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JUDICIAL UPDATE

California

California Supreme Court Issues Opinion Criticizing "Trial by Formula" in Class Actions

In Duran v. U.S. Bank National Association the California Supreme Court found that class decertification was appropriate where the class had been certified based on a flawed process. U.S. Bank National Association ("USB") employed loan officers who were responsible for cultivating new business and selling bank products, including loans and lines of credit, to its small business customers. USB classified these employees as exempt under the outside salesperson exemption. In 2001, a class action was filed against USB for unpaid overtime, claiming that USB misclassified its loan officers. Following years of litigation, a class of 260 loan officers was certified.

The trial court then developed a two-phase trial management plan. First, the court heard testimony from a random sample of twenty loan officers about their work habits. The court did not permit USB to introduce evidence about the work habits of any other loan officers. Based on testimony from this small group, the trial court determined that the entire class of loan officers had been misclassified. Second, the trial court extrapolated the average amount of overtime reported by the twenty loan officers to the entire group as a whole, resulting in a verdict of approximately $15 million (an average recovery of over $57,000 per person).

The Court of Appeal reversed the judgment, and the California Supreme Court recently upheld the appellate court's decision. The California Supreme Court was critical of the trial court's "flawed implementation of sampling" and referred to the trial court's method as "manifest injustice." A class action trial management plan must permit the litigation of relevant affirmative defenses, even when those defenses turn on individual questions. Under the trial court's method, USB had not been permitted to produce evidence showing that some class members were exempt from overtime and not entitled to any recovery. Moreover, there were serious flaws in the sampling plan. For instance, the sample size was too small, the "randomness" of the selection of the sample was questioned, and the margin of error was too high.

In misclassification cases, the primary consideration is how employees actually spend their workday. Therefore some evidence regarding individual employees' work habits is necessary to determine liability. Sampling methods are only effective where

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they are truly representative of the putative class members and where the employer is permitted to provide input regarding the adequacy of the sampling.

While the trial court's method in *Duran* was flawed, the California Supreme Court recognized that statistical sampling may provide an appropriate means of proving liability and damages in some wage and hour cases. For example, it may be shown that the employer had a consistently-applied policy that violated the Labor Code. However, the employer must still be permitted to introduce its own evidence challenging the plaintiff's showing. *Duran* is a prime example of how difficult it can be to certify a class on misclassification grounds.

Appellate Court Affirms Delegation of Enforceability of Arbitration Agreement

In *Tiri v. Lucky Chances, Inc.*, a California Court of Appeal held that the trial court lacked the authority to rule on the enforceability of the parties' arbitration agreement because the parties had delegated this authority to the arbitrator, and their delegation of this authority was valid.

More than three years after she was hired as a cook, Lourdes Tiri ("Tiri") signed an agreement with her employer, Lucky Chances, Inc. ("Lucky Chances"), requiring disputes between them to be resolved by arbitration. In one of the provisions ("the delegation clause"), the parties agreed to delegate questions about the enforceability of the agreement to the arbitrator, instead of a court. Tiri was subsequently fired, and she filed a complaint in Superior Court for wrongful discharge. Lucky Chances petitioned to compel arbitration. The trial court denied the petition on the basis that the arbitration agreement was unconscionable and therefore unenforceable. Lucky Chances appealed the court's order denying arbitration.

The Court of Appeal sought to determine whether the trial court properly denied Lucky Chances' petition to compel arbitration in light of the delegation clause. The answer turned on whether the delegation clause was valid under state law unconscionability principles.

Parties to an arbitration agreement may agree to delegate to the arbitrator, instead of a court, questions regarding the enforceability of the agreement. There are two prerequisites for a delegation clause to be effective. First, the language of the clause must be clear and unmistakable. Second, the delegation must not be revocable under state contract defenses such as fraud, duress, or unconscionability.

The appellate court examined the language of the delegation clause and determined that it was clear and unmistakable. The clause stated unambiguously that "[t]he Arbitrator, and not any federal, state, or local court or agency, shall have the exclusive authority to resolve any dispute relating to the interpretation, applicability, enforceability, or formation of this Agreement." Next, the court analyzed the delegation clause on state law unconscionability principles and determined that it was valid. Although the court found that the delegation clause was procedurally unconscionable because it was a contract of adhesion and was presented on a take-it-or-leave-it basis, the court nonetheless determined that the clause was valid because it was not substantively unconscionable.

An arbitration agreement imposed in an adhesive context lacks basic fairness and mutuality if it requires one party, but not the other, to arbitrate all claims arising out of the same transaction or occurrence. The court determined that the delegation clause here did not lack mutuality because Tiri and Lucky Chances were bound by it equally. Therefore, because the delegation clause was not overly harsh, and did not sanction one-sided results, it was not substantively unconscionable.

Having determined that the delegation clause was valid, the appellate court concluded that the trial court's denial of Lucky Chances' petition to compel arbitration was improper. The Court of Appeal ruled that the arbitrator must consider the conscionability of the arbitration agreement as a whole and any of its other severable provisions. This case confirms that parties to an arbitration agreement may provide in the agreement that the arbitrator has the sole authority to determine the agreements validity of the arbitration agreement.

<u>California Court of Appeal Examines the Disparate Impact Theory of Discrimination and the Avoidable Consequences Doctrine</u>

The importance of a thorough and legitimate internal grievance process is widely known among employers. It provides employees with a clear avenue for voicing complaints, clearly identifies the nature of complaints early for employers, and enables a uniform procedure for both sides in addressing certain problems that arise. The California Court of Appeal offered a reminder to employers of both the subtlety of potential discrimination and the need for an effective grievance process in *Rosenfeld v. Abraham Joshua Heschel Day School, Inc.*

Ruth Rosenfeld ("Rosenfeld") resigned from her teaching position at Abraham Joshua Heschel Day School ("Heschel") in 2007, citing an intolerable work environment. Heschel had reduced Rosenfeld's teaching hours from 25 to 10 hours per week over a three year period. Rosenfeld attributed this solely to age discrimination. Heschel defended its decision to reduce her hours on the grounds that its enrollment had dropped from 455 to 391 students.

Rosenfeld filed a lawsuit in 2008 alleging age discrimination under a "disparate treatment" theory. She later attempted to add a "disparate impact" theory, but the trial court rejected this claim on the ground that Rosenfeld did not assert it in her initial pleading. At trial, Heschel prevailed on the basis that its reduction of Rosenfeld's hours was valid and her at-will status did not guarantee a specific number of hours. Rosenfeld appealed the ruling on the ground that she should have been allowed to pursue her claim of discrimination under both disparate impact and disparate treatment theories. Rosenfeld also asserted that the trial court improperly admitted evidence that Rosenfeld failed to exhaust Heschel's internal grievance procedure.

The Second Appellate District upheld the verdict in favor of Heschel. In its ruling, the court explained the clear distinction between discrimination that is direct and intentional (disparate treatment) and conduct that unintentionally leads to a discriminatory result (disparate impact). Because these claims turn on distinguishable facts, they must both be pled explicitly to allow the defendant a reasonable opportunity to prepare a defense. Rosenfeld did not plead both theroies, and as such was limited to pursuing the disparate treatment theory.

The court also held that Heschel had validly asserted the "avoidable consequences" doctrine as a defense to damages. Under this theory, Heschel could avoid liability for any damages that likely could have been prevented by Rosenfeld's reasonable utilization of Heschel's internal grievance process. Rosenfeld's decision to resign rather than file an internal grievance prevented her from having her hours

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reinstated (which the court determined would have happened). Notably, the Court recognized that if Heschel's internal grievance process was ineffective or Rosenfeld's failure to use it was reasonable, the defense would have been unavailable to Heschel.

This case highlights the benefits of a effective internal grievance process. Such a program not only fosters better relationships between staff and management, it can provide a strong defense for employers against damages should claims arise. Because the impact of this defense turns on the quality of the grievance and investigation process, employers must consistently review their programs.

This is Pettit Kohn Ingrassia & Lutz PC's monthly employment update publication. If you would like more information regarding our firm, please contact Tom Ingrassia, Jennifer Lutz, Jenna Leyton-Jones, Christine Mueller, Heather Stone, Ryan Nell, Lauren Bates or Jennifer Suberlak at (858) 755-8500; or Jennifer Weidinger, Tristan Mullis or Andrew Chung at (310) 649-5772.

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