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Management Alert

California Appeals Court Upholds Class Action Arbitration Waivers

On December 19, 2006, the California Court of Appeal in Los Angeles issued a decision that may help employers stem the rising tide of class action litigation. In *Konig v. U-Haul Company of California*, the court upheld a class action waiver contained in an arbitration agreement that employees signed as a condition of employment. Although a similar issue is now before the California Supreme Court, the *Konig* decision may provide California employers a valuable tool for controlling exposure to expensive, time-consuming class actions in certain types of claims.

The Arbitration Agreement

The U-Haul arbitration agreement provided that the parties agreed to waive jury trial in favor of arbitrating "all disputes relating to or arising out of an employee's employment with [the company] or the termination of that employment." The agreement expressly covered various claims, including claims under the California Labor Code. The agreement also contained a waiver of "any right to join or consolidate claims in arbitration with others or to make claims in arbitration as a representative or as a member of a class or in a private attorney general capacity."

The agreement provided that an employee's decision to accept or continue employment with the company was an "agreement to be bound" by the company's arbitration policy. U-Haul claimed that plaintiff had signed the arbitration agreement in 2003, while he contended that his signature was a forgery. The court declined to address this issue, presumably because it found the plaintiff to have accepted the terms of the agreement by electing to accept the benefits of employment.

The Lawsuit

In 2005, plaintiff filed a proposed class action against U-Haul for unpaid wages and unfair business practices, alleging that U-Haul had failed to pay employees for overtime work and for accrued vacation, and had denied employees meal and rest breaks.

U-Haul moved for an order enforcing the arbitration agreement. When the trial court granted the motion, the plaintiff appealed.

The Court of Appeal's Decision

The Court of Appeal confirmed that arbitration agreements are generally favored under both state and federal law, but noted that they are not enforceable if they are unconscionable. Unconscionability has both a procedural and a substantive element. Generally, for a contractual provision to be invalidated due to unconscionability, both forms of unconscionability must be present. Procedural unconscionability means "oppression" arising from unequal bargaining power or from "surprise" created by buried terms in a complex printed form. Procedural unconscionability thus exists if there has been no meaningful opportunity to negotiate and no way to opt out of the agreement. Absent an opt-out clause, employers rarely prevail on the procedural issue, and U-Haul did not prevail on it here.

As to the issue of substantive unconscionability, the *Konig* court reviewed the California Supreme Court's decision in *Discover Bank v. Superior Court*, 36 Cal. 4th 148 (2005). In *Discover Bank*, the Supreme Court held that a class action waiver in a consumer contract is substantively unconscionable if disputes between the contracting parties involved "predictably . . . small amounts of damages." The reasoning for this result was that small amounts of damages make an individual lawsuit impractical, leaving class actions as the only viable method by which victims can bring a wrongdoer to account.

Applying this reasoning, the *Konig* court determined that the plaintiff had failed to show that potential recoveries for class members would be predictably small amounts that would render the class action waiver substantively unconscionable. Indeed, the plaintiff had alleged that his own damages exceeded $25,000 and that his claim was typical of the class claims. Because he could not establish substantive unconscionability, the court upheld the class action waiver and the trial court's order compelling arbitration.

What The Case Means for California Employers

Although cases now under review by the California Supreme Court preclude a definitive recommendation, California employers should find the *Konig* decision encouraging. Including class action waivers in arbitration agreements can be viable if the case remains undisturbed, provided that the agreements otherwise comply with the standards that have been established by California courts in recent years.

Those employers who have refrained from instituting arbitration agreements out of concern that they face an arbitration on a class-wide basis now have reason to revisit the issue. Moreover, the dichotomy between the requirement that "predictably . . . small amounts" of damage be involved to avoid the class action waiver and arbitration and the economics of litigating these cases may deter the plaintiffs' bar in trying to maximize the potential penalty exposure. Employers might also consider further ensuring the defensibility of class action waivers by putting them in opt-out forms of arbitration agreements.

There is cause for optimism. First, it may be that those who decline to sign the agreement (or opt out of arbitration) do not have sufficient similarity of interest

to represent or be included in a class of those who did sign the agreement. Second, it may also be the case that only those with extremely small claims can escape the waiver. That, in turn, may mean that most claims seeking penalties will be too large to support the finding of unconscionability necessary to void the arbitration agreement and escape the class action waiver. Third, those with claims too large to support an unconscionability finding may not be proper representatives of a class who do have small damages and signed or did not opt out. In sum, if the *Konig* decision stands, it may present a number of opportunities to prevent class certification and to limit the size of any certified class.

Obviously, a lot can happen (including de-publication of the *Konig* decision or a grant of review by the Supreme Court). Further, major policy changes based on a single lower court opinion are not for the faint of heart. Nonetheless, the *Konig* case highlights an important issue to follow in 2007.

If you have any questions concerning this Management Alert, please contact the Seyfarth Shaw LLP attorney with whom you work or any attorney on the website at www.seyfarth.com.

ATLANTA
One Peachtree Pointe
1545 Peachtree Street, N.E.
Suite 700
Atlanta, GA 30309-2401
404-885-1500
404-892-7056 fax

BOSTON
World Trade Center East
Two Seaport Lane
Suite 300
Boston, MA 02210-2028
617-946-4800
617-946-4801 fax

CHICAGO
131 South Dearborn Street
Suite 2400
Chicago, IL 60603-5577
312-460-5000
312-460-7000 fax

HOUSTON
700 Louisiana Street
Suite 3700
Houston, TX 77002-2797
713-225-2300
713-225-2340 fax

LOS ANGELES
One Century Plaza, Suite 3300
2029 Century Park East
Los Angeles, CA 90067-3063
310-277-7200
310-201-5219 fax

NEW YORK
1270 Avenue of the Americas
Suite 2500
New York, NY 10020-1801
212-218-5500
212-218-5526 fax

SACRAMENTO
400 Capitol Mall
Suite 2350
Sacramento, CA 95814-4428
916-448-0159
916-558-4839 fax

SAN FRANCISCO
560 Mission Street
Suite 3100
San Francisco, CA 94105-2930
415-397-2823
415-397-8549 fax

WASHINGTON, D.C.
815 Connecticut Avenue, N.W.
Suite 500
Washington, D.C. 20006-4004
202-463-2400
202-828-5393 fax

BRUSSELS
Boulevard du Souverain 280
1160 Brussels, Belgium
(32) (2) 647 60 25
(32) (2) 640 70 71 fax

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