California Supreme Court Provides Valuable Blueprint For Your Arbitration Agreement Strategy

Insights
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The California Supreme Court recently handed down an intriguing decision which casts doubt on – and in some cases even condemns – some of the most common practices used by employers in both drafting and presenting arbitration agreements to their employees. In doing so, the court highlighted circumstances under which similar agreements with "an unusually high degree" of procedural unconscionability may be blocked from being enforced. Accordingly, it's important that you understand which of the employer's terms and practices were criticized by the court so you can avoid those same pitfalls in your own arbitration programs moving forward.

Arbitration Agreements And Enforceability

To understand the holding in *OTO v. Kho*, we first have to understand the law on enforcing arbitration agreements in California. In general, agreements to arbitrate require the parties to pursue their claims before a private arbitrator (usually a retired judge) outside of the normal court system. Because of the reduced costs and delays associated with these more informal proceedings, many employers often choose to require their employees to consent to mandatory arbitration as a standard condition of their employment.

However, a court will refuse to enforce an arbitration agreement if the employee can show that the agreement is both (a) substantively unconscionable, such that the terms themselves were unfair or one-sided; and (b) procedurally unconscionable, such that the way the agreement was presented was unfair, surprising, or oppressive. In *OTO v. Kho*, the court considered both aspects when analyzing the agreement.

The Arbitration Agreement In Question

Ken Kho was a service technician for car dealership One Toyota of Oakland (also known as OTO). After working for the dealership for about three years, a low-level human resources employee stopped by Kho's work area to have him sign a handful of documents, including an arbitration agreement. The employee then waited by Kho's workstation for the three to four minutes that it took Kho to sign each of the documents. Kho's first language is Chinese, and he was not invited to review, discuss, or ask questions about the arbitration agreement. He was only told that he was required to sign and return it immediately, and was not provided with his own copies.

The agreement – "Comprehensive Agreement, Employment At-Will and Arbitration" – contained an arbitration provision that appeared as a dense, single-spaced paragraph filled with legalese. The

large paragraph, with text between 7 and 8.5 font, explained the terms of the agreement using long sentences (i.e. sometimes as long as 12 lines) and references to specific statutes, the effect of which weren't always expressly explained. For example, a reference to certain statutes could have been read to indicate that the employer would be responsible for paying for the arbitration, but a legally untrained employee unfamiliar with those statutes wouldn't be able to understand that from the agreement itself.

Approximately one year later, Kho's employment with OTO ended and he filed a complaint for unpaid wages with the California Department of Labor Standard's Enforcement (DLSE). The car dealership asked the agency to suspend the administrative DLSE proceedings—arguing that Kho was required to resolve the dispute in private arbitration per the terms of the signed agreement. The DLSE refused to call off the scheduled hearing, and OTO refused to participate. In the employer's absence, the hearing officer awarded Kho over $150,000 in damages. In response, OTO petitioned the California Superior Court to vacate the administrative award and compel the matter to arbitration. After several years of appeals, the California Supreme Court issued a ruling on the case on August 29, 2019.

The Unfortunate Presence Of "An Unusually High Degree" Of Procedural Unconscionability

Ultimately, the California Supreme Court struck down the arbitration agreement as both procedurally and substantively unconscionable. However, the court's main focus was on the agreement's "unusually high degree" of procedural unconscionability in particular — a criticism that went directly to the heart of how the agreement was presented to the employee. In relevant part, the court highlighted several key problems, including:

- The arbitration agreement appeared in a single paragraph containing 51 lines of text in either 7 point or 8.5 point font;
- The agreement contained complex sentences (one of them 12 lines long) filled with unexplained statutory references and legal jargon;
- The agreement was presented to Kho by a low-level employee who waited in his work bay for him to sign it;
- Kho did not have time to read it or ask questions of someone knowledgeable, and the agreement was not explained to him;
- Kho was not given a copy of the arbitration agreement after he signed it;
- The agreement was not clear as to who would pay for the arbitrator, due to the complex legal statutory language; and
- The agreement did not explain how to bring a dispute to arbitration. While the agreement mandated that the arbitrator be a "retired California Superior Court Judge," it gave no indication how an employee might find such a person, let alone one willing to arbitrate a wage claim.

Curiously, the court also held the agreement to be substantively unconscionable, but only in light of the "unusually high degree" of procedurally unconscionability already present. Specifically, the court took aim at the agreement's effective waiver of Kho's right to pursue his wage claims before the administrative agency — which would have provided a more informal and inexpensive forum to resolve his claims, as opposed to the more rigid arbitration procedure that closely approximated litigation within the traditional court system.

The court acknowledged that this waiver, standing alone, would in most cases be insufficient to find the agreement substantively unconscionable. However, because of the "unusually high degree" of procedural unconscionability, the facts indicated that Kho wasn't provided a full and fair chance to actually understand what he was actually waiving. As stated by the court, "had One Toyota set out the terms of its agreement in a legible format and fairly understanding language, or had it given Kho a reasonable opportunity to seek clarification or advice, this would be different case."

Recommendations

While it's unlikely that any of the above-described terms or practices, standing alone, would cause an arbitration agreement to be held unenforceable, the court's analysis provides a critical roadmap for employers. We now have a better understanding of what California courts will and won't be skeptical of when examining employer arbitration agreements. Based on this decision, it's critical to understand not only what's going into your arbitration agreements, but also how they are being rolled out to employees. Accordingly, with regard to your own policies, you may want to consider the following steps:

- Don't use illegible fonts in your arbitration agreements. The smaller you get, the more you will be approaching the "small print legalese" standard that the court in *OTO* took issue with as being surprising and unfair.
- Break up the agreement into multiple paragraphs. The larger, more complex, and dense you make the agreement, the more courts will believe you are drafting it "with an aim to thwart, rather than promote, understanding," as commented on by the court in *OTO*.
- Make things as readable and easy to understand as possible. While protracted sentences and references to statutes may technically communicate important information such as who will pay for or how to initiate the process, a legally untrained employee may not be able to discern this information just from the face of the agreement.
- Consider including a carveout that allows employees to still bring claims before administrative agencies like the DLSE. While the "unusually high degree" of procedural unconscionability was certainly the court's focus, if the agreement hadn't waived Kho's right to seek administrative relief, the outcome of the case may have been different.
- Make sure that employees are provided copies of the agreement and have ample opportunity to ask questions. If arbitration agreements are given to employees through electronic onboarding processes, a preliminary team meeting about the agreements may be helpful.

With these guidelines in mind, it's important that you carefully analyze your own practices related to arbitration agreements, and whether your terms might run afoul of the new decision. While each employer is unique, and what works for one may not work for another, this decision provides valuable insight into what employers can expect to be challenged on with regard to their own practices and agreements moving forward. In that way, it would be far from unwise to heed the California Supreme Court's new warning.

We recommend you work your California counsel as soon as possible to ensure your arbitration agreement and procedure for acquiring employee signature is in line with the most current standard. For more information, contact your regular Fisher Phillips attorney or one of the attorneys in any of our California offices:

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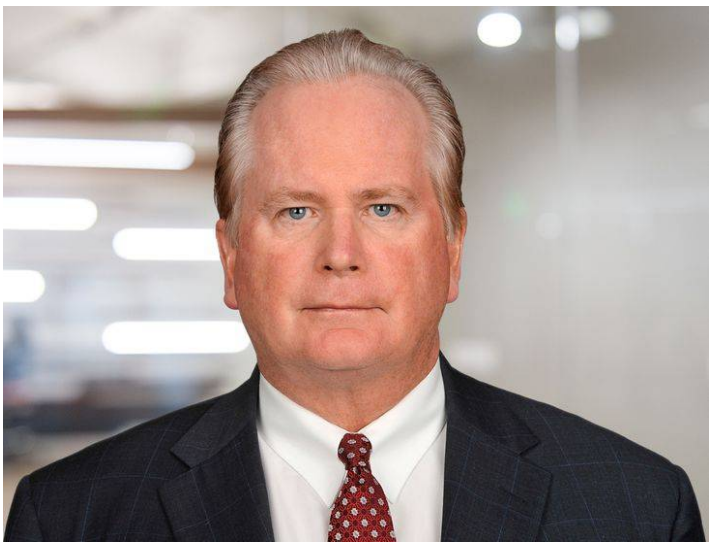

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