

# California Labor & Employment Law Review

Official Publication of the State Bar of California Labor and Employment Law Section

Volume 26  
No. 6

November  
2012

## SPECIAL ISSUE:

## ALTERNATIVE DISPUTE RESOLUTION

MCLE Self-Study:

### *Concepcion and Armendariz*

Goodbye *Armendariz*, Hello *Concepcion*:  
FAA Preemption of State Law Obstacles  
to Enforcement of Arbitration Agreements

By Tyler M. Paetkau and Jay Withee

*Concepcion* Has No Impact on the  
Application of the *Armendariz* Factors

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### I. INTRODUCTION

Over a decade ago, the Supreme Court of California recognized the enforceability of mandatory arbitration agreements in employment contracts in its landmark decision, *Armendariz v. Foundation Health Psychcare Services, Inc.*<sup>1</sup> *Armendariz* evaluated the enforceability of employment arbitration agreements under two frameworks: (1) certain minimum "fairness factors" aimed at preserving an employee's non-waivable statutory rights under the California Fair Employment and

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The question of how the United States Supreme Court decision in *AT&T Mobility v. Concepcion*<sup>1</sup> affects *Armendariz v. Foundation Health Psychcare Services, Inc.*<sup>2</sup> in its application to arbitration agreements has a surprisingly simple answer: It has no effect. *Concepcion* was a case that originated in federal, not state, court. (See discussion of the decision in Joel Grossman, *Big News in Arbitration: Sonic-Calabasas v. Moreno and AT&T Mobility v. Concepcion*, Cal. Labor & Employment L. Rev., p. 14 (July 2011).) In five prior U.S. Supreme Court opinions or dissents, Justice Thomas, the fifth vote in the

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Housing Act (FEHA) and (2) “general unconscionability principles” that govern all contracts. But now, *Armendariz* is questionable precedent in light of federal preemption under the Federal Arbitration Act (FAA),<sup>2</sup> as well as several recent pro-arbitration decisions that have rejected various “obstacles” to enforcement of arbitration agreements.

Squarely in the crosshairs of the recent line of federal pro-arbitration decisions is one of the two pillars of *Armendariz*’s analysis: the “[f]ive minimum requirements” for arbitration of “nonwaivable” statutory rights: (1) a neutral arbitrator; (2) “more than minimal” discovery; (3) a written award; (4) the availability of all court remedies; and (5) the prohibition of “unreasonable” arbitration costs being imposed on employees.<sup>3</sup>

More specifically, the United States Supreme Court’s recent decision in *AT&T Mobility v. Concepcion*<sup>4</sup> signaled the death knell for state laws that impose limitations on arbitration agreements subject to the FAA. (See discussion of the decision in Joel Grossman, *Big News in Arbitration: Sonic-Calabasas v. Moreno and AT&T Mobility v. Concepcion*, Cal. Labor & Employment L. Rev., p. 14 (July 2011).)

Subsequent case law also indicates that state legislatures and courts are severely limited in their power to override the FAA’s pro-arbitration policy, even when guided by “public policy” interests.<sup>5</sup> Because the FAA applies to the full extent of Congress’ broad Commerce Clause power, and because the doctrine of implied obstacle preemption (broader than express conflict preemption) displaces any state law that impedes the FAA’s purposes, it is now clear that the FAA preempts, and thus *Concepcion* abrogates, the *Armendariz* fairness factors.

## II. FAA PREEMPTION: THE BROADEST POSSIBLE EXERCISE OF CONGRESS’ COMMERCE CLAUSE POWER

Congress has plenary authority under the Commerce Clause to regulate the “channels” of interstate commerce (highways, navigable waterways, etc.); “instrumentalities” of interstate commerce (railroads, trucks, etc.); and activities bearing a “substantial relation” to interstate commerce.<sup>6</sup> Section 2 of the FAA states:

A written provision in any . . . contract evidencing a transaction involving commerce to settle by arbitration a controversy thereafter arising out of such contract or transaction . . . shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract.

The phrase “involving commerce” equates to “affecting commerce,” and signals the broadest permissible exercise of Congress’ Commerce Clause power.<sup>7</sup> Section 2 of the FAA “declare[s] a national policy favoring arbitration,” a policy that “appli[es] in state as well as federal courts” and “foreclose[s] state legislative attempts to undercut the enforceability of arbitration agreements.”<sup>8</sup> The FAA’s broad preemptive effect displaces any state statute, ordinance, regulation, or rule of decision that “[s]tands as an obstacle to the accomplishment and execution of the full purposes and objectives of [the FAA].”<sup>9</sup>

In *Citizens Bank v. Alafabco, Inc.*,<sup>10</sup> the U.S. Supreme Court held:

Congress’ Commerce Clause power may be exercised in individual cases *without showing any specific effect upon interstate commerce* if in the aggregate the economic activity in question would

represent a general practice subject to federal control. Only that general practice need bear on interstate commerce in a substantial way.<sup>11</sup>

Thus, the FAA covers nearly all contracts of employment, excluding only contracts involving employees engaged in the transportation of goods or services.<sup>12</sup> If the employee is not engaged in any kind of transport of goods or services, the arbitration agreement is subject to the FAA, so long as the employment relationship involves the minimal relationship to interstate commerce that *Alafabco* requires.

*Armendariz* itself made only a passing mention of FAA preemption. At that time, prior to the recent string of federal pro-arbitration cases, the California Arbitration Act (CAA) appeared for all purposes to be “[m]anifestly designed to encourage resort to the arbitral process.”<sup>13</sup> In this context, the *Armendariz* court noted that “[C]alifornia law, like federal law, favors enforcement of valid arbitration agreements,” and that, from the time Congress enacted the FAA, “[C]alifornia courts and its Legislature have consistently reflected a friendly policy toward the arbitration process.”<sup>14</sup>

However, the subsequent divergence between federal arbitration jurisprudence and California law emphasizes the significance of *Concepcion*’s expansive application of obstacle preemption. Several commentators have observed a disparity, for example, between the manner in which California courts apply the unconscionability doctrine to employment arbitration agreements, and all other contracts.<sup>15</sup> Because *Concepcion* operates upon generally applicable state law defenses to arbitration, it precludes courts from invalidating arbitration agreements by finding these contracts do not “involve commerce.”

### III. ARMENDARIZ: THE RATIONALE BEHIND THE FAIRNESS FACTORS

*Armendariz* grounded the fairness factors—the “five minimum requirements” that an arbitration agreement affecting unwaivable statutory claims must possess—on a statutory public policy rationale.<sup>16</sup>

The *Armendariz* court concluded that the California Legislature intended FEHA claims to be unwaivable, and that arbitration agreements affecting such claims must contain provisions allowing for the full vindication of those rights. *Armendariz* implicitly ruled that the California Legislature and individual judges possessed authority to identify public policies that it could insulate from the FAA’s broad preemptive effect.

This is clear from *Armendariz*’s citation to, and interpretation of, *Mitsubishi Motors v. Soler Chrysler-Plymouth*,<sup>17</sup> in which the Court held that substantive rights under federal statutes reflecting fundamental public policies (in *Mitsubishi*, federal antitrust law) were not presumptively non-arbitrable, but rather that “[b]y 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.”<sup>18</sup> Drawing on this distinction, the *Armendariz* court ascertained a “prescriptive” doctrine in *Mitsubishi*, one that “[s]ets a standard by which arbitration agreements and practices are to be measured, and disallows forms of arbitration that in fact compel claimants to forfeit certain substantive statutory rights.”<sup>19</sup> From this, *Armendariz* proceeded directly to the “non-waivability” analysis supporting its formulation of the fairness factors.

*Armendariz* was not the first case in which the California Supreme Court identified a strong statutory public policy that insulated a claim

from mandatory arbitration. A year earlier, in *Broughton v. Cigna Healthplans*,<sup>20</sup> the court held that the fundamental public policies in the Consumer Legal Remedies Act (CLRA), Cal. Civ. Code § 1750, precluded arbitration of representative claims for public injunctive relief brought under the statute.<sup>21</sup> In fact, *Armendariz*, which cites to *Broughton* eleven times, summarized the public policy rationale for the fairness factors as follows:

[I]t is evident that an arbitration agreement cannot be made to serve as a vehicle for the waiver of statutory rights created by the FEHA. We suggested as much in our recent discussion [in *Broughton*] of rights derived from the [CLRA], which the Legislature had declared to be unwaivable. In determining that the attorney fees and cost-shifting provisions provided by that statute, which advanced the statute’s goals, should be implicitly incorporated into the arbitration agreement at issue, we stated that parties agreeing to arbitrate statutory claims must be deemed to “consent to abide by the substantive and remedial provisions of the statute.” [Citation.] Otherwise, a party would not be able to fully “vindicate [his or her] statutory cause of action in the arbitral forum.”<sup>22</sup>

*Armendariz*’s policy-driven fairness factors analysis is clearly connected to what became known as the *Broughton-Cruz* rule.<sup>23</sup> Both assume that, without judicial tinkering, employers or other “stronger parties” may craft arbitration agreements to serve as vehicles to defeat strong public policy interests and victimize weaker parties, and that the arbitral forum will be inadequate. This assumption reflects an underlying judicial mistrust of

arbitration that animated adoption of the FAA in the first place, and that the U.S. Supreme Court has recognized as antithetical to the FAA’s objectives on numerous occasions.<sup>24</sup> The trend of federal arbitration jurisprudence following *Armendariz* conflicts with these assumptions.

### IV. ARMENDARIZ AND FEDERAL PREEMPTION UNDER THE FAA

California courts have repeatedly affirmed the state’s strong public policy, codified in the CAA, favoring the enforcement of arbitration agreements and encouraging resort to arbitration as a fair and efficient alternative to litigation. This policy is in harmony with the long-standing federal arbitration policy embodied in the FAA. *Armendariz* affirmed these shared state and federal pro-arbitration policies.

When the California Supreme Court decided *Armendariz* in 2000, the enforceability of mandatory arbitration agreements in employment contracts under the FAA was still an open question. In the two years prior to *Armendariz*, the Ninth Circuit Court of Appeals had ruled that (1) civil rights claims under both Title VII of the Civil Rights Act of 1964 and corresponding state anti-discrimination laws, such as the FEHA, were non-arbitrable;<sup>25</sup> and (2) the FAA precluded pre-dispute arbitration agreements in all employment agreements.<sup>26</sup> The *Armendariz* court declined to follow the Ninth Circuit on either point. Acknowledging the shared pro-arbitration policies of federal and California law, *Armendariz* decided as a matter of state law that the FEHA’s silence regarding employment arbitration agreements, and the absence of any exclusion for employment agreements in the CAA, precluded a blanket rule banning arbitration agreements in employment contracts.<sup>27</sup> As a matter of statutory interpretation, a critical

California Supreme Court rejected the Ninth Circuit's reasoning that amendments to Title VII in the 1991 Civil Rights Act precluded arbitration of FEHA claims.<sup>28</sup>

*Armendariz* was ahead of the curve on the issue of employment arbitration, but subsequent developments in federal arbitration jurisprudence have left it behind. Among the numerous pro-arbitration developments since *Armendariz* are the following:

(1) the broadest form of federal preemption, implied obstacle preemption,<sup>29</sup> applies to state laws that conflict with the FAA;<sup>30</sup>

(2) Congress must expressly exclude federal statutory rights from mandatory arbitration, *i.e.*, there is no "implied" non-arbitrability doctrine;<sup>31</sup>

(3) the *Prima Paint* severability doctrine<sup>32</sup>—under which arbitration clauses are severable from contracts containing them, making challenges to the contract as a whole arbitrable—applies to all generally applicable grounds for challenging the enforceability of contracts;<sup>33</sup>

(4) *Prima Paint* has been expanded to make "antecedent delegation" clauses in stand-alone arbitration contracts—under which arbitrators (and not courts) decide threshold enforceability and arbitrability challenges—severable from the rest of the arbitration agreement;<sup>34</sup>

(5) the principle that Congress enacted the FAA under its broad Commerce Clause power has been expanded;<sup>35</sup>

(6) states can no longer use vague, result-oriented "public policy" rationales to impair the strong federal pro-arbitration policy of the FAA;<sup>36</sup> and

(7) the FAA applies to all employment contracts except those involving channels of commerce (interstate trucking, etc.).<sup>37</sup>

## V. HELLO *CONCEPCION* AND *MARMET HEALTH CENTER*. GOODBYE *ARMENDARIZ*

### A. *Concepcion* Closes the Door on Judicially-Imposed, Minimum Criteria for Enforcement of Arbitration Agreements

Not enough time has passed for lower courts and commentators to have reached a consensus on the scope of *Concepcion*, but federal and California appellate courts agree on at least one point:

*Concepcion* adopts a sweeping rule of FAA preemption. Under *Concepcion*, the FAA preempts any rule or policy rooted in state law that subjects agreements to arbitrate particular kinds of claims to more stringent standards of enforceability than contracts generally.<sup>38</sup>

*Concepcion* specifically rejected California's *Discover Bank* rule, which held that class arbitration waivers in consumer contracts of adhesion were unconscionable and unenforceable to the extent those waivers insulated certain wrongful conduct from effective deterrence.<sup>39</sup> *Concepcion*, however, is remarkable for the breadth and depth of its pronouncements concerning both the strength of federal pro-arbitration policy and the scope of the FAA's broad preemption of contrary state law. *Concepcion*'s scope extends well beyond preemption of the *Discover Bank* rule, because *Concepcion* announced a federal pro-arbitration policy that abrogates not only state laws that "[p]rohibit outright the arbitration of a particular type of claim,"<sup>40</sup> but any state statute, regulation, or rule of decision that "rel[ies] on the uniqueness of an agreement to arbitrate" to impose restrictions on the parties' freedom of contract.<sup>41</sup>

The consequences for the *Armendariz* fairness factors should be obvious. The *Armendariz* fairness factors impose the same type of arbitration-specific hindrances that the FAA forbids, including requirements for "adequate" discovery, a written award, and availability of judicial relief, among others. *Concepcion* leaves little doubt that singling out arbitration agreements for skepticism and added judicial scrutiny transgresses the FAA, which preempts and invalidates the FEHA-specific analytical framework of *Armendariz*.

California state courts and federal courts have already recognized *Concepcion*'s abrogation of a similar California rule that singles out arbitration agreements, the *Broughton-Cruz* rule, which held on broad policy grounds that representative claims for public injunctive relief were non-arbitrable. The Ninth Circuit, for example, recently concluded that *Broughton-Cruz* "[d]oes not survive *Concepcion* because the rule 'prohibits outright the arbitration of a particular type of claim'—claims for broad public injunctive relief."<sup>42</sup> Similarly, in *Nelsen v. Legacy Partners Residential, Inc.*,<sup>43</sup> California's First Appellate District followed the Ninth Circuit in acknowledging *Concepcion*'s abrogation of the *Broughton-Cruz* rule.

Because *Armendariz* rested so much of its analysis on *Broughton-Cruz*'s public policy assumptions, it is likely *Armendariz* will suffer the same fate.

*Concepcion* also abrogated another California Supreme Court arbitration-specific decision, *Gentry v. Superior Court*.<sup>44</sup> *Gentry* established a barrier to class action waivers in arbitration agreements distinct from the *Discover Bank* rule. The *Gentry* court held that class action waivers of wage and hour claims in arbitration agreements were unenforceable to the extent that those waivers impaired vindication

of employees' "non-waivable" rights under the California Labor Code.

Two recent California appellate decisions address *Concepcion's* effect on *Gentry*. In *Iskanian v. CLS Transportation Los Angeles, LLC*,<sup>45</sup> Division Two of the Second Appellate District held that *Concepcion* abrogated *Gentry* just as it had *Broughton-Cruz*.<sup>46</sup> Division One of the Fourth Appellate District reached the same conclusion in *Truly Nolen of America v. Superior Court*,<sup>47</sup> but declined to follow *Iskanian* absent instruction from the California Supreme Court.<sup>48</sup> That specific instruction is forthcoming, as the California Supreme Court recently granted review in *Iskanian*.<sup>49</sup>

*Gentry* rested on precisely the same foundation as the *Armendariz* fairness factors; namely, California public policy requires that arbitration agreements implicating non-waivable statutory rights must receive special judicial scrutiny. *Gentry*, like *Discover Bank*, manifested judicial hostility to arbitration and likely will not survive the "sweeping rule of FAA preemption" *Concepcion* announced.

## **B. MARMET HEALTH CENTER: STATES MAY NOT DISFAVOR ARBITRATION OR FRUSTRATE THE FAA ON "PUBLIC POLICY" GROUNDS**

The U.S. Supreme Court recently affirmed *Concepcion* and sternly rebuked the West Virginia Supreme Court for an "[i]nterpretation of the FAA [that] was both incorrect and inconsistent with clear instruction in the precedents of this Court."<sup>50</sup>

In *Marmet Health Center*, the West Virginia Supreme Court declined to follow *Concepcion* and expressed considerable frustration regarding the U.S. Supreme Court's arbitration jurisprudence, calling it "tendentious" and "created from whole cloth."<sup>51</sup>

In repudiating the West Virginia Supreme Court's analysis, the U.S. Supreme Court (pointedly relying on *Concepcion*) held that state public policy, no matter how sincere and worthy its purpose (in this case, protecting the elderly from nursing home abuse), cannot serve as a vehicle to defeat the FAA's pro-arbitration policy, or to avoid its preemptive effect.<sup>52</sup>

*Armendariz*, like *Broughton-Cruz* and *Gentry*, expressly relied on public policy concerns (whether arbitration could properly vindicate nonwaivable statutory rights) in fashioning a set of five minimum fairness factors forced only upon parties to employment arbitration agreements. The Supreme Court's unambiguous holding in *Marmet Health Center*, extending *Concepcion* to public policy-based scrutiny of arbitration agreements, forecloses continued reliance on this rationale, no matter how laudable the motives for preserving *Armendariz's* fairness factors. Interestingly, the California Supreme Court's recent reference to *Marmet Health Center* indicates that it acknowledges the authority of that case to preclude states from relying on their own public policy to avoid or limit enforcement of arbitration agreements.

In *Pinnacle Museum Tower Ass'n v. Pinnacle Market Development (US), LLC*,<sup>53</sup> the court briefly considered and then rejected an argument that enforcement of an arbitration provision in a recorded declaration of covenants and restrictions for a common interest development would violate public policy as expressed in Cal. Code of Civ. Proc. § 1298.7.<sup>54</sup>

*Armendariz's* interpretation of *Mitsubishi Motors v. Soler Chrysler-Plymouth*<sup>55</sup> cannot save its fairness factors either. If it was ever possible that *Mitsubishi* supported a "prescriptive" doctrine allowing state legislatures to insist on certain terms in arbitration agreements governed by the FAA, recent authority makes clear that only Congress has that authority. As the Ninth Circuit recently stated in

recognizing *Concepcion's* abrogation of *Broughton-Cruz*:

The difficulty with the preemption analysis urged by Plaintiffs [ ] is twofold. First, it improperly gives weight to state public policy rationales to contravene the parties' choice to arbitrate. *Concepcion* rejected this proposition, holding that state law "cannot require a procedure that is inconsistent with the FAA, even if it is desirable for unrelated reasons."<sup>56</sup>

Among the cases the Ninth Circuit cited to demonstrate that only federal statutes can preclude the FAA's broad preemptive application was *Mitsubishi, supra*, the very case *Armendariz* relied on to impose arbitration-specific restrictions on the parties' freedom of contract in the name of ensuring vindication of statutory rights. Thus, the California Legislature cannot impose arbitration-specific restrictions on contracting parties with respect to non-waivable statutory rights, which is precisely what the California Supreme Court did in *Armendariz, Broughton-Cruz, and Gentry*.

## **VI. CONCLUSION**

The U.S. Supreme Court's recent *Concepcion* decision abrogates *Armendariz's* "fairness factors" because the fairness factors subject agreements to arbitrate FEHA claims to more stringent standards of enforceability than other contracts generally. The acknowledged abrogation of *Broughton-Cruz* erodes the foundation of the *Armendariz* fairness factors, at least to the extent that *Armendariz* relied on *Broughton*, and the similar disapproval of *Gentry* removes whatever doubts may remain.

Further, the FAA's broad preemptive effect forbids state legislatures or lower courts from

erecting obstacles to arbitration that do not apply to all contracts. No less than *Broughton-Cruz* and *Gentry*, the *Armendariz* fairness factors “[s]tand as an obstacle to the accomplishment of the FAA’s objectives,”<sup>57</sup> and the FAA clearly preempts them. ☞

## ENDNOTES

1. 24 Cal. 4th 83 (2000).
2. 9 U.S.C. §§ 1–16.
3. *Armendariz*, 24 Cal. 4th a 102. This article refers to these five minimum requirements as the *Armendariz* “fairness factors.”
4. 131 S. Ct. 1740 (2011).
5. *Marmet Health Care Ctr., Inc. v. Brown*, 132 S. Ct. 1201 (2012); *Kilgore v. KeyBank, N.A.*, 673 F.3d 947, 962 (9th Cir. 2012). NOTE: On September 21, 2012, the Ninth Circuit granted rehearing en banc in *Kilgore*. As a result, the decision is no longer citable per Ninth Circuit rules.
6. *United States v. Lopez*, 514 U.S. 552, 558 (1995); see also *Gonzales v. Raich*, 545 U.S. 1, 18, 25 (2005) (wholly intrastate production that, in aggregate, could affect interstate market, satisfies “substantial relation” test).
7. *Citizens Bank v. Alafabco, Inc.*, 539 U.S. 52, 55 (2003); see also *Allied-Bruce Terminix Cos., Inc. v. Dobson*, 513 U.S. 265, 273–74 (1995) (phrase “involving commerce” encompasses mere flow of interstate commerce, and includes any contract “affecting commerce”).
8. *Southland Corp. v. Keating*, 465 U.S. 1, 10, 16 (1984).
9. *AT&T Mobility v. Concepcion*, 131 S. Ct. 1740, 1753 (2011).
10. *Citizens Bank v. Alafabco, Inc.*, 539 U.S. 52 (2003).
11. *Id.*, at 56–7 (emphasis added; internal citations and quotations omitted).
12. *Circuit City Stores, Inc. v. Adams*, 532 U.S. 105 (2001).
13. *Volt Info. Sciences, Inc. v. Board of Trustees of Leland Stanford Junior Univ.*, 489 U.S. 468, 476 (1989).
14. *Armendariz*, 24 Cal. 4th at 97.
15. See Broome, *An Unconscionable Application of the Unconscionability Doctrine: How the California Courts Are Circumventing the Federal Arbitration Act*, 3 Hastings Bus. L. J. 39, 54, 66 (2006).
16. *Armendariz*, 24 Cal. 4th at 100.
17. *Mitsubishi Motors v. Soler Chrysler-Plymouth*, 473 U.S. 614 (1985).
18. *Id.* at 628.
19. *Armendariz*, 24 Cal. 4th at 99–100 (emphasis added).
20. 21 Cal. 4th 1066 (1999).
21. *Broughton* also held that the CLRA’s fee and cost-shifting provisions should be deemed incorporated into any arbitration agreement covering claims brought pursuant to the statute. 21 Cal. 4th at 1087.
22. *Armendariz*, 24 Cal. 4th at 101.
23. The rule derives its name from the two California Supreme Court decisions that announced it and defined its scope: *Broughton v. Cigna Healthplans*, 21 Cal. 4th 1066 (1999) and *Cruz v. PacifiCare Health Sys., Inc.*, 30 Cal. 4th 303 (2003).
24. *Doctors’ Assocs., Inc. v. Casarotto*, 517 U.S. 681 (1996).
25. *Duffield v. Robertson Stephens & Co.*, 144 F.3d 1182 (9th Cir. 1998).
26. *Craft v. Campbell Soup Co.*, 177 F.3d 1083 (9th Cir. 1999).
27. *Armendariz*, 24 Cal. 4th at 97–99.
28. *Id.* at 93–96.
29. Alan Untereiner, *The Defense of Preemption: A View from the Trenches*, 84 Tulane L. Rev. 1257, 1263–65 (2010).
30. *Concepcion*, 131 S. Ct. at 1753.
31. *CompuCredit Corp. v. Greenwood*, 132 S. Ct. 665 (2012).
32. *Prima Paint Corp. v. Flood & Conklin Mfg. Co.*, 388 U.S. 395 (1968).
33. *Buckeye Check Cashing, Inc. v. Cardegna*, 546 U.S. 440 (2006).
34. *Rent-a-Center West, Inc. v. Jackson*, 130 S. Ct. 2772 (2010).
35. *Citizens Bank v. Alafabco, Inc.*, 539 U.S. 52 (2003).
36. *Marmet Health Care Ctr., Inc. v. Brown*, 132 S. Ct. 1201 (2012).
37. *Circuit City Stores, Inc. v. Adams*, 532 U.S. 105 (2001).
38. *Nelsen v. Legacy Partners, Residential, Inc.*, 207 Cal. App. 4th 1115, 1136 (2012).
39. *Discover Bank v. Superior Court*, 36 Cal. 4th 148 (2005).
40. *Concepcion*, 131 S. Ct. at 1747.
41. *Id.*
42. *Kilgore*, 673 F.3d at 960.
43. 207 Cal. App. 4th 1115 (2012).
44. 42 Cal. 4th 443 (2007).
45. 206 Cal. App. 4th 949 (2012).
46. *Id.* at 959 (“[w]e find that the *Concepcion* decision conclusively invalidates [*Gentry*]”).
47. 2012 Cal. App. LEXIS 871 (August 9, 2012).
48. *Id.* (“[A]lthough we agree with *Truly Nolen* that *Concepcion* implicitly disapproved the reasoning of the *Gentry* court, the United States Supreme Court did not directly address the precise issue presented in *Gentry*. Under the circumstances, we decline to disregard the California Supreme Court’s decision without specific guidance from our high court.”)
49. 2012 Cal. LEXIS 8925 (2012).
50. *Marmet Health Care Ctr., Inc.*, 132 S. Ct. at 1203.
51. *Id.* at 1202.
52. *Id.* at 1203.
53. 55 Cal. 4th 223 (2012).
54. Disallowing arbitration provisions from precluding or limiting any right of action for bodily injury or wrongful death.
55. 473 U.S. 614 (1985).
56. *Kilgore*, 673 F.3d at 947. *Kilgore* similarly notes the strengthening of this conclusion by *Marmet Health Center*.
57. *AT&T Mobility*, 131 S. Ct. at 1748. ☞

5-4 opinion, has consistently stated that the Federal Arbitration Act (FAA) does not apply to the enforcement of arbitration agreements in state law actions. Accordingly, as discussed below, and as Justice Thomas' ardent and repeated pronouncements make clear, state contract law governs the enforceability of arbitration agreements.

**THE VIABILITY OF ARMENDARIZ FOLLOWING CONCEPCION**

California law requires the existence of a valid arbitration agreement before an employee can be compelled to arbitrate employment-related disputes involving unwaivable public rights, such as an employee's claims under the California Labor Code and the Fair Employment and Housing Act (FEHA).<sup>3</sup> In *Armendariz*, the California Supreme Court held that the FAA does not preempt California law in determining the validity of an arbitration agreement.<sup>4</sup> This holding was based, at least in part, on the fact that most federal courts have held that employment contracts are excluded from the scope of the FAA.<sup>5</sup> The court then set out five requirements for an agreement to arbitrate a FEHA claim to be enforceable. Specifically, the arbitration agreement must: (1) provide for more than minimal discovery; (2) require a written decision allowing at least limited judicial review; (3) permit the types of relief that would be available in court; (4) not require the plaintiff to bear costs unique to the arbitral forum; and (5) provide for a neutral arbitrator.<sup>6</sup>

The U.S. Supreme Court's ruling in *Concepcion* did nothing to change the applicability of the five *Armendariz* factors to determine the enforceability of an arbitration agreement. First, the Court in *Concepcion* cited the *Armendariz*

decision with approval, specifically noting that state contract law governs the enforceability of arbitration agreements.<sup>7</sup> Thus, *Concepcion* makes clear that California state law regarding the application of the *Armendariz* factors remains in full force and effect, and is not supplanted by federal authorities. This is reinforced by Justice Thomas' concurring opinion and prior decisions, in which he has consistently stated that the FAA "does not apply in state courts."<sup>8</sup> Thus, *Concepcion* reaffirms that the FAA "was not meant as a statement of substantive law binding on the states," and California state law still governs whether an arbitration agreement exists at all.<sup>9</sup>

**EXISTENCE OF AN AGREEMENT TO ARBITRATE IS DETERMINED PURSUANT TO CALIFORNIA LAW**

Under California law, before even embarking on an analysis of the *Armendariz* factors, any arbitration agreement must be evaluated to determine whether all parties to the litigation are also parties to the arbitration agreement. A non-party to an arbitration agreement cannot be compelled to arbitrate a dispute, thus making this an essential first inquiry—an inquiry that is governed by state, not federal, authority.<sup>10</sup>

An order to compel arbitration is proper only if a two-pronged test is satisfied: (1) a valid agreement to arbitrate exists between the parties; and (2) the agreement encompasses the dispute at issue.<sup>11</sup> The party seeking to compel arbitration, usually the employer, bears the burden of proving the existence of a valid contract by a preponderance of the evidence.

Once this inquiry has been satisfied, the next step is governed by Cal. Code Civ. Proc. § 1281.2,

which states that upon the petition of a party to compel arbitration, the court shall "order arbitration unless it determines that . . . grounds exist for the revocation of the agreement."<sup>12</sup> Revocation of an arbitration agreement is proper on any "grounds as exist at law or in equity for the revocation of any contract,"<sup>13</sup> including "generally applicable contract defenses, such as fraud, duress, or unconscionability, [which] may be applied to invalidate arbitration agreements . . . ." <sup>14</sup> The court in *Armendariz* found that "because unconscionability is a reason for refusing to enforce contracts generally, it is also a valid reason for refusing to enforce an arbitration agreement under Cal. Code Civ. Proc. § 1281.2"<sup>15</sup> Only after all of these hurdles have been surmounted can a valid agreement to arbitrate a statutory employment claim be found.

**BOTH PROCEDURAL AND SUBSTANTIVE UNCONSCIONABILITY ARE DETERMINED PURSUANT TO CALIFORNIA LAW**

As noted by the California Supreme Court in *Armendariz*, "unconscionability has both procedural and substantive elements, the former focusing on oppression or unfair surprise due to unequal bargaining power, the latter on overly-harsh or one-sided results."<sup>16</sup> Procedural and substantive unconscionability "need not be present in the same degree. Essentially a sliding scale is invoked . . . the more substantively oppressive the contract term, the less evidence of procedural unconscionability is required to come to the conclusion that the term is unenforceable, and vice versa."<sup>17</sup> If the arbitration agreement is found to be a contract

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of adhesion, the court must conduct a further analysis to determine whether other factors exist that would render it unenforceable.<sup>18</sup>

The California Supreme Court noted that “the term [contract of adhesion] signifies a standardized contract, which, imposed and drafted by the party of superior bargaining strength, relegates to the subscribing party only the opportunity to adhere to the contract or reject it.”<sup>19</sup> The court explicitly held that “when an arbitration agreement is imposed on an employee as a condition of employment and there is no opportunity to negotiate, the arbitration agreement is *adhesive*.”<sup>20</sup> When an arbitration agreement is presented to an employee in a “take it or leave it” fashion, where the employee is not permitted to modify, or even negotiate, the terms of the arbitration agreement, such agreements are consistently found to be procedurally unconscionable.<sup>21</sup>

Under California law, an arbitration agreement must also be free from substantively unconscionable provisions to be enforceable.<sup>22</sup> In *Kinney v. United HealthCare Services, Inc.*, the court of appeal found a unilateral obligation

to arbitrate to be “so one-sided as to be substantively unconscionable.”<sup>23</sup> Later, the California Supreme Court endorsed this holding in *Armendariz*.

An arbitration agreement also is substantively unconscionable if it imposes on an employee the significant and unwieldy cost of the arbitral forum chosen by the employer—costs that an employee would decidedly *not* incur by litigating his or her claims in civil court. The California Supreme Court held that provisions in arbitration agreements that require an employee to pay fees “unique to arbitration” are “unlawful and hence substantively unconscionable.”<sup>24</sup>

Discovery limitations may also render an arbitration agreement substantively unconscionable. While parties to an arbitration agreement are free to agree to “something less than the full panoply of discovery provided in Code of Civil Procedure § 1283.05 . . . arbitration agreements must ‘ensure minimum standards of fairness’ so employees can vindicate their public rights.”<sup>25</sup> Thus, severe limitations on an employee’s ability to conduct any discovery is substantively unconscionable, and renders an arbitration agreement unenforceable.

In post-*Concepcion* opinions, federal and state courts have held that the FAA does not preempt California authority regarding factors that constitute procedural or substantive unconscionability with respect to an arbitration agreement—essentially affirming the continued viability of the *Armendariz* factors.

#### **PRINCIPLES OF FEDERALISM REQUIRE THE CONTINUED VIABILITY OF *ARMENDARIZ***

The conservative majority of the United States Supreme Court traditionally has been protective of states’ rights. Simultaneously, this same majority has championed arbitration as a preferred forum for resolving cases, particularly those brought by consumers and employees. The only manner in which these two lines of jurisprudence could have been reconciled was for the Supreme Court to hold that while arbitration may be favored under the FAA, whether an agreement to arbitrate exists—and specifically, whether an arbitration agreement is enforceable—is a matter of state contract law. This result makes sense because for the Supreme Court to have held that state contract law is preempted by the FAA would have required the conservative majority to ignore numerous opinions regarding the importance of states’ rights, many of which were authored or joined by Justices Thomas and Scalia (who wrote the Court’s opinion in *Concepcion*).

With respect to the initial issue of whether arbitration is appropriate as a forum for particular types of disputes—franchise claims, employment disputes, or consumer class actions—the Supreme Court has clearly and repeatedly held that the FAA preempts state laws prohibiting arbitration as a forum. For example, as early as 1984, in *Southland Corp. v. Keating*, the Court held that “[I]n enacting § 2 of the [FAA], Congress declared a national policy favoring

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*In five prior U.S. Supreme Court opinions or dissents, Justice Thomas, the fifth vote in the 5-4 [Concepcion] opinion, has consistently stated that the Federal Arbitration Act (FAA) does not apply to the enforcement of arbitration agreements in state law actions.*

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arbitration and withdrew the power of the states to require a judicial forum for the resolution of claims which the contracting parties agreed to resolve by arbitration.”<sup>26</sup> Less than a decade later, in *Gregory v. Ashcroft*,<sup>27</sup> Justice O’Connor reaffirmed the Court’s commitment to arbitration, writing:

The federalist structure of joint sovereigns preserves to the people numerous advantages. It assures a decentralized government that will be more sensitive to the diverse needs of a heterogeneous society; it increases opportunity for citizen involvement in democratic processes; it allows for more innovation and experimentation in government; and it makes government more responsive by putting the States in competition for a mobile citizenry.<sup>28</sup>

The only manner in which the pro-arbitration and federalist jurisprudence established by the conservative majority of the Supreme Court can be maintained, as demonstrated by *Concepcion*, is to continue to permit FAA preemption with respect to state laws that seek

to prohibit arbitration as a forum for certain cases, but permit state authority to set forth the rules and limits on arbitration agreements. This is the meaning of the Court’s favorable citation to *Armendariz* in *Concepcion*. Thus, while arbitration bans are not permitted, state law limits on the enforceability of arbitration agreements—including application of the *Armendariz* factors—is supported by the Supreme Court’s case history regarding both arbitration and federalism.

### CONCLUSION

*Concepcion* does not alter how the *Armendariz* factors are applied, or the legitimacy of their application. California law has, and will continue, to govern the enforceability of arbitration agreements. *Concepcion*, as evidenced by the vote of Justice Thomas and the favorable reference to *Armendariz*, only serves to underscore that state law, including the five *Armendariz* factors, controls the enforceability of arbitration agreements.

Yet, as we look towards the future, the continuing vitality of *Armendariz* remains in question. Whether the Court will continue to balance federalism and a pro-

arbitration approach consistent with the FAA will likely be determined by the next retirement and subsequent nominee to the Supreme Court. For the moment, however, California law, and specifically, the *Armendariz* factors, are in full force and effect. [↩](#)

### ENDNOTES

1. 131 S. Ct. 1740 (2011).
2. 24 Cal. 4th 83 (2000).
3. *Little v. Stiegler, Inc.*, 29 Cal. 4th 1064 (2003).
4. *Armendariz*, 24 Cal. 4th at 97-99; see also *Circuit City Stores, Inc. v. Adams*, 279 F.3d 889, 893 (9th Cir. 2002).
5. *Armendariz*, 24 Cal. 4th at 97-99.
6. *Id.* at 91, 102-03.
7. *Concepcion*, 131 S. Ct. at 1746.
8. See, e.g., *Allied-Bruce Terminix Cos. v. Dobson*, 513 U.S. 265, 285 (1995) (Thomas, J., dissenting).
9. *Id.*
10. *Berglund v. Arthroscopic & Laser Surgery Ctr. of San Diego, LP*, 44 Cal. 4th 528, 536-37 (2008).
11. *Id.*
12. Cal. Code Civ. Proc. § 1281.2(b).
13. *Armendariz*, 24 Cal. 4th at 98.
14. *Id.* at 115 [internal citations omitted; emphasis in original].
15. *Id.* at 114.
16. *Id.* [internal citations omitted].
17. *Id.*

18. *Id.* at 113.
19. *Id.*
20. *Id.* at 114-15.
21. *Id.* at 115.
22. *Id.* at 113.
23. *Kinney*, 70 Cal. App. 4th at 1330.
24. *Armendariz*, 24 Cal. 4th at 111.
25. *Quoted in Ontiveros v. DHL Express (USA), Inc.*, 164 Cal. App. 4th 494, 512 (2008).
26. 465 U.S. 1, 10 (1984).
27. 501 U.S. 452 (1991).
28. *Id.* at 458.



*The California Labor & Employment Law Review* is published by the Labor and Employment Law Section of The State Bar of California.

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