CASE NO. S244630

IN THE SUPREME COURT OF THE STATE OF CALIFORNIA

OTO, LLC, AN ARIZONA LIMITED LIABILITY COMPANY, DBA ONE TOYOTA OF OAKLAND, ONE SCION OF OAKLAND,

Plaintiff and Appellant.

v.

KEN KHO,

Defendant and Petitioner, Real Party in Interest,

v.

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

Intervenor and Appellant.

SUPREME COURT
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AFTER DECISION BY THE COURT OF APPEAL
FIRST APPELLATE DISTRICT, DIVISION 1
CASE NO. A147564

ON APPEAL FROM THE SUPERIOR COURT
FOR THE COUNTY OF ALAMEDA
CASE NUMBER RG15781961
HONORABLE EVELIO GRILLO, PRESIDING

REPLY BRIEF OF REAL PARTY IN INTEREST, KEN KHO

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I. INTRODUCTION

OTO, LLC's Answer Brief (RAB) has no theme or coherent position. It ignores the more recent decisions of this Court in *Sanchez v. Valencia Holding Co., LLC* (2015) 61 Cal.4th 899 (*Sanchez*); *McGill v. Citibank, N.A.* (2017) 2 Cal.5th 945 (*Citibank*); and *Baltazar v. Forever 21, Inc.* (2016) 62 Cal.4th 1237 (*Baltazar*) which have clarified and strengthened this Court's decision in *Sonic-Calabasas A, Inc. v. Moreno* (2013) 57 Cal.4th 1109 (*Sonic II*). OTO ignores the command of *Dynamex Operations W. v. Superior Court* (2018) 4 Cal.5th 903 (*Dynamex*) which reemphasizes the importance in California law of protecting workers.

OTO argues that the procedural unconscionability is "minute," contrary to the court below which found "that the degree of procedural unconscionability was extraordinarily high." (*OTO, LLC v. Kho* (2017) 14 Cal.App.5th 691, 709 (*OTO v. Kho*).) The argument highlights how extraordinarily unfair the employer's process was which forced Mr. Kho, while working, to sign an agreement that he did not understand. The argument ignores the holding of this Court that such a contract of adhesion is unconscionable and requires a court to review the substantive unconscionability of the Arbitration Agreement.

OTO argues that there is no substantive unconscionability without addressing the real issue, that the entire Berman statutes[1] provide important protections and tilt the enforcement process favorably towards the wage claimant and against the employer. Most fundamentally, OTO focuses only on a few provisions of the entire Berman statutes and ignores the entire

[1] In Petitioner's Opening Brief (POB) at 13, we explained that the reference to "Berman statutes" is the entire process from filing claims to the trial de novo to enforcement procedures. References to the "Berman hearing" are to the hearing process before a Deputy Labor Commissioner who issues the Order Decision and Award (ODA).

context, which gives the wage claimant procedural and substantive advantages while providing protections from the employer against whom a claim is made.

OTO furthermore fails to explain why the far more complicated civil proceedings that it imposes on the individual wage claimant do not render the Arbitration Agreement unconscionable. Indeed, OTO concedes that these procedures render the process more complicated, effectively conceding the unconscionability of the process. As we shall address, its only rejoinder is that the wage claimant can use counsel on a contingency basis to move through the minefields of civil litigation because in some cases fees can be obtained, even for small wage claims.

OTO fails to address most of the favorable provisions of the Berman statutes. OTO fails to confront many of the other issues raised by the Petitioner and Real Party in Interest, Ken Kho (Kho or Petitioner).

Finally, Petitioner addresses briefly the question of whether the trial court properly vacated the ODA and the applicability of Code of Civil Procedure section 1094.5. Most strikingly, OTO concedes that Code of Civil Procedure section 1094.5 does not apply but still attempts to rely upon it to argue that the ODA should have been vacated, rather than as the Labor Commissioner and Petitioner argue to conduct a trial de novo as required by Labor Code section 98[2] without vacating the ODA.

[2] All further statutory references are to the California Labor Code unless otherwise stated.

II. THE ARGUMENTS OF OTO EMPHASIZE AND REINFORCE THE UNCONSCIONABILITY, BOTH PROCEDURAL AND SUBSTANTIVE, OF THE OTO AGREEMENT, RATHER THAN JUSTIFY THE AGREEMENT

A. THE GENERAL PRINCIPLES

All seem to agree that both procedural and substantive elements of unconscionability must be present in order to find an agreement unconscionable. (See RAB at 20. See also *Sanchez*, *supra*, 61 Cal.4th at p. 910 [quoting *Armendariz v. Foundation Health Psychcare Services, Inc.* (2000) 24 Cal.4th 83 (*Armendariz*)].)

OTO, however, ignores the elaboration that this Court went at lengths to explain in *Sanchez*, *supra*, 61 Cal.4th at pp. 910-911. OTO claims that the standard remains "shock the conscience." (See RAB at 23.) See also *Baltazar*, *supra*, 62 Cal.4th at pp. 1243-1245.) Among the terms that this Court approved, given the context of the Berman statutes, we believe the phrase that is most applicable is "unreasonably favorable" because the Berman statutes are designed to create a process that is favorable to the wage claimant, and OTO's process is unreasonably favorable to the employer, contrary to the entire statutory scheme. (See *Sonic II*, *supra*, 57 Cal.4th at pp. 1133, 1147, 1159.)

The parties agree that there is a sliding scale, meaning the more procedurally unconscionable, the less substantively unconscionable a contract must be to find it unconscionable and to refuse enforcement, and vice versa. (See RAB at 20.)

The parties agree that the burden is on Kho and the Labor Commissioner to demonstrate the unconscionability. OTO does not expressly make this point, but we agree that the burden lies squarely with the party who asserts unconscionability. (See *Sanchez*, *supra*, 61 Cal.4th at p. 911.)

OTO, however, ignores the important instruction that a contract must be evaluated within its context. This Court made clear that "[a]n evaluation of unconscionability is highly dependent on context." (*Sanchez*, *supra*, 61 Cal.4th at p. 911. See also *Sonic II*, *supra*, 57 Cal.4th at pp. 1147-1148.) This was made evident in *Sanchez*, which this Court described as a commercial case involving the purchase of "a high-end luxury item." (*Sanchez*, at pp. 914, 921.) The purchaser in that case was apparently well financed and the issue of affording litigation in court or before an arbitrator was not at issue. (*Id.* at p. 921.) *Sanchez* also made it clear that the Court continues to recognize the difference between buying a consumer item and the pressures on the wage earner: "a family in search of a job confronts a very different set of burdens than one seeking a new vehicle." (*Id.* at pp. 919-920.)

In summary, OTO has attempted to mischaracterize the standard applied by this Court with respect to determining unconscionability and has deliberately ignored the context in which unconscionability is determined. Here, the framework that is most important to keep in mind is that the Berman statutes provide a very "accessible and affordable" process, which in many respects assists the wage claimant in collecting unpaid wages without cost or the complications of court proceedings.[3] This is the fundamental concept that is missing from OTO's argument.

The finding of the court below that the procedural unconscionability "demonstrated a high degree of oppression" is not undermined by OTO's arguments.

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[3] *Sanchez* dealt with consumer protection statutes which were designed to protect indigent consumers and not well-financed consumers such as Mr. Sanchez.

B. PROCEDURAL UNCONSCIONABILITY

OTO first argues that a court must find both surprise and oppression with respect to the procedural elements of unconscionability. (See RAB at 22.) This proposition was rejected in *Sanchez*, in which this Court clearly used the word "or." (See *Sanchez*, *supra*, 61 Cal.4th at p. 910 [citing *Sonic II*, *supra*, 57 Cal.4th at p. 1133].) The court below explained the difference, using the word "or" again. (*OTO v. Kho*, *supra*, 14 Cal.App.5th at pp. 707-709.)

OTO submits that the procedural unconscionability is "minute" even in light of the record that the degree of oppression was "extraordinarily high." (See RAB at 20.)

This Court resolved the question of whether a preprinted contract of employment is one of adhesion in *Baltazar*. In that case, the Court found no procedural unconscionability except that the arbitration agreement was a preprinted form that was a requirement of employment. It then went on to analyze the substantive unconscionability and found none in that case. OTO's argument that the Agreement in this case is "not one of adhesion" should be rejected, both because of this Court's decision in *Baltazar* and because here, as noted below, all employees of OTO are required to sign the same contract. (See also *Sanchez*, *supra*, 61 Cal.4th at pp. 913-914 [preprinted contract is adhesive]; *Sandquist v. Lebo Automotive, Inc.* (2016) 1 Cal.5th 233, 248.)

There are two factual misstatements in OTO's RAB that are of significance and substantially undermine the credibility of its arguments to this Court.

OTO first suggests that Mr. Kho was required to sign the Arbitration Agreement "at the beginning and in the middle of his employment." (RAB

at 21.) There is no evidence that Mr. Kho was asked to sign any arbitration agreement at the beginning of his employment in 2009, although he was required to sign various documents at that time. (CT 109.) OTO never asserted that he signed one at the beginning of his employment before the reference in the brief before this Court, and the only Arbitration Agreement ever submitted to the trial court or considered by the appellate court was the one that he signed in 2013, almost four years after he started work.[4] Since it is also conceded that OTO has the burden of proving that there is an arbitration agreement, OTO certainly would have offered an earlier agreement had it existed. We note this mistake because if Mr. Kho had signed two agreements and if OTO had proven it, OTO would have a better argument in light of *Baltazar*, a case that it does not even cite. Palpably, this position is incorrect.

Second, OTO claims that there is nothing in the record that shows that the Arbitration Agreement was presented on a "take-it-or-leave-it basis." (RAB at 21 and 23.)

When Mr. Kho started his employment, he was required to sign a group of documents while working and was provided no opportunity to review those documents. (CT 109.) This reflects the "take-it-or-leave-it" process by which the employer required employees to sign documents. He was required to "sign them quickly and return them immediately to the human resources representative." (CT 109.)

The same process happened three years later when he was required to sign "additional paperwork." (CT 109.) He was given "about three to four minutes ... to sign those documents." The human resources

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[4] This assertion is contrary to the statement made in its Memorandum of Points and Authorities in Support of Petition to Compel Arbitration. (CT 55.)

representative waited ("hovered") while he was at his work station to have him complete those documents. He was working piece rate, and any time he took to review and question the documents would have reduced his pay and productivity. The documents included both the Arbitration Agreement and a separate document acknowledging a new pay plan, which likely was of more interest to him. (See CT 115-116.)

What OTO fails to acknowledge is that its own witness stated that all employees were required to sign the very same document: "All personnel who commence or continue employment at One Toyota of Oakland are required to comply with the company's alternative dispute resolution policy, which includes the mandatory arbitration of employment-related claims." (CT 60.)[5] The declaration does not suggest that Mr. Kho was required to sign the document initially upon employment but only in 2013, more than three years after he was employed.

OTO is correct that Mr. Kho didn't ask any questions of the human resources representative. There is no suggestion that the representative was authorized to answer any questions and the person waited while Mr. Kho signed all the documents. Moreover, the employer did not provide copies for Mr. Kho to review. Nor was there even an opt-out provision. This Court in *Sanchez* rejected the necessity of "require[ing], as a prerequisite to finding procedural unconscionability, that the complaining party show it tied to negotiate standardized contract provisions." (*Sanchez*, *supra*,

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[5] As noted, Mr. Kho was required to sign a new pay plan. That pay plan included elements of a piece rate system and was presented on the same "take-it-or-leave-it" basis. That pay plan does not comply with state law. (See § 226.2, subd. (a) and *Gonzales v. Downtown LA Motors, LP* (2013) 215 Cal.App.4th 36.) Section 226.2, subdivision (b) and the subsequent subsections would not be applicable to Kho since OTO is a new car dealer. (§ 226.2, subd. (g)(6).)

61 Cal.4th at p. 914.) The same applies with more force to an employee such as Mr. Kho.

Although OTO is correct that the Arbitration Agreement refers to "employment-at-will and arbitration," there is no evidence that Mr. Kho had any idea what he was signing. Compare *Baltazar* (employee was well aware of arbitration and raised questions about it), or *Sanchez* (consumer purchasing high end automobile with financial ability to pay for some arbitration costs), or *Sonic II* (salaried employee at relatively high salary level). All Mr. Kho knew was, consistent with when he was first hired, he was required to sign all the documents and had to do so while he was working. And, as noted above as a flat rate mechanic, any time he takes to read documents and question their meaning directly reduces his earnings, which are dependent upon the amount of work he performs.

The prolix, complicated and legalese language, as well as the small font used, further confirms the take-it-or-leave-it nature of the Arbitration Agreement, which could not be scrutinized by anyone in any reasonable manner.

In summary, the court below was correct that the degree of unconscionability was "extraordinarily high." There are both elements of surprise and oppression. We address below the substantive unconscionability of the Arbitration Agreement. This all demonstrates the correctness of this Court's rule that in the employment context, in particular, a standardized arbitration agreement is normally a contract of adhesion and constitutes the element of procedural unconscionability. It is a contract of adhesion, which "'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.'" (*Armendariz, supra*, 24 Cal.4th at

p. 113 [quoting *Neal v. State Farm Ins. Cos.* (1961) 188 Cal.App.2d 690, 694].)

C. SUBSTANTIVE UNCONSCIONABILITY

The arguments of OTO do not undermine the arguments made by Kho and the Labor Commissioner that the Arbitration Agreement is substantively unconscionable because it is neither accessible nor affordable.

1. OTO Fails to Analyze the Totality of the Agreement as to Whether It Is Accessible and Affordable

OTO offers no coherent analysis of the Arbitration Agreement to explain why it is on the whole "accessible and affordable." Rather, OTO analyzes four provisions, which it concedes by its argument undermine the accessibility and affordability of the Arbitration Agreement. (RAB 23-29.) OTO does acknowledge indirectly that the "accessible and affordable test governs." (See RAB at 29.) It incorrectly, however, states that Petitioner insists that "an arbitration procedure [must] resemble[] the Berman hearing process." (RAB at 29.) As the Petitioner has made clear, the arbitration process must be "accessible and affordable." Here, however, as we explained in the POB, the Arbitration Agreement fails to meet those conditions because it eliminates the advantage of the Berman statutes. (POB at 30-35.) It furthermore simultaneously imposes significant barriers to wage claimants. (POB at 37-40.)

What *Sanchez* and *Baltazar* emphasize after *Sonic II*, is that the Legislature may create procedures and protections that benefit one side of a transaction. It may provide for protections for individuals who are consumers or employees against employers, or in some cases the reverse. It may do so in protecting some types of entities against others. It can provide protection for health care consumers. It can tilt the playing field substantially or not at all. These are matters of policy, and efforts by one

party to contract a relationship to undermine the balance created by the Legislature are subject to unconscionability analysis.

OTO addresses only four issues: (1) arbitration costs (RAB at 23-24); (2) attorneys' fees (RAB at 25-28); (3) initiation of the arbitration process (RAB at 28); and (4) the imposition of all of the provisions of the Code of Civil Procedure (RAB at 28-29). We address these issues in more detail later. First, we review *Sanchez* and *Baltazar* because the analysis used in those cases supports the finding of unconscionability of the OTO Agreement.

In *Sanchez*, this Court examined only certain challenged provisions of an arbitration agreement. This Court examined three different provisions only after it had found that "the adhesive nature of the contract is sufficient to establish some degree of procedural unconscionability." (*Sanchez*, *supra*, 61 Cal.4th at p. 915.) It is worth examining each of those issues because the analysis applies here and leads to the conclusion that the provisions analyzed by OTO support the conclusion that the Agreement, in its totality, is unconscionable.

First, only parties who either received nothing or more than $100,000 were allowed to appeal to an appellate tribunal. Because this Court found in the context of the purchase of this high-end vehicle that "the appeal threshold provision does not, on its face, obviously favor the drafting party" it was not unconscionable. (*Sanchez*, *supra*, 61 Cal.4th at p. 916.) In contrast, in this case, the deprivation of the advantages of the Berman statutes and the imposition of the more complicated litigation procedures considerably benefit the drafting party, namely OTO.

Similarly, in examining the right of appeal to the granting of injunctive relief, this Court recognized that the dealership, Valencia Holding, was entitled to "the extra protection of additional arbitrable

review." (*Sanchez, supra*, 61 Cal.4th at p. 917.) The result under OTO's agreement is the reverse. Analyzed in context, the OTO Agreement deprives the wage claimant, such as Mr. Kho, of the extra protections of the Berman statutes while granting a substantial measure of extra protection to OTO.[6] This is contrary to the statutory purpose.

This Court addressed a second provision, which required the car buyer to pay arbitration costs up to a maximum of $2,500, which could be reimbursed at the arbitrator's discretion. (*Sanchez, supra*, 61 Cal.4th at pp. 917-918.)

This Court contrasted that to "mandatory employment arbitration of unwaivable statutory rights, [where] we have held that arbitration agreements 'cannot generally require the employee to bear any *type* of expense that the employee would not be required to bear if he or she were free to bring the action in court.'" (*Sanchez, supra*, 61 Cal.4th at p. 918 [citing *Armendariz, supra*, 24 Cal.4th at pp. 110-111].) As noted in the POB, the Berman statute process is entirely free to the wage claimant, including translators, assistance from the Labor Commissioner, and even counsel in the trial de novo; and the OTO Agreement imposes costs that would not be required. Those costs include the time and effort in dealing with the complexities of civil litigation, the possibility of needing an interpreter, and the fees that would have to be paid an attorney on a contingency basis where there is no clear statutory entitlement to fees.

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[6] In *Sanchez*, this Court declined to address the question of whether claims under the Consumers Legal Remedies Act (CLRA), Civil Code section 1750 et seq., or unfair competition law (UCL), Business and Professions Code section 17200 et seq., could be waived by predispute arbitration. (*Sanchez, supra*, 61 Cal.4th at p. 917.) This Court has addressed that issue in *Citibank*, and found that such waiver "is contrary to California public policy and is thus unenforceable under California law." (*Citibank, supra*, 2 Cal.5th at p. 952.) This supports the finding that the provisions of the Arbitration Agreement are also unconscionable.

Further, this Court recognized that the Legislature had protected indigent consumers by applying "an ability-to-pay approach ... in the context of consumer arbitration agreements." (*Sanchez*, *supra*, 61 Cal.4th at p. 920. See Code Civ. Proc., § 1284.3.) Again, in this case, Mr. Kho, like many wage claimants, is unable to afford counsel or the other costs that were imposed by the OTO Agreement. The procedures established by the Berman statutes eliminate costs to the wage claimant (and the employer) in ways that are undermined by the OTO Agreement. This Court recognized that the Legislature had the right to develop rules that favored the indigent car buyer or, in this case, the low-wage worker and that any agreement that undermined that legislative choice would be unconscionable.

This Court in *Sanchez* recognized that "courts are required to determine the unconscionability of the contract 'at the time it was made.' (Civ. Code, § 1670.5.)" (*Sanchez*, *supra*, 61 Cal.4th at p. 920.) Kho entered into the Agreement while working. But for purposes of this case, the Agreement contemplated that it would extend even after he was terminated to any claims he raised while unemployed. Thus, the unconscionability has to be judged in light of the contemplation that it would apply when he was unemployed and with no income, seeking compensation that was not paid while working. This underscores the unconscionable nature of an agreement that makes it more difficult to obtain unpaid[7] wages.[8]

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[7] There is some irony about a process where the employee is not paid what he is owed, including the minimum wage and then has to pay for the effort to recover what he was owed.

[8] Part of the claim is the failure of the employer to pay all wages due upon termination under section 203. OTO ignores the fact that no fees are recoverable by Mr. Kho for the pursuit of that claim under any statutory provision except in court after OTO appeals an ODA. (See § 98.2, subd. (c).) Mr. Kho is thus required to pay to recover the statutory penalty, which is designed to ensure prompt payment to protect workers.

Finally, in finding that language enforceable in *Sanchez*, this Court again noted that "[t]he dispute in this case concerns a high-end luxury item." (*Sanchez*, *supra*, 61 Cal.4th at p. 921.) The Court also noted that there was "no evidence in the record suggest[ing] that the cost of appellate arbitration filing fees were unaffordable to him ...." (*Ibid.*)[9] The contrary, of course, is true here and because of the many costs imposed on Kho, the arbitration procedure is unconscionable.

Finally, this Court addressed what appeared to be a one way provision allowing "self-help remedies, such as repossession." (*Sanchez*, *supra*, 61 Cal.4th at pp. 921-922.) In upholding that exclusion, this Court noted several issues.

First, the Court noted that the arbitration had a "contract provision that preserves the ability of the parties to go to small claims court [which] likely favors the car buyer." (*Sanchez*, *supra*, 61 Cal.4th at p. 922.) This Court recognized that that simplified small claims court procedure would favor the car buyer. Here, there is no exception that would favor the wage claimant because both the Berman statutes and small claims court are unavailable.

Second, the Court noted that "self-help remedies are, by definition, sought outside of litigation, and they are expressly authorized by statute." (*Sanchez*, *supra*, 61 Cal.4th at p. 922.) The same is true here because the wage claimant is specifically authorized by statute to use the more simplified procedure of the Berman statutes. Moreover, the Arbitration Agreement would prohibit the self-help remedy of joining with other workers to coordinate and consolidate their claims. It is also broad enough

[9] In *Sonic II*, the claimant Moreno was a highly paid sales person, and this Court was not troubled by his resort to the free Berman statute process. Compare to this case where Mr. Kho is an auto mechanic and paid substantially less.

to require the employee to utilize the arbitration process rather than take collective action of picketing or striking because it requires use of the arbitration procedure for any claim that could be brought in court. Wage claims, for example, could be the subject of public protest, but that would violate the arbitration process.

Finally, this Court noted that "the remedy of repossession of collateral is an integral part of the business of selling automobiles on credit and fulfills a 'legitimate commercial need.'" (*Sanchez*, *supra*, 61 Cal.4th at p. 922 [citing *Armendariz*, *supra*, 24 Cal.4th at p. 117].) The Labor Commissioner in California has had the authority since the nineteenth century to investigate claims. The Berman statute process was adopted in the 1970s. Although this is not "self-help," it is a process that the Legislature has felt to be necessary to protect wage claimants. The history and strength of the worker protections in California discussed in the POB at 55-58, as well as the other statutory provisions that are not waivable, serve the same purpose.

The mode of analysis by this Court in *Sanchez* of each of the three challenged provisions supports a finding in this case that the arbitration agreement is unconscionable.

This Court's analysis recently in *Baltazar* also supports this analysis and conclusion.

In *Baltazar*, this Court analyzed a challenge to the right of the parties to seek a provisional remedy. As this Court noted, it was more likely the employer would have resort to the provisional remedy provision than the employee. (*Baltazar*, *supra*, 62 Cal.4th at pp. 1246-1248.) This Court rejected that argument because the provision was facially neutral and it did not eliminate provisional remedies available to either the employee or the employer. Here, however, there are provisional remedies available to the