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California Supreme Court Decision May Jeopardize Enforceability of Employment Arbitration Agreements

In *Gentry v. Circuit City Stores, Inc.*, No. S141502 (Aug. 30, 2007), the California Supreme Court issued its eagerly anticipated decision addressing the enforceability of class action arbitration waivers in employment arbitration agreements.

For those who were hoping the decision would provide some certainty about the enforceability of such waivers, the decision will likely be a disappointment. Perhaps more importantly, the decision may call into question the enforceability of many employment arbitration agreements in California, regardless of whether they contain such waivers.

In remanding to the Court of Appeal, the *Circuit City* Court ruled that class action arbitration waivers may or may not be enforceable, depending upon a number of factors to be analyzed by the trial court: the size of the potential recovery; the potential for retaliation; whether absent class members may be ill-informed of their rights; and other “real world obstacles” to the vindication of class members’ rights through individual arbitration.

As the case has been remanded, it may be some time before there is a final determination whether the waiver at issue in *Circuit City* in fact is enforceable. Moreover, the factors articulated by the Supreme Court may be exceedingly difficult to assess prior to a dispute arising, making it even more difficult for these waivers to be drafted and their enforceability analyzed. The ultimate effect of this decision is that the enforceability of class action arbitration waivers will be determined on a case-by-case basis by the trial courts, with only a few guidelines, which would not seem to provide employers with the certainty they were hoping for. The only certainty appears to be that there will be more litigation over the enforceability of these waivers.

Importantly, the Court also remanded to the Court of Appeals the issue of whether the employment arbitration agreement at issue in the case was procedurally and substantively unconscionable and, therefore, should be invalidated. The Court expressed its concern that the arbitration agreement may not have been obtained through “authentic informed choice,

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because the employer's description of the benefits of arbitration was one-sided, and because the employee may not have felt comfortable opting out of it. The concerns articulated by the Court may well arm employees with arguments to try to avoid the enforcement of arbitration agreements, and may send many employers back to the drawing board to try to revise their arbitration agreements and their communications to employees about them.

This Alert provides a summary of the Court's decision and highlights concerns for employers.

Case-by-Case Analysis

In *Circuit City*, the California Supreme Court considered whether class arbitration waivers in employment arbitration agreements could be enforced to prevent class arbitrations by employees with wage-and-hour claims. The plaintiff in the underlying case, Robert Gentry, had signed Circuit City's arbitration agreement, which expressly provided that he would arbitrate his disputes, but that an arbitrator could not hear arbitration as a class action. Gentry was provided with a form that allowed him 30 days to opt out of the agreement if he so desired. He did not in fact opt out.

Remanding to the Court of Appeal, which had compelled arbitration and enforced the class action arbitration waiver, the Supreme Court explained that such waivers may or may not be enforceable depending upon the circumstances. The court explained that a trial court must examine the following factors in determining whether a class action arbitration waiver is enforceable in a particular case:

- 1) the size of the potential individual recovery
- 2) the potential for retaliation against class members
- 3) whether absent class members may be ill-informed of their rights
- 4) other "real world obstacles" to the vindication of the class members' rights through individual arbitration

These considerations plainly would need to be addressed on a case-by-case basis.

One-sided Communications

The *Circuit City* Court also remanded to the Court of Appeal the issue of whether the arbitration agreement should be invalidated as procedurally and substantively unconscionable—even though Circuit City had provided an explanation of arbitration to its employees and had given the employees a 30-day window within which they could opt out of their arbitration agreements after signing them.

The Court concluded that there were several indications that Gentry's failure to opt out of the arbitration agreement may not have been "an authentic informed choice." The Court was particularly troubled by the explanation of the benefits of arbitration in Circuit City's handbook, which it found to be "markedly one-sided."

Additionally, the Court was concerned that someone in Gentry's position might not have felt free to opt out of the arbitration agreement, given Circuit City's stated preference that employees participate in it. The Court was also troubled by provisions in the arbitration agreement that provided for shorter limitations periods than provided by statute, as well as a \$5,000 cap on punitive damages.

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unconscionable—even though Circuit City had provided an explanation of arbitration to its employees and had given the employees a 30-day window within which they could opt out of their arbitration agreements after signing them.

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If the Court of Appeal determines that the arbitration agreement was both procedurally and substantively unconscionable, the agreement could be invalidated in its entirety.

What Does *Circuit City* Mean to Employers?

Many employers and employment attorneys, who have been awaiting this decision in the hopes that it would provide some certainty as to whether or not class action arbitration waivers are enforceable, may be disappointed by the decision. The Supreme Court ruled that these waivers may or may not be enforceable, depending upon the circumstances, which would require a case-by-case analysis. Moreover, not only are the factors articulated by the Court difficult to assess prior to a dispute arising, making it even more difficult for these waivers to be drafted and analyzed, but employers will only be able to speculate whether their waivers would be enforced. Simply put, one trial court may well find a particular waiver to be enforceable, while another court may find that the very same waiver to be unenforceable.

Perhaps more importantly, the Court's decision to remand the unconscionability issue to the Court of Appeals may call into question the enforceability of many employers' arbitration agreements, regardless of whether they contain class action waivers. The Court held that providing employees with a window of time to opt out of the waiver is not a guarantee that a waiver is not procedurally unconscionable. The Court also criticized the language in Circuit City's handbook regarding the benefits of arbitration as being too one-sided. Once again, it appears the unconscionability issue will be decided on a case-by-case basis. One trial court may find a particular waiver unconscionable, while another court may find the very same waiver not to be unconscionable. Moreover, the concerns articulated by the Court would appear to arm many employees with arguments to try to avoid the enforceability of their arbitration agreements.

The decision will likely send many employers and their attorneys back to the drawing board to try to craft arbitration agreements and waivers that would satisfy the concerns raised by the Court, knowing that ultimately there is little certainty about enforceability. Employers will also need to review their communications to employees about the benefits of arbitration to try to ensure that they would not be deemed one-sided. The decision may lead some employers to abandon pursuing class action arbitration waivers rather than run the risk that their waivers would be found to be void or that they would be compelled to arbitrate class claims. It may also lead to more litigation over the enforceability of arbitration agreements in general.

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In light of *Circuit City*, employers with arbitration agreements should promptly review those agreements, and their communications about those agreements, with counsel, regardless of whether they contain class action arbitration waivers.

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If you have any questions regarding the California Supreme Court's decision in *Gentry v. Circuit City Stores, Inc.*, or about employment class actions, please contact Michael Kun at (310) 557-9501 or mkun@ebglaw.com

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