motion to compel arbitration, after which the employer is free to appeal.¹⁴⁴ The Labor Commission typically intervenes on behalf of the employee in the court proceeding, just as it does in other court proceedings pursuant to section 98 of the Labor Code.¹⁴⁵ Given the close scrutiny the California courts apply to these arbitration agreements, and the rigorous standards required by *Armendariz*, it is by no means certain that the employer will succeed in his motion to compel arbitration. While the DLSE does not collect data on the outcome of these motions, according to Locker, there have been an increasing number of such motions in recent years.¹⁴⁶ He estimates that in seventy-five percent of these cases, the court has found the arbitration agreement unconscionable and denied the motion.¹⁴⁷

The Labor Commission proceeding continues throughout this time, and only in the face of an order to compel arbitration will the Labor Commissioner halt it. Thus, the Labor Commission has made clear its view that California workers have the right to their “day in court,” albeit an administrative court, whether or not they have signed an agreement to arbitrate.

How have the courts responded to this position? The answer is mixed, and this area of law is still evolving. There are only a few cases that have gone up on appeal. As far back as 1987, the U.S. Supreme Court ruled in *Perry v. Thomas*¹⁴⁸ that the FAA preempts section 229 of the California Labor Code.¹⁴⁹ This case involved an employee who took his claim to court, however, rather than to the Labor Commission.¹⁵⁰ This ruling predated *Circuit City*, so the Court had yet to make it clear that the FAA was to apply to nearly all employment contracts.

A few years later, the California Court of Appeal addressed the validity of an arbitration clause in a Labor Commission case, *Baker v. Aubry*.¹⁵¹ As in *Perry*, the court held that the FAA preempted the California Labor Code, and that arbitration did not deprive appellant of her substantive rights under the Code.¹⁵² This case was unique, however, in that it involved an arbitration agreement signed not with the employer, but with the New York Stock Ex-

143. Interview with Michael Jackman, *supra* note 3.

144. *Id.*

145. *Id.* See CAL. LAB. CODE §§ 98.2 – 98.7 (West 2003).

146. Telephone Interview with Michael Locker, Senior Counsel, California Labor Commission (Sept. 16, 2003) [hereinafter Locker Interview I].

147. *Id.*

148. 482 U.S. 483 (1987).

149. *Id.* at 490-91. Section 229 is the anti-arbitration statement in the California Labor Code. The Court reasoned that because this statement is in direct conflict with the FAA, the state statute must defer. *Id.*

150. *Id.* at 484.

151. 265 Cal. Rptr. 381 (1989).

change (NYSE).¹⁵³ Commonly known as "U-4's," these agreements are required of all employees who register with the NYSE or National Association of Securities Dealers (NASD).¹⁵⁴ There is a long line of cases involving U-4 agreements,¹⁵⁵ and while they have generally been upheld as binding the employee to arbitrate disputes with the employer,¹⁵⁶ they are not, strictly speaking, employer-employee agreements. Moreover, "[a]fter many challenges against the arbitration of civil rights claims, the NYSE and NASD amended the rules. As of January 1, 1999, statutory employment-related discrimination claims are arbitrable only if the parties agree to arbitration after the dispute has arisen."¹⁵⁷ Therefore, *Baker*, like *Perry*, is not strictly applicable to Labor Commission cases today.

*Livadas v. Bradshaw*¹⁵⁸ is another case in a class by itself. The Labor Commission refused to take this case because the employee was covered by a collective bargaining agreement. However, the U.S. Supreme Court held that the employee could proceed with her Labor Commission claim because it was outside the scope of her collective bargaining agreement.¹⁵⁹ *Livadas* is one of a line of cases that have held that employees under collective bargaining agreements (which typically contain arbitration clauses) may pursue statutory employment disputes in court or other tribunals.¹⁶⁰ It is ironic that the workers who already have all the protections and benefits of a union contract are able to bypass arbitration to claim their statutory rights, while the least protected employees cannot do the same.¹⁶¹

153. *Id.* at 382. This case is also unique in that claimant was suing the Labor Commission under a writ of mandate to compel it to adjudicate her claim. This was prior to the Labor Commission's current stance on arbitration agreements. The Commissioner declined jurisdiction because of the arbitration agreement. *Id.*

154. Jiang, *supra* note 24, at 253.

155. See *id.* for a discussion of several U-4 cases. *Perry v. Thomas* was itself a U-4 case. 482 U.S. 483 (1987).

156. Jiang, *supra* note 24, at 251.

157. *Id.* at 254.

158. 512 U.S. 107 (1994).

159. *Id.* at 124-25. *Livadas'* claim was brought under California Labor Code section 203, which requires immediate payment of all wages owed upon severance of employment. This was an issue not covered in the collective bargaining agreement between her union and her employer. *Id.*

160. *Id.* at 123-24. The Court's rationale in these cases is that because the arbitration agreement is not entered into directly by the employee, but is part of a collective bargaining agreement, the employee cannot thereby be deprived of his statutory rights. *Id.* In addition, labor arbitrators have no authority to adjudicate statutory claims. *Id.* at 128 n.21 (citing *Alexander v. Gardner-Denver*, 415 U.S. 36, 53-54 (1974)). In *Livadas*, the Court also argued that to deny the union member the right to pursue statutory claims elsewhere is to force the member to choose between belonging to a union and protecting her statutory rights. *Id.* at 117. As such, it violates the intent of the National Labor Relations Act, which guarantees workers the right to bargain collectively. *Id.*

161. Michael R. Holden, Note, *Arbitration of State-Law Claims by Employees: An Ar-*

The first case directly on point is *FirstAmerica Automotive, Inc. v. Sweeney*.¹⁶² This 2000 case both pre-dated and presaged *Circuit City*. Here, the California Court of Appeal chose not to follow the Ninth Circuit's position, expressed in *Craft v. Campbell Soup, Co.*,¹⁶³ that the FAA excluded most employment contracts.¹⁶⁴ The *Sweeney* court held that the FAA did not exclude a car salesman from coverage, and therefore the FAA applied to his case and preempted section 229 of the California Labor Code.¹⁶⁵ *Sweeney* was therefore unable to pursue his claim for unpaid wages with the Labor Commissioner.¹⁶⁶

Whether arbitration agreements can be enforced in Labor Commission cases seems to have been answered once and for all in *Circuit City Stores, Inc. v. Adams*,¹⁶⁷ and the answer seems to undermine the position of the Labor Commissioner. In *Circuit City*, the Court decreed that most employment contracts fall within the scope of the FAA,¹⁶⁸ and that the FAA preempts contrary state law.¹⁶⁹ Thus, it would seem that an employee who has signed an arbitration clause is now barred from bringing a claim under the California Labor Code to the Labor Commission (or to court).

However, as discussed earlier, the situation is made more complex by the fact that arbitration agreements are subject to state contract law and the doctrine of unconscionability.¹⁷⁰ The court held in *Mercurio v. Countrywide Securities Corp.*¹⁷¹ that the arbitration agreement signed by Mr. Mercurio could not be enforced because its terms were unconscionable under *Armendariz*.¹⁷² Mercurio's claims were brought under FEHA and the California Labor Code.¹⁷³ While he pursued his claims in court, he could have brought the Labor Code claims to the Labor Commission. Had he done so, the court's ruling would have allowed him to pursue his Labor Commission claim. Thus, while an arbitration agreement theoretically trumps an employee's right to take a claim to the Labor Commissioner (or to court), the employer will often fail when it tries to compel arbitration, because the agreement is held unconscionable under *Armendariz*. This means that, while in theory, *Circuit City* overrules the Labor Commissioner's refusal to honor arbitration clauses, in practice the Labor Commissioner may prevail after all.¹⁷⁴

162. 94 Cal. Rptr. 2d 623 (Ct. App. 2000).

163. 177 F.3d 1083, 1094 (9th Cir. 1998).

164. *Sweeney*, 94 Cal. Rptr. 2d at 625.

165. *Id.*

166. *Id.*

167. 532 U.S. 105 (2001).

168. *Id.* at 119.

169. *Id.* at 121-22.

170. See *supra* notes 74-113 and accompanying text.

171. 116 Cal. Rptr. 2d 671 (2002).

172. *Id.* at 680, 682.

173. *Id.* at 679. The California Labor Code claims were brought under sections 230.8 and 970. *Id.* at 680.

174. The California Labor Commission has seen an increasing number of its cases go to 19

C. Labor Commission Discrimination Claims

Mr. Mercurio's Labor Code claims were actually discrimination claims, not wage claims.¹⁷⁵ When an employee files a discrimination claim with the Labor Commission, he hands the claim over to the Labor Commission for investigation and a decision, rather than going directly against his employer.¹⁷⁶ Here, the Labor Commission is in a position similar to that of the EEOC in *Waffle House*.¹⁷⁷ The Labor Commission argues that like the EEOC, it is a third party and can pursue victim-specific relief, notwithstanding an arbitration agreement.¹⁷⁸ *Ralph's Grocery Co. v. Massey*,¹⁷⁹ is a Labor Commission discrimination case currently on appeal in the Fourth District Court of California. At trial, the employer moved to prevent the Labor Commission from investigating and to compel arbitration.¹⁸⁰ The trial judge denied the motion, agreeing with the Labor Commission that it held third party status and could pursue its investigation on behalf of Mr. Massey.¹⁸¹ *Ralph's* is now appealing the ruling, arguing that the Labor Commission is not a third party, but an agent of Massey.¹⁸²

The Labor Commission appears to be on strong legal ground here, with *Waffle House* as precedent. If it can establish that it is acting as a third party in discrimination cases, it will be able to pursue claims on behalf of individual claimants, notwithstanding an arbitration agreement. Rather than relying on the likelihood that an arbitration agreement will be held unconscionable, as it must in wage claims, the Labor Commission could proceed with a discrimination case with greater certainty and efficiency.

IV. LEGAL ANALYSIS

Despite the California courts' willingness to void unfair arbitration agreements in employment contracts, this is not an adequate solution to those who see mandatory arbitration as unfair in the employment context.

court in recent years on the employer's motion to compel arbitration. Locker Interview I, *supra* note 146. The motions to compel arbitration are denied in approximately seventy-five percent of these cases because the arbitration agreement is held to be unconscionable. *Id.*

175. *Mercurio v. Countrywide Secs. Corp.*, 116 Cal. Rptr. 2d 671, 685 (2002). Mr. Mercurio filed claims under California Labor Code section 230.8, which prohibits an employer from discriminating against workers for taking time off to participate in their children's school activities; and section 970, which prohibits employers from fraudulently inducing a person to change residences to take a job, by misrepresenting the terms and conditions of employment. *Id.* at 680.

176. CAL. LAB. CODE § 98.7 (West 2003).

177. *EEOC v. Waffle House, Inc.*, 534 U.S. 279 (2002).

178. *Id.* at 297.

179. No. D042249 (4th Dist. Ct. App. filed May 23, 2003).

180. Interview with Michael Jackman, *supra* note 3.

181. *Ralph's Grocery Co. v. Kelvin Massey*, No. G.I.C. 805279 (Sup. Ct., San Diego County, California filed Apr. 22, 2003).

182. *Ralph's Grocery Co. v. Kelvin Massey*, No. D042249.

For every plaintiff who asserts the right to take an employment claim to court or to the Labor Commission, there are no doubt many more who do not, even though they may have signed an unconscionable arbitration agreement. Many will not know that their arbitration agreement is unconscionable, because the only way to be sure is to have it tested in court. Many will believe their employer who tells them they have no choice but to arbitrate an employment dispute.

In addition, the current situation actually creates a new source of litigation—a “race to the courthouse”¹⁸³ to determine whether the claimant has the right to take his claim to the Labor Commission or to court, or whether he must submit it to arbitration. To the extent that the FAA was designed to reduce courthouse congestion, this trend in employment law is counterproductive.

A new development in this area is the legal theory currently being proposed by attorneys at the Labor Commission.¹⁸⁴ They are taking a proactive stance with regard to their rights to take claims in the face of an arbitration agreement. Their position is:

1. Under *Armendariz*, employees cannot be required to give up their substantive rights. By taking away their right to have an administrative agency resolve their employment dispute, forcing arbitration amounts to a loss of substantive rights.¹⁸⁵

2. The FAA was not intended to, and does not, state that it preempts the right to an administrative hearing.¹⁸⁶

3. In order for an arbitration agreement in California to comport with *Armendariz*, it should contain a provision granting the employee the right to proceed first to the Labor Commission to resolve any dispute that falls under its jurisdiction. If the employer wants to appeal the decision of the Labor Commission, it must post an appeal bond equal to the amount of the disputed award (as currently provided for in the California Labor Code¹⁸⁷). In this case, however, arbitration—rather than Superior Court—would become the appeal forum.¹⁸⁸

This theory is still being developed and has yet to be tested in court. However, if successful, it would establish the Labor Commission’s right to proceed with any claim within its jurisdiction, notwithstanding the existence of an arbitration agreement. If an arbitration agreement existed, it would serve as an appeals forum. This would eliminate the case-by-case approach of testing the validity of each arbitration agreement. With this theory, the Labor Commission is attempting to establish that administrative proceedings

183. Interview with Michal Belknap, Professor of Law, California Western School of Law, in San Diego, Cal. (Sept. 23, 2003).

184. Locker Interview II, *supra* note 119.

185. *Id.*

186. *Id.*

187. CAL. LAB. CODE § 98.2(b) (West 2003).

188. Locker Interview II, *supra* note 119.

are not the same as judicial proceedings, and should be treated differently in resolving questions about arbitration of employment disputes.

The U.S. Supreme Court has made clear that the FAA preempts state employment law, and that when a valid arbitration agreement exists, it must be honored, even in statutory claims.¹⁸⁹ Disagree as one may with these rulings, they do not appear likely to be reversed in the near future. However, as we have seen, the question is not as fully settled as it may at first appear. Even with judicial claims, employees are able to take a “back-door” route, by going to court, forcing the employer to move to compel arbitration, and in many cases having the arbitration agreement declared void.

Similarly, with Labor Commission claims, the employee may take a “back-door” route by going directly to the Labor Commission. In addition, the Labor Commission now argues that because it is an administrative forum, it is in a class by itself, similar to employees covered by collective bargaining agreements. As such, its cases warrant different treatment by the FAA. There are some strong arguments to be made in support of this position.

The Labor Commission’s administrative proceeding is a non-judicial forum, which shares many of the advantages of arbitration. Administrative proceedings are faster and lower in cost to all parties than court proceedings.¹⁹⁰ In fact, many cases are resolved at pre-hearing settlement conferences, which makes the process even more efficient and conciliatory than arbitration.¹⁹¹

More importantly, Labor Commission Hearing Officers are extremely familiar with the relevant law and handle employment cases full-time.¹⁹² In addition, Labor Commission rulings are subject to *de novo* judicial review.¹⁹³ These facts stand in sharp contrast to arbitration, where the arbitrator is likely to be less familiar with California employment law, is not bound to apply the law, and where appeals are strictly limited.¹⁹⁴

The Labor Commission represents a valuable resource for employees, protecting their statutory rights and providing an efficient avenue for redress of their grievances. To preempt its authority undermines the fairness of social policy. An arbitration clause should not be allowed to stand between employees and their right to pursue claims with the Labor Commission.

189. *Circuit City Stores, Inc. v. Adams*, 532 U.S. 105 (2001); *EEOC v. Waffle House, Inc.*, 534 U.S. 279 (2002); *Perry v. Thomas*, 482 U.S. 483 (1987).

190. See *supra* notes 122-23 and accompanying text.

191. LEGAL AID SOC’Y EMP. LAW CTR., *supra* note 6, at 56.

192. CAL. LAB. CODE § 81 (West 2003).

193. *Id.* § 98.2(a).

194. See *supra* Part II.B.

V. CONCLUSION

Employees should not be forced to sign away their right to take a claim to the Labor Commission in order to obtain a job. The protections provided by the Labor Code and enforced by the Labor Commission were hard won, and should not be tossed aside.

In addition, employees should not have to rely on the courts to scrutinize arbitration clauses for unfairness. Many of these agreements are unconscionable in their terms, yet few will be tested in court. Many employees will not know that they have the right to challenge the arbitration agreement, and will assume that their employer is correct when he tells them that they have no choice but to proceed to arbitration. This can mean that arbitration will occur based on an illegal agreement to arbitrate. The employer will have succeeded in contracting out of his statutory obligations, evading the scrutiny of *Armendariz*.

When an arbitration clause is tested in court, it will frequently be found unconscionable under *Armendariz*, and the employee's statutory rights will be protected. However, this also means that one of the key purposes of arbitration has been defeated. Instead of shrinking the court docket, the arbitration clause has expanded it. Where there would have been one court proceeding over the claim, now there are two: one to test the arbitration clause, and if it is voided, another to try the claim. Even if the clause is found valid, the court docket has not been reduced: a court case on the claim has been replaced with a court case on the arbitration clause. Similarly, with a Labor Commission claim, an arbitration clause increases the use of court rooms, rather than decreases it.

Society is served by protecting employee's rights, and by striving to mitigate the inherently unequal relationship between employee and employer. Mandatory arbitration clauses do not do so, especially when they bar employee access to the Labor Commission—the very agency dedicated to protecting those rights.

The Labor Commission has so far been forced to take a “back-door” approach to upholding a claimant's right to pursue his claim in spite of an arbitration clause. This is often effective for an individual claimant, but ultimately insufficient as a broad solution to the problem. The Commissioner's new legal theory is an attempt to move from the “back-door” to the “front-door,” with a policy that exempts administrative proceedings from the FAA altogether. Is it likely to succeed? The California courts may respond favorably to the argument, based as it is on *Armendariz's* insistence on protecting the statutory rights of employees. However, if the Labor Commission's new approach is successful in individual cases, it will ultimately be tested on appeal, where the outcome is less certain. If the theory makes its way to the U.S. Supreme Court, it is not likely to find a friendly reception. The Court's recent positions on the FAA indicate that it favors arbitration in nearly every context, and will oppose any obstacles to it.

Ultimately, an act of Congress would probably be required to exempt administrative proceedings from the FAA. In recent years, Democratic members of Congress have introduced legislation exempting employment contracts altogether from the FAA, or at least barring mandatory arbitration of statutory claims for workers.¹⁹⁵ These attempts were unsuccessful. However, a proposal to exempt administrative proceedings from the FAA is much less sweeping in its scope. Because it is narrower, and because a good argument can be made that administrative proceedings offer both efficiency and protection of workers' statutory rights, such a proposal may stand a better chance of success.

Whatever the outcome, it seems safe to say that *Circuit City* and *Waffle House* have not given us the final word on arbitration clauses in employment contracts. In California, at least, any such thought is premature.

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195. See *supra* note 60.

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