
Legal Updates & News

Legal Updates

Are Class Action Waiver Provisions in Pre-Employment Arbitration Agreements Enforceable in California After *Gentry*?

September 2007

by [Rick Bergstrom](#)

Related Practices:

- [Consumer Litigation & Class Action](#)
- [Employment and Labor](#)
- [Employment Class Actions](#)
- [Litigation](#)

Employment class actions have become a costly pandemic in California and in many other states. In an attempt to stem the tide of such actions, some employers adopted mandatory pre-dispute arbitration agreements which prohibit arbitrations on a class basis. Based on existing case law, however, it was unclear whether these types of class action waiver provisions are enforceable in the employment context.

On August 30, 2007, the California Supreme Court found in a split four to three decision that a class action waiver provision cannot be enforced where the claims at issue cannot be waived as a matter of law (e.g., a claim for unpaid wages including overtime), and a class action would be a “significantly more effective means” of resolving the claims at issue in the case.

The Facts

In 1995, while employed by Circuit City, plaintiff Robert Gentry (“Gentry”) received an “Associate Issue Resolution Package” and a copy of the company’s “Dispute Resolution Rules and Procedures” setting forth various procedures for resolving employment-related disputes. The dispute resolution materials contained an arbitration agreement that included a class action waiver provision which stated, in relevant part: “The Arbitrator shall not consolidate claims of different [employees] into one proceeding, nor shall the Arbitrator have the power to hear arbitration as a class action. . . .” As written, this provision purported to preclude employees subject to the arbitration process from bringing class actions against Circuit City (the “Class Action Waiver”). The dispute resolution documents also contained an “opt-out” form that, if completed and returned to Circuit City within thirty (30) days after receiving the materials, allowed the employee to reject the arbitration provision and avoid the alternative dispute resolution process. If an employee did not return the “opt-out” form, he or she was deemed to have accepted the arbitration provision. In addition, the arbitration clause contained provisions limiting the statute of limitations to one year and limiting any punitive damages award to \$5,000.

Gentry signed an acknowledgement for the dispute resolution package and did not return the “opt-out” form. In 2002, he filed a putative class action against Circuit City in California state court, seeking unpaid overtime, penalties and interest based on his allegation that Circuit City misclassified managers as exempt employees. Circuit City filed a petition to compel arbitration. The trial court granted the petition, found the Class Action Waiver was enforceable, and struck the provisions reducing the statute of limitations and limiting an award of punitive damages. Gentry then filed a writ of mandate challenging the trial court’s decision.

After a complicated appeals process, the Court of Appeal reviewed the superior court’s decision in light of the California Supreme Court’s recent decision in *Discover Bank v. Superior Court*, 36 Cal.4th 148 (2005), in which a class action waiver clause in an agreement between a credit card company and card holders was held to be not enforceable. The appellate court framed the issue before it as a narrow one: *whether the Class Action Waiver in the Circuit City arbitration agreement was an unconscionable provision that rendered the arbitration agreement unenforceable.* The

Court of Appeal held that Circuit City's arbitration agreement, and specifically the Class Action Waiver, was enforceable. It found that the provision was not procedurally unconscionable based on the existence of the opt-out provision. It likewise determined the class action waiver was not substantively unconscionable (e.g., unfairly one-sided) because, unlike in *Discover Bank*, the overtime claims at issue in this case potentially involved large amounts of money which provided an incentive for employees to bring individual claims.

The California Supreme Court's Ruling and Rationale

The California Supreme Court reversed the judgment of the Court of Appeal.

Class Action Waiver

The Court began its analysis by noting that the overtime claims at issue in this case are based on a statutory right which is "unwaivable" according to California Labor Code Section 1194. As a result, the Court found that a Class Action Waiver cannot not be enforced in this context if a class action is "likely to be a significantly more effective practical means of vindicating the rights of the affected employees than individual litigation" and the waiver of the ability to maintain the action on a class basis "will likely lead to less comprehensive enforcement of overtime laws" for the employees at issue. In determining whether this is the case, the Court found that the following four factors must be considered:

1. The modest size of the potential individual recovery;
2. The potential for retaliation against members of the class;
3. The fact that absent members of the class may be "ill informed" about their rights; and
4. Other "real world obstacles" to the vindication of class members' right to overtime pay through individual litigation.

In setting forth this analysis, the Court specifically left open the possibility that a Class Action Waiver, even where an unwaivable statutory claim is at issue, may be enforceable. It stated, "[w]e do not foreclose the possibility that there may be circumstances under which individual arbitrations may satisfactorily address the overtime claims of a class of similarly aggrieved employees, or that an employer may devise a system of individual arbitration that does not disadvantage employees in vindicating their rights under section 1194."

Notably, however, the Court commented that various arguments asserted by Circuit City concerning the absence of a compelling need for class treatment of claims for overtime wages did not carry the day. It rejected the contention that ability to recover attorneys' fees was sufficient protection for claims involving a small individual recovery. It also disregarded the ability of an employee to bring an administrative claim with the Labor Commissioner as an efficient option for individual claims. Last, the Court did not find persuasive the fact there have been some 40 published cases over the last 70 years in California specifically involving individual employees (not on a class basis) pursuing claims for overtime violations.

The Court then remanded the issue of enforceability of the Class Action Waiver in this case to the trial court to determine whether a class action would be a significantly more effective means of resolving the overtime claims at issue in this case than individual actions. Importantly, the Court indicated that even if the trial court finds the Class Action Waiver is not enforceable, the provision may be stricken and the parties can proceed with arbitration as a class action, unless the trial court finds the arbitration agreement in total is unenforceable for the reasons set forth below. The Court indicated that severance of a Class Action Waiver provision was particularly appropriate because it is not invalid on its face and may only be invalidated after the proper factual showing.

Procedural Unconscionability

The California Supreme Court then turned to the issue of procedural unconscionability. It specifically disagreed with the determination by the Court of Appeal that the ability of an employee to opt out of the arbitration agreement for a period of 30 days automatically led to the conclusion that the arbitration provision was not procedurally unconscionable. Instead, it determined that some degree of procedural unconscionability did exist in this case based on the one-sided provisions included in the arbitration agreement (e.g., shortened statute of limitations and punitive damages cap), and Circuit City's failure to clearly explain the impact of these provisions. Moreover, the Court observed "it is not clear that someone in Gentry's position would have felt free to opt out."

Accordingly, the Court remanded the issue of unconscionability to the trial court for it to determine: (a) whether the arbitration provision has substantive unconscionable terms (e.g., the provisions

shortening the statute of limitations and limiting punitive damage awards); and (b) if so, whether those provisions should be severed or the arbitration agreement should be invalidated.

Questions Unresolved by *Gentry* And Practical Advice To Employers

Although the *Gentry Court* seemed to suggest that a class action would be a significantly more effective means of resolving the overtime claims at issue, it stopped short of reaching this conclusion. Thus, it remains unclear whether the trial courts in this case and other trial courts, when applying the criteria adopted by the Court, will favor class treatment of such claims. Notably, an increasing number of trial courts have found that overtime claims are not suitable for class treatment based in part on the fact that it is not a superior method for resolving these types of disputes.^[1] Further, even if a class proceeding is deemed to be more efficient, it is unclear whether an individual that has waived his/her right to pursue claims on a class basis can qualify as a proper representative of a class which he/she agreed not to represent.

In light of the ambiguity concerning how trial courts will apply the *Gentry* decision and the fact that the Court expressly suggested that Class Action Waiver provisions should be severed if found unenforceable (rather than invalidating the entire agreement), employers should consider taking the following steps:

1. Implement a binding pre-employment arbitration agreement with or without a Class Action Waiver, to the extent such an agreement does not already exist;
2. Review any existing arbitration agreements to ensure they do not contain provisions that may be deemed to be invalid on their face (e.g., shortening the statute of limitations or limiting punitive damage awards);
3. Carefully develop thorough procedures for educating employees about any pre-employment arbitration agreement adopted by the company; and
4. Provide employees with an opportunity to review any pre-employment arbitration agreement, seek counsel, and opt out of the agreement if they choose.

Footnotes:

[1] See, e.g., *Dunbar v. Albertsons*, 141 Cal.App.4th 1422 (2006).