LOS ANGELES & SAN FRANCISCO
Daily Journal
www.dailyjournal.com
WEDNESDAY, APRIL 10, 2024

PERSPECTIVE

# California: friend or foe of arbitration?

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The majority and minority opinions in a recent California appellate decision highlight the conflict between California and federal attitudes about arbitration. The case is *Dana Hohenshelt v. The Superior Court of Los Angeles County; Golden State Foods Corp (real party in interest)* (2024) 99 Cal.App.5th 1319. The majority opinion, authored by Justice Maria Stratton, claims to further the objectives of arbitration. Sharply dissenting, Justice John Shepard Wiley writes, "Judged by actions, California law over the last few decades … has not been a friend of arbitration."

Hohenshelt sued his former employer Golden State Foods for alleged violations of FEHA and wage and hour laws. The employer moved successfully to compel arbitration and stay court proceedings. Invoices sent by JAMS on July 29 and Aug. 29, 2022, were both due upon receipt and due to be paid within 30 days of their due dates. However, on Sept. 30, JAMS sent a letter extending the payment date to Oct. 28. Also on Sept. 30, Hohenshelt notified JAMS and the court that because the employer had not paid within 30 days of the due date, he was unilaterally electing to withdraw his claims from arbitration to proceed in court, pursuant to Code of Civ. Proc., section 1281.98(b)(1).

Section 1281.98(a)(1) provides that in employment and consumer arbitrations, "if the fees or costs required to continue the arbitration proceeding are not paid within 30 days after the due date, the drafting party is in material breach of the arbitration agreement, is in default of the arbitration, and waives its right to compel the employee or consumer to proceed with that arbitration as a result of the material breach." Subpart (b)(1) provides that in case of the drafting party's material breach, the employee or consumer may elect to "[w]ithdraw the claim from arbitration and proceed in a court of appropriate jurisdiction." That is exactly what Hohenshelt elected to do.

But the trial court cut the employer slack, denying Hohenshelt's motion to lift the litigation stay.

"The court held that 'the arbitrator seemingly *set a new due date* of Oct. 28, 2022.' (Italics added.)" Hohenshelt then filed a petition for writ of mandate to direct the trial court to vacate its order denying his motion to lift the stay.

In the appellate majority opinion, the court granted the petition and directed the trial court to vacate its order denying Hohenshelt's motion and to lift the litigation stay. Justice Stratton explained that section 1281.98 and California case law were clear and unambiguous: the trial court could not extend the 30 days to pay arbitration costs.

The majority relied on an earlier unanimous opinion of its court authored by Justice Wiley, *Cvejic v. Skyview Capital, LLC* (2023) 92 Cal.App.5th 1073. Justice Wiley explained in *Cvejic*: "In enacting sections 1281.97 through 1281.99, the Legislature perceived employers' and companies' failure to pay arbitration fees was foiling the efficient resolution of cases. This contravened public policy… The Legislature responded by making nonpayment and untimely payment grounds for proceeding in court and getting sanctions. The point was to take this issue away from arbitrators, who may be financially interested in continuing the arbitration and in pleasing regular clients." Note, however, that Skyview made no claim that the statute was unconstitutional. Also, Skyview forfeited a federal preemption argument. Of course, issues not raised are issues not decided.

However, other California appellate decisions did address the preemption issue. For example, *Gallo v. Wood Ranch USA, Inc.* (2022) 81 Cal. App.5th 621, held that the state laws were not preempted "because the procedures they prescribe *further* – rather than *frustrate* – the objectives of the FAA [Federal Arbitration Act, 9 USC sections 1-16] to honor the parties' intent to arbitrate and to preserve arbitration as a speedy and effective alternative forum for resolving disputes." Also, the statute does not outright prohibit and does not discourage initiating arbitration.

Viewed narrowly, *Hohenshelt* is simply one more in a battery of California cases strictly enforcing the statutory requirement in section 1281.98, that drafters of arbitration agreements must pay arbitration fees within 30 days, or else waive the right to arbitrate and allow employees and consumers the option to choose whether to arbitrate or to litigate in court.

However, the case has broader significance. In deciding that section 1281.98 means what it says and must be strictly interpreted, resulting in an employer's waiver of its ability to arbitrate, the court again confronted the issue of federal preemption of state law by the FAA. Where federal and state law conflict, federal law reigns supreme. The Supremacy Clause is Article VI, par. 2 of the Constitution, and the FAA is federal law. And the FAA has been interpreted to mean that, while state law defenses to arbitration such as fraud and unconscionability remain, a state cannot burden a contract to arbitrate more than any other contractual agreement. In other words, contracts to arbitrate and other contracts are placed on an equal footing. Now that the preemption issue had been raised, Justice Wiley dissented.

Justice Wiley wrote, "What preempts this statute is the decision to make *arbitration* the hostage of delay." We can guess that the majority might respond that the statute exists to prevent employees and consumers from being held hostage to delay.

However, Justice Wiley suggests that the Legislature could have remedied the problem with a less drastic approach: "[S]anctions like damages, a statutory fine of a motivating magnitude, and attorney fees would amply deter delay. Why abolish the *arbitration itself?"* As Justice Wiley points out, ordinarily one does not lose a contractual right through delay unless "time is of the essence" is written into the contract, and arbitration contracts should be treated the same as other contracts. One wonders, however, how sanctions and statutory fines would be administered after a court referred the case to arbitration, leaving the court with vestigial powers. Would arbitrators hasten to level sanctions and fines?

Justice Wiley cited six United States Supreme Court opinions in which "the United States has rebuked California state law that continues to find new ways to disfavor arbitration." However, those six cases do not present the specific issue addressed in *Hohenshelt*: whether a statute requiring the payment of arbitration costs in 30 days by the employer or the corporation "disfavors" arbitration, or whether the statute furthers "the objectives of the FAA to honor the parties' intent to arbitrate and to preserve arbitrations as a speedy and effective alternative forum for resolving disputes." *Gallo* at 630. Nor do the Supreme Court cases squarely address whether, in the circumstances here, it matters that the statute does not outright prohibit or discourage initiating arbitration.

While the Supreme Court may not have squarely addressed the issues here, a United States district court has done so. *Belyea v. GreenSky, Inc.* (N.D. Cal. 2022) 637 F.Supp. 3d 745. Therefore, Justice Wiley relied on *Belyea:* "The *Belyea* court examined this friend-of-arbitration claim that the statute encourages arbitration. *Belyea* then asked the incisive question: 'But how? It does so by making the arbitration agreement *unenforceable*.' … A friend of arbitration does not make the arbitration agreement unenforceable. Federal law does not allow a state to save arbitration by destroying it."

While Justice Wiley believes that the stick of damages, a statutory fine, or attorney's fees would serve as an appropriate carrot to induce good behavior and prevent delay, he believes that a sanction allowing the employee or consumer to choose between arbitration and litigation goes too far. It is conceivable, however, that if the statute had been drafted to allow for sanctions short of making the arbitration agreement unenforceable, the preemption argument would still have been raised.

Justice Wiley states that California state law disagrees "about whether arbitration is desirable." Another point of view, which does not necessarily contradict Justice Wiley, is simply that California is a blue state in which California law has evolved to protect employees and consumers. Viewed in that light, section 1281.98 is a remedial statute intended to prevent employees and consumers from being held hostage to arbitration placed in limbo by an employer or corporation's failure to pay costs. Viewed that way, the intended message to employers is not that they will be held hostage to delay. Rather, to put it euphemistically, it is to cook or get out of the kitchen, to fish or cut bait.

In the April 2, 2024 Daily Journal, appellate specialist Ben Shatz summarized a statistical study by Alma Cohen, *"The Pervasive Influence of Political Composition on Circuit Court Decisions"* as follows: "specifically that 'panels with more Democratic judges are more likely than those with Republican judges to reach a decision that favors the individual party' who is often 'perceived by judges to be the weaker party.' … Note that there is significant literature finding that 'Litigation is structurally biased against weak parties.' "Does that finding also help explain how California case law has evolved to protect individual consumers and employees, in circumstances where the non-drafting party of an arbitration agreement will be viewed as "the weaker party"? Perhaps it is not so much pervasive hostility to arbitration as it is the desire to protect employees and consumers from a very specific arbitration abuse that explains the judicial decisions strictly interpreting section 1281.98.

Whether one views the "friend-of-arbitration logic" as convincing, or as a pretext for enforcing a statute that can be used to avoid arbitration, the application of the Supremacy Clause raises a constitutional question. "By again putting arbitration on the chopping block," Justice Wiley ominously predicts, "this statute invites a *seventh* reprimand from the Supreme Court of the United States." It seems likely the preemption issue concerning section 1281.98 will not go away without a definitive resolution.

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