AMERICAN ARBITRATION ASSOCIATION
Class Action Arbitration Tribunal

In the Matter of the Arbitration between

Re: 11 160 03041 04

James C. Allen, Craig Wilder, and Mark Depue, on behalf of themselves and all others similarly situated (Claimants)

and

Sport and Fitness Clubs of America, Inc. a California corporation doing business as 24 Hour Fitness; 24 Hour Fitness USA, Inc., a California corporation doing business as 24 Hour Fitness (Respondents)

PARTIAL FINAL CLAUSE CONSTRUCTION AWARD OF ARBITRATOR

I, THE UNDERSIGNED ARBITRATOR, having been designated by agreement of the parties, as confirmed by the Order of the California Superior Court for the County of Los Angeles, dated December 17, 2004, and having heard the arguments and submittals of the parties on the matter of Clause Construction, do hereby make this Partial Final Clause Construction Award pursuant to the American Arbitration Association's Supplementary Rules for Class Arbitrations, Rule 3, as follows:

This Partial Final Clause Construction Award determines whether the applicable arbitration clause permits this arbitration to proceed on behalf of a class. The matter has been fully briefed by the parties, and oral argument was heard in a telephone hearing conducted on March 24, 2005 in which Thomas G. Foley, Jr., Esq., Richard E. Donahoo, Esq., and Phillip Dracht, Esq. appeared for Claimants, and, Henry D. Lederman, Esq. appeared for Respondents.

By agreement of the parties, and as confirmed by order of the California Superior Court dated December 17, 2004, this matter is proceeding under the American Arbitration Association's National Rules for the Resolution of Employment Disputes, as supplemented by the Association's Supplementary Rules for Class Arbitrations.

Preliminary Matter

Respondents, as an initial matter, request a stay of this arbitration pending final court approval of settlements reached through mediation in various putative class actions brought against Respondents in

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federal and state courts in California. Respondents contend there is substantial overlap between the claims asserted in those actions and the claims asserted in this arbitration, and, that those settlements may resolve many if not all of the claims asserted here. Claimants, on the other hand, resist a stay, contending that Claimants will be prejudiced by delay, and, that parties expect that arbitration will be a speedy and efficient process.

Claimants also contend that their Fair Labor Standards Act ("FLSA") claim will not overlap with the pending class action litigation, since that claim is asserted here solely on behalf of a class of employees outside California. Claimants further argue that it is at this time speculative whether and on what terms and conditions the pending class action settlements will be approved by the courts, noting that Claimants intend to contest court approval of those settlements. Claimants also anticipate that even if a class action settlement is approved in the pending court litigation, many class members will opt out in sufficient numbers to qualify as a class in this arbitration.

Given the foregoing, and in the absence of any persuasive showing by Respondents that they will be substantially prejudiced if this arbitration proceeds to the Clause Construction and Class Certification phases, it is determined on balance that Respondents' request for a stay pending final resolution of the various judicial class actions should be and the same is hereby denied.

The Association's Supplementary Rules for Class Arbitrations, Rule 3, provides for a "stay of all proceedings following the issuance of the Clause Construction Award for a period of at least 30 days to permit any party to move a court of competent jurisdiction to confirm or vacate the Clause Construction Award". Accordingly, this arbitration is stayed for 30 days from the date of issuance of this Clause Construction Award.

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Procedural Background

Because some of Respondents' arguments on clause construction relate to the manner in which this matter has come to arbitration, it is useful to review the relevant procedural history of the dispute in some detail.

On July 2, 2004, Claimants' counsel Thomas Foley submitted a Demand for Arbitration to the American Arbitration Association ("AAA"), accompanied by a copy of what Mr. Foley believed to be the applicable arbitration policy of Respondents, effective October, 2000. That policy provides for arbitration of disputes arising from employees' employment with Respondents according to "the specific rules established by the legislature for the particular state in which [the employee] is employed, or, by the rules of the American Arbitration Association if there are no such laws enacted." The Statement of Claim accompanying the Demand for Arbitration asserted claims for wages and resulting penalties under California's Labor Code for failure to pay wages and to provide mandatory breaks to personal trainers, and sought certification of a class of all similarly situated employees in California. Declaration of Henry D. Lederman In Support of Defendant's Petition to Compel Arbitration in the Superior Court of the State of California, County of Los Angeles Case No. BS093362 (hereinafter "Lederman Declaration"), Exh. A.

The AAA acknowledged receipt of the Demand on July 21, 2004 and stated that the case would be administered under the Association's Employment Rules and the Supplemental Rules for Class Arbitrations. Id., Exh. B.

On the same day, Respondents' counsel, Henry Lederman, wrote to Claimants' counsel advising that a different arbitration policy had been implemented by Respondents in December, 2001 that did not provide for AAA administered arbitration. Mr. Lederman indicated, however, that Respondents would be

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willing to consider proceeding with arbitration under the 2001 policy, using AAA rules and administration. Id., Exh. C.

On July 23, 2004, Claimants' counsel advised the AAA to consider the Demand for Arbitration to be withdrawn, without prejudice to re-filing in the future, while the parties discussed whether Respondents would agree to have the AAA administer the matter. Id., Exh. E.

Thereafter, during August, counsel for the parties exchanged correspondence regarding selection of a mutually acceptable arbitrator. After agreement was reached on arbitrator selection, Respondents' counsel Mr. Lederman sent a letter stating: "Our client agrees that the matter will be arbitrated under the applicable AAA employment and supplemental class action rules and under the 2001 Arbitration Policy, as confirmed in my letters of July 21 and 23, 2004." Id., Exh. M.

The December 2001 arbitration policy provides: "Unless controlling legal authority requires otherwise, there shall be no right or authority for any dispute to be heard or arbitrated on a class action basis . . ." Id., Exh. C.

On September 28, 2004, counsel for both parties submitted a joint letter to the AAA attaching a "Class Action Complaint" identical to the one previously submitted by Claimants, and, attaching copies of signatures by two of the representative Claimants (Wilder and DePue) confirming their acceptance of the December 2001 arbitration policy, and, indicating that Claimant Allen had already been an employee of Respondents but had received a copy of the policy at the time it was issued. The letter also states that while Claimants allege that it may be maintained as a class arbitration, Respondents maintain that class arbitrations are forbidden by the arbitration agreement and that the matter is not suitable for class arbitration. Id., Exh. P.

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On October 6, 2004, Claimants' counsel's office sent a copy of Respondents' December, 2001 arbitration policy to Respondents' counsel, referring to it as "the applicable arbitration provision for the above entitled case." Id., Exh. R. In a contemporaneous e-mail, Claimants' counsel Thomas Foley stated: "[AAA's] letter requests a 'complete copy of the arbitration procedures." In speaking with [the AAA representative], it is my understanding that she is requesting a copy of the arbitration provision contained in the Employee Handbook, or any other writings which specify the arbitration procedures to be utilized by employees of 24 Hour Fitness. I will forward to you today copies of what Claimant's understand to be the applicable arbitration provisions. If you believe that there are any other writings which contain any references to "arbitration procedures", please forward them to me for my review." Id, Exh. T.

On October 8, 2004, Claimants' counsel sent a letter to the AAA enclosing "the applicable arbitration provisions found in Respondent's 2001 Employment Agreement." On October 18, 2004, the AAA advised the parties that since the arbitration clause did not designate the AAA as the administering agency and prevents the filing of class action claims, the AAA was inviting Claimant to amend its Demand for Arbitration to remove the class action claims or provide the AAA with a court order compelling arbitration of said claims. Id., Exh. V.

On November 2, 2004, Respondents petitioned the Los Angeles Superior Court to compel arbitration of this matter. In their Memorandum in support of their petition, Respondents requested that the court, pursuant to the California and Federal Arbitration Acts, compel [Claimants] to arbitrate their claims "under the parties' agreements." They also stated in the memorandum that "this case is subject to arbitration under the 24 Hour Fitness 2001 Arbitration Policy."

In the memorandum they also stated as follows:

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Whether the Arbitration Policy permits or forbids class actions is not a matter for this Court to address. In Howsam v. Dean Witter Reynolds, Inc., (2002) 537 U.S. 79, the United States Supreme Court identified only two "gateway" issues that courts may consider in deciding whether to compel arbitration: (1) "whether the parties are bound by a given arbitration clause" and (2) 'whether an arbitration clause in a concededly binding contract applies to a particular type of controversy." Id., at 84. All other issues are for the arbitrator, at least in the first instance. [citations omitted]" The memorandum further stated: "If there is any doubt as to the proper interpretation of the agreement or on any issue related to arbitrability, such as whether class actions are prohibited by the Arbitration Policy, that question not only must be sent to the arbitrator, but must also be resolved in favor of arbitration . . .

Respondents' memorandum later went on to state:

Put simply, after [the U. S. Supreme Court decision in Green Tree Financial v. Bazzle] courts no longer may address class certification issues if members of the purported class are subject to an enforceable arbitration agreement. [Citation Omitted] Once a court determines that there is an arbitration agreement and that it covers the dispute, the court's function is complete.

In conclusion, Respondents' memorandum prayed for relief as follows:

For the foregoing reasons, 24 Hour Fitness respectfully requests that the Court compel [Claimants] to submit their claims to binding arbitration pursuant to 24 Hour Fitness' Arbitration Policy and their post-dispute agreement with Petitioners.

In their December 7, 2004 memorandum supporting the petition to compel arbitration, Claimants argued that under applicable case law, a bar on class-wide arbitration was "manifestly and shockingly one-sided" and "substantively unconscionable". They further stated that the court, in ordering this matter

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to AAA arbitration, should not preclude the arbitrator from determining the enforceability or severability of the bar on class-wide arbitration found in Respondents' arbitration policy.

In a December 10, 2004 reply, Respondents argued that the arbitration agreement is not unconscionable because 1) the agreement to arbitrate was not procedurally unconscionable because its terms had been negotiated by counsel for the parties after Claimants had first attempted to submit the case to arbitration; and 2) the arbitration agreement was not substantively unconscionable as a matter of law. However, on the latter issue of substantive unconscionability, Respondents argued that this was not a "gateway" issue within the court's purview. Reply memorandum, at p. 3.

At the hearing of the petition, according to the court reporter's transcript, the Superior Court stated as follows:

> Okay. Counsel, this is a petition to compel arbitration, and the parties have no disagreement that there is a – the proper wording and language for a binding arbitration agreement. The only issue appears to be as to whether – who is to make the determination as to whether this should be arbitrated as a class action or not.
>
> It seems that the AAA, the American Arbitration Association, will not hear it as a class action unless there is a court order to that degree or to that effect. And so the issue before this court is whether a class action is permissible under the arbitration agreement. That is for the arbitrator to decide.

Respondents' counsel Henry Lederman then interjected as follows:

> I think both sides are in agreement with the conclusion that the court made, that it's up to the arbitrator to decide whether the agreement permits class arbitration and whether or not it should proceed.

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The court then continued:

I will grant the petition, and I will have one of the attorneys, whoever wishes to, do the order so there is no question with the AAA.

Declaration of Thomas G. Foley, Jr. in Support of Claimants' Reply Brief, etc., dated March 18, 2005 ("Foley Declaration"), Exh. A.

Following the hearing, the court was presented with two competing proposed orders prepared by each of the parties ordering this matter to AAA arbitration. The court chose to sign the order prepared by Claimants herein, dated December 17, 2004, which provides in pertinent part as follows:

A. The arbitration provision in Petitioner's Employee Handbook provides that the arbitrator shall be selected by the mutual agreement of the parties;

B. [The parties] have mutually selected the American Arbitration Association ("AAA") to conduct the arbitration pursuant to its National Rules for the resolution of Employment Disputes ("National Rules"). The parties have agreed that the arbitrator, utilizing the AAA's criteria in Rule 4 of the AAA's Supplementary Rules for Class Arbitrations ("Supplementary Rules"), shall make the determination as to whether the dispute shall be maintained as an individual or class arbitration. The parties have mutually selected Yaroslav Sochynsky as the sole neutral arbitrator.

Foley Declaration, Exh. B. [1]

On January 3, 2005, Claimants submitted an Amended Statement of Claim, making certain modifications, including dropping "Doe" Defendant allegations and adding a claim for unjust enrichment.

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[1] The form of order proposed by Respondents is not part of the present record.

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On January 25, 2005, Claimants submitted a Second Amended Statement of Claim, which added several additional class representative Claimants, and, added class claims under the federal Fair Labor Standards Act of 1938 (excluding claims on behalf of California employees).

Respective Positions of the Parties

Claimants seek a determination in this Clause Construction Phase that this arbitration may proceed as a class action. They contend that although the January 1998 and October 2000 iterations of Respondents' arbitration policy are silent as to whether an arbitration may proceed as a class action, that does not preclude class action treatment under California law as to those class members who were employed by Respondents during the time that these two policies were in effect. With respect to those class members who may be covered by the December, 2001 arbitration policy, which states that: "Unless controlling legal authority requires otherwise, there shall be no right or authority for any dispute to be heard or arbitrated on a class action basis . . .", Claimants contend that the provision is procedurally unconscionable because it is adhesive, and, that similar provisions have been held to be substantively unconscionable by a number of state and federal courts applying California law, citing Szetela v. Discover Card, 97 Cal. App.4th (2002); Ting v. AT&T, 319 F.3d 1126 (9th Cir. 2003); Lozano v. AT&T Wireless, 2003 U.S. Dist LEXIS 21794; and Ingle v. Circuit City Stores, Inc., 328 F.3d 1165 (9th Cir. 2003). Claimants also cite the U. S. Supreme Court decision in Green Tree Financial Corp. v. Bazzle, 539 U.S. 444 (2003) as authority for the proposition that whether an agreement for arbitration of disputes forbids class action is a matter for the arbitrator, rather than the court, to decide.

Respondents, on the other hand, present several arguments in opposition, that can be summarized as follows:

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1. Focusing on the December 2001 arbitration policy as the only operative provision, Respondents argue that this policy expressly provides that there shall be no right or authority for any dispute to be heard or arbitrated as a class action. Respondents also argue that it is beyond the jurisdiction of an arbitrator, and solely within the province of a court, to rule whether any other arbitration policy that preceded the December 2001 policy applies to this arbitration.

2. Respondents next argue that both the California Superior Court's Order granting the Petition to Compel Arbitration, and, the applicable AAA Supplementary Rules for Class Arbitration, limit the arbitrator's jurisdiction here to construing the parties' agreement to determine whether class arbitration is permissible or forbidden; going beyond that limited scope to address whether or not the prohibition against class arbitration is unconscionable or invalid is impermissible and within the sole province of a court. Under Bazzle, and, Nagrampa v MailCoups, Inc., (9th Cir., 3/21/2005 DAR 3379), Respondents argue, only a court, not an arbitrator, can decide whether the parties have entered into a valid arbitration agreement.

3. Respondents then contend that the present arbitration is the product of a post-dispute agreement to arbitrate. Therefore, they argue, Claimants cannot establish that the agreement to arbitrate is an adhesion contract or is otherwise procedurally unconscionable.

4. Alternatively, Respondents contend, whether an arbitration clause prohibits class actions is not a "gateway" issue under Bazzle (such as contract validity) that must be determined by a court; it follows, therefore, that such a clause cannot render a contract invalid or substantively unconscionable.

5. Respondents next argue that a ban on class action is not substantively unconscionable because it is merely a procedural device that does not involve substantive rights: also, because it can be waived,

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just like the right to a jury trial; and, because in arbitration the parties have the right to choose who will decide their dispute, a right that must be respected under the policy favoring arbitration under the FAA.

6. Finally, Respondents seek to distinguish the decision in Szetela as involving consumer claims for relatively small amounts as compared to what one would expect the monetary range of the wage and hour claims to be in this case, as well as on other grounds.

Determination of Clause Construction and Related Issues

Based on the procedural record described above, it is determined as a threshold matter that the parties mutually agreed to submit this matter to arbitration pursuant to Respondents' December 2001 arbitration policy, as modified in certain respects by their agreement to provide for the conduct and administration of the arbitration pursuant to the AAA employment and supplementary class arbitration rules. That agreement was confirmed by the Superior Court in its order granting the petition to compel arbitration under the auspices of the AAA. It also appears that the parties' agreement, as well as the Superior Court's order compelling arbitration, intended to submit to this arbitration claims made by all of the Claimants in their arbitration demand, whether or not they were employed prior to or after implementation of the December, 2001 policy.

Turning next to the question of whether an arbitrator is authorized to determine whether or not the bar against class actions contained in the December 2001 policy is enforceable, it is determined that this question is arbitrable and may be decided in this arbitral forum for the following reasons:

1. The United States Supreme Court, in Bazzle, held that whether an arbitration agreement forbids class arbitration is a matter for the arbitrator to decide.

2. Claimants asserted in the Superior Court on the petition to compel arbitration that the bar against class arbitration is unconscionable. Respondents argued that it is not. Rather than address and

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decide the issue of unconscionability, the Superior Court referred the entire matter to arbitration. Therefore, the Superior Court must have intended that the issue of whether the arbitration agreement here permits or forbids class actions was for the arbitrator to decide.

3. By referring to arbitration a determination of whether the language of the 2001 arbitration policy permits or forbids arbitration, the Superior Court must have also intended that the arbitrator decide whether "... controlling legal authority requires" that this matter "be heard or arbitrated on a class action basis." The issue of whether controlling legal authority requires that this matter be heard on a class basis necessarily encompasses the issue of whether the provision or any part of it is unconscionable.

4. In Howsam v. Dean Witter Reynolds, Inc., 537 U.S. 79 (2002), the United States Supreme Court identified only two "gateway" issues that district courts may decide when the litigants are parties to an arbitration agreement: (1) whether the parties are bound by a given arbitration clause; and (2) whether an arbitration clause in a concededly binding contract applies to a particular type of controversy; all other issues are in the first instance for the arbitrator.[2]

5. The operative agreement being challenged here as unconscionable is Respondents' stand alone arbitration policy. In other words, in the present case the overall contract and the agreement to arbitrate are one and the same. This renders the distinction drawn in Nagrampa, supra, between what courts can decide (arbitration agreements contained in contracts) versus what arbitrators can decide (the overall contract) inapplicable here.

[2] As indicated above, this was the position taken by Respondents in support of their petition to the Superior Court to compel arbitration. It was also argued by Respondents in related federal district court litigation (Boyce v. Sports and Fitness Clubs of America, U.S.D.C, S. D. Cal. No. 03cv2140-IEG) when they sought to exclude unnamed class members who were parties to arbitration agreements, See, Exhibit D to Foley Declaration.

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Having determined that the issue of the validity or enforceability of the bar against class arbitration in the 2001 policy is arbitrable, it is further determined that the bar is unenforceable because it is both procedurally and substantively unconscionable.

The bar in the 2001 policy against class arbitration is procedurally unconscionable because it is adhesive. Based on the present record, there is nothing to indicate that Respondents' employees have any option other than to accept Respondents' arbitration policy. Although the parties agreed to modify the 2001 arbitration policy to provide for AAA arbitration, the rest of the 2001 policy, which is adhesive, remains. The parties' agreement to modify the policy to provide for AAA arbitration was not a novation or a new agreement, but merely a modification to the 2001 policy to provide for arbitration under the rules and administration of the AAA.

The bar in the 2001 policy against class arbitration is also determined to be substantively unconscionable for the reasons discussed in the Szetela, Ingle and Lozano decisions cited above. Respondents' challenges to the holding in Szetela as being inconsistent with the FAA's policy favoring arbitration, or, on the grounds that class actions are merely procedural devices with no substantive implications, are not persuasive. Simply put, the greater weight of California decisional law addressing the issue supports Claimants' contention that a bar on class actions in an arbitration agreement is substantively unconscionable. Such an unconscionable provision is severable from the remaining provisions in the agreement to arbitrate.

Stripped of the unconscionable bar on class arbitration, the arbitration agreement here must then be construed to permit class arbitration. It states that if "any dispute arises from or relates to your employment with [Respondents] . . . you and [Respondents] agree that you both will submit it exclusively to final arbitration." The "arising from or relating to" language is the broadest possible

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description of the scope of an arbitration clause. Other than the invalid bar, there is no limitation, substantive or procedural, in the language of the arbitration provision placed on the nature or type of dispute that is arbitrable. Representative or class claims are a kind or type of dispute. Therefore, the operative arbitration agreement here must be interpreted to encompass, and therefore, to permit class arbitration.

April 13, 2005
Date

Yaroslav Sochynsky

I, Yaroslav Sochynsky, do hereby affirm upon my oath as Arbitrator that I am the individual described in and who executed this instrument which is my Award.

April 13, 2005
Date

Yaroslav Sochynsky