

1 **I. BACKGROUND**

2 Plaintiffs in this putative class action are current and former workers for A Perfect Day
3 Franchise, Inc. (“Perfect Day”). Perfect Day owns and operates spas in Fremont, Santa Clara, and
4 Millbrae, California. Among other things, Plaintiffs claim that Perfect Day has mis-categorized
5 them as independent contractors rather than employees. According to Plaintiffs, Perfect Day failed
6 to pay them and other putative class members minimum wages and overtime, wrongly subtracted
7 materials costs from Plaintiffs’ wages, wrongly took Plaintiffs’ tips, and committed other violations
8 of California wage and hour laws. Based on these allegations, Plaintiffs claim violations of both
9 the Fair Labor Standards Act (FLSA, 29 U.S.C. §§ 201-19) and California law. Perfect Day denies
10 any unlawful conduct.

11 Plaintiffs filed their first complaint on March 22, 2010. On March 27, 2010, named
12 Plaintiff Guifu Li attempted to serve Perfect Day with a copy of the Complaint. *See* Sanctions
13 Mot. at 1; Dkt. No. 7. Because Mr. Li is a party to this case, this attempted service was not
14 effective. Plaintiffs filed a First Amended Complaint (FAC) on May 12, 2010, and Perfect Day
15 was properly served with the First Amended Complaint on June 3, 2010. *See* Dkt. No. 21. As
16 outlined in detail in this Court’s previous Orders (see docket numbers 85 and 122), during the
17 month of May, 2010, Perfect Day held mandatory meetings during working hours at the different
18 Perfect Day locations. During these meetings, workers were presented with “Opt-Out Forms,”
19 stating that they would not participate in this case. Perfect Day obtained many signed Opt-Out
20 Forms through these mandatory meetings. Pursuant to a motion brought by Plaintiffs, the Court
21 found that these meetings were inherently coercive and invalidated the signed Opt-Out Forms.
22 Dkt. No. 85. Further, the Court required that Perfect Day distribute a curative notice to current
23 workers, explaining that the forms had been invalidated. *Id.*

24 In addition, the Court ordered counsel for Perfect Day to show cause why they should not
25 be sanctioned for submitting false testimony in declarations and affidavits relating to the Opt-Out
26 Forms. *Id.* At the hearing on the Order to Show Cause, counsel for Perfect Day claimed that they
27 were retained in a limited scope regarding this case in May, 2010, and later retained as litigation
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1 counsel in this case after service of the FAC, in June, 2010.¹ See October 22, 2010 Tr. at 13:16-21.
2 Until service of the FAC, counsel did not advise Perfect Day that it should institute a litigation
3 hold. However, it appears that counsel was aware of the litigation before this time, because Jade
4 Li, a Perfect Day manager, testified that she provided counsel with a copy of the original
5 Complaint after the attempted service in March, 2010. See Olivier Decl. ISO Opp'n. to Arbitration
6 Mot., Ex. 4 ("Li Dep.") at 191:18-22. In any case, Perfect Day admits that it did not institute a
7 litigation hold until after service of the FAC. Prior to this, and pursuant to what it describes as a
8 "paperless policy," Perfect Day destroyed all original copies of the Opt-Out Forms and retained
9 only electronic scans of these forms in JPEG format. See October 22, 2010 Tr. at 44:20-45:18.
10 Perfect Day represents that since the institution of the litigation hold, it has stopped following its
11 "paperless policy" and now retains newly-generated, original documents relevant to this matter.
12 See generally, Opp'n. to Sanctions Mot. at 3-4.

13 In addition to destroying original Opt-Out Forms prior to the institution of its litigation
14 hold, Perfect Day destroyed original copies of all forms signed by new hires, including original,
15 signed copies of the Independent Contractor Agreement Perfect Day relies upon in its Motion to
16 Compel Arbitration ("Defendants' ICA"). See Opp'n. to Sanctions Mot. at 4. When Perfect Day
17 hires a new worker, it requires that the worker sign or initial a series of forms (the "new hire"
18 marterials), including the ICA, an "Independent Contractor's Affidavit," a sexual harassment
19 policy, a Proprietary Information Agreement, and other documents written in Chinese. See Olivier
20 Decl. ISO Opp'n. to Arbitration Mot., Ex. 18; Ex. 5 ("Ma Dep.") at 181:14-21. A Perfect Day
21 manager, Mr. Jun Ma, testified that once these documents are signed, he scans them into an

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23 ¹ At the hearing on the Order to Show Cause, Counsel for Perfect Day asserted that the scope of
24 their engagement was privileged information. The Court finds that given Perfect Day's disclosures
25 about and reliance on the scope of representation at the hearing, it has waived any privilege over
26 the scope of representation (assuming such a privilege existed in the first place, which is very
27 doubtful). See *Luna Gaming - San Diego LLC v. Dorsey & Whitney, LLP*, No. 06cv2804 BTM
28 (WMc), 2010 U.S. Dist. LEXIS 2459 at *10-*11 (S.D. Cal. Jan. 11, 2010) (finding reliance on
evidence about the scope of representation waives any privilege that might attach to this
information); see also *In re Michaelson*, 511 F.2d 882, 888 (9th Cir. 1975) ("In the absence of
unusual circumstances, the fact of a retainer, the identity of the client, the conditions of
employment and the amount of the fee and who paid it do not come within the privilege of
attorney-client relationship.") (internal citations omitted). In any event, Perfect Day's obligations
to preserve evidence existed regardless of whether Perfect Day had retained counsel.

1 electronic format and then destroys the original, paper copies of the signed documents. Ma Dep. at
2 40:23-41:14. Plaintiffs have submitted several declarations from Perfect Day workers stating that
3 they were never provided with a copy of the new hire paperwork, even if they requested one. *See*
4 *generally* Sanctions Mot. at 6. Although Mr. Ma disputed this in deposition, Perfect Day’s
5 Opposition to the Sanction Motion does not dispute that it did not provide its workers with copies
6 of the signed documents.

7 Plaintiffs allege that the Defendants’ ICA is not the ICA actually signed by Perfect Day
8 workers. Plaintiffs raise a number of inconsistencies and irregularities regarding Defendants’ ICA.
9 In addition to the facts that all original documents were shredded prior to June, 2010, and that no
10 copies were provided to Perfect Day workers, Plaintiffs point out that Defendants’ ICAs contain a
11 long, redaction-style box in the footer of the document. This box blacks out the lower lines of the
12 document. Mr. Ma testified that he added this box to the ICA. Ma Dep. 95:7-15. According to
13 Mr. Ma, he originally obtained the ICA as a Microsoft Word document from an attorney “four or
14 five years” before 2010, meaning in 2005 or 2006. Ma Dep. 103:7-18. Mr. Ma testified that in
15 2005 or 2006 he added the black box as an “ID mark” on the Microsoft Word version of the ICA to
16 “differentiate the document from others, because this is a contract document” Ma Dep. 95:7-
17 15. Mr. Ma testified repeatedly that he added the black box in order to identify the ICA as a
18 contract document, and to differentiate it from other documents maintained by Perfect Day such as
19 customer paperwork. However, as Plaintiffs point out, none of the other contracts in the new hire
20 materials bear a similar black box.

21 After adding the “ID mark” to the ICA, Mr. Ma stated that he printed it out, scanned the
22 print-out to JPEG format, saved the JPEG scan, and then destroyed or otherwise lost the Word
23 document. Ma Dep. 104:14-24. Ma also testified that after adding the “ID mark” to the ICA in
24 2005 or 2006, he made no further changes to the document. Ma Dep. 107:13-109:16. Plaintiffs
25 note that Perfect Day has produced ICAs containing the business address of the Santa Clara and
26 Millbrae and locations of Perfect Day, but that these locations did not open until 2007 and 2008,
27 respectively. When Mr. Ma was asked how the “Millbrae version” of the ICA was created if he
28 made no changes after 2005 or 2006, he changed his testimony to state that at the time the Millbrae

1 store opened, he still had the Microsoft Word version of the ICA and that he edited it at that time to
2 add in the Millbrae address. Ma Dep. at 197:19-199:17.

3 Plaintiffs have cited testimony from the depositions of five former Perfect Day workers
4 stating that they did not sign any documents containing the black box “ID mark” when they
5 completed their initial hire paperwork. *See* Opp’n. to Arbitration Mot. at 10. When confronted
6 with Defendant’s ICA during deposition, most of the former workers volunteered (without being
7 asked) that they did not recognize the black box on the document and that this made them believe
8 that the document they were shown in deposition was not the same document they signed. *Id.* All
9 of them testified that they did not sign any document containing a black box. *Id.* In addition,
10 several of the Plaintiffs testified that they were asked to initial each page of an ICA agreement, but
11 the black box covers the space where their initials would have otherwise appeared. *Id.* at 11.

12 Defendants’ ICA contains a section titled “Arbitration,” which states that “[a]ll claims,
13 disputes, controversies or disagreements . . . including any claim arising out of or in connection
14 with Independent Contractor’s employment or the termination of Independent Contractor’s
15 employment . . . shall be submitted to final and binding arbitration.” The agreement also states that
16 “[e]mployer will pay for all types of costs that are unique to arbitration.”

17 The Plaintiffs have introduced a different Independent Contractor Agreement (“Plaintiffs’
18 ICA”), which they claim is the one that was actually signed by Perfect Day workers. Plaintiffs’
19 ICA contains a one-paragraph arbitration clause which states that “[a]ny dispute between Employer
20 and Independent Contractor arising under this Agreement will be submitted to binding arbitration
21 in accordance with the rules of the American Arbitration Association in the jurisdiction in which
22 this Agreement is executed. Each party will be responsible for any fees or costs, including, but not
23 limited to, attorney fees resulting from the arbitration.” Mr. Ma testified that he did not recognize
24 Plaintiffs’ ICA, and that he had never used it during his time at Perfect Day. Ma Dep. 117:19-
25 118:11. Ms. Li testified that she believed Plaintiffs’ ICA had been drafted by an attorney for
26 Perfect Day at her request, but was never used. Li Dep. 194:3-16.

27 Plaintiffs’ ICA is three pages long, while Defendants’ ICA is four pages long. The two
28 ICAs are substantially similar, and include verbatim language in some subsections. The most

1 significant difference between the two documents is the replacement of the one-paragraph
2 “Dispute” section in Plaintiffs’ ICA with the seven-paragraph “Arbitration” section in Defendants’
3 ICA. Plaintiffs’ ICA contains a line in the lower left-hand section of the footer on each page
4 marked “Initial,” presumably for a worker to place his or her initials, and page numbering
5 indicating “Page 1 of 3, Page 2 of 3” and so forth. The signature page of Plaintiffs’ ICA is
6 identical to that of Defendants’ ICA except that where the “Initial” line and page numbering appear
7 on Plaintiffs’ ICA, the black box “ID Mark” appear on Defendants’ ICA.

8 II. LEGAL STANDARD AND APPLICATION

9 a. Motion to Compel Arbitration

10 The Federal Arbitration Act (FAA) “placed arbitration agreements on equal footing with
11 other contracts” and “established a federal policy in favor of arbitration.” *Circuit City Stores v.*
12 *Adams*, 279 F.3d 889, 892 (9th Cir. 2002). Under the FAA, arbitration agreements “shall be valid,
13 irrevocable, and enforceable, save upon such grounds that exist at law or in equity for the
14 revocation of any contract.” 9 U.S.C. § 2. Accordingly, the Court looks to California law to
15 determine whether Defendants’ ICA is a valid agreement to arbitrate.

16 When deciding whether a claim is subject to an arbitration clause, the Court must first
17 determine if there is a valid arbitration agreement. It is the burden of the party moving to compel
18 arbitration to prove, by a preponderance of the evidence, that such an agreement exists. *Bruni v.*
19 *Didion*, 160 Cal. App. 4th 1272, 1282 (Cal. App. 2008). If the moving party carries this burden,
20 the opposing party must prove any contrary facts by the same burden. *Bruni* 160 Cal. App. 4th at
21 1282 (“[t]he petitioner bears the burden of proving the existence of a valid arbitration agreement by
22 the preponderance of the evidence, and a party opposing the petition bears the burden of proving
23 by a preponderance of the evidence any fact necessary to its defense.”). “In these summary
24 proceedings, the trial court sits as a trier of fact, weighing all the affidavits, declarations, and other
25 documentary evidence, as well as oral testimony received at the court’s discretion, to reach a final
26 determination.” *Id.*

27 Here, the analysis need not go past the initial step because the Court cannot find that there
28 is a valid agreement to arbitrate. Given the significant uncertainty raised by Perfect Day’s opaque

1 document retention practices, the inconsistent testimony Perfect Day’s managers have provided
2 about the origins of Defendants’ ICA, and the credible testimony by five Perfect Day workers
3 stating that they did not sign Defendants’ ICA, the Court finds that Perfect Day has not carried its
4 burden to establish by a preponderance of the evidence that the arbitration clause it is attempting to
5 enforce was contained in the agreements signed by its workers.

6 The Court bases this conclusion on the following findings of fact:

- 7 • Mr. Ma’s testimony regarding the origins of Defendants’ ICA is inconsistent and
8 lacks credibility. Specifically, Mr. Ma’s explanation that he added a black box to
9 Defendants’ ICA in order to distinguish it as a contract between workers and
10 Perfect Day, when none of the other contracts in the new hire documents are
11 similarly marked, is not credible.
- 12 • Mr. Ma’s testimony that he modified Defendants’ ICA by adding the black box in
13 2005 or 2006, made no further changes to the document after this time, and lost or
14 destroyed the editable Microsoft Word ICA is contradicted by the fact that Perfect
15 Day has produced signed versions of Defendants’ ICA listing the Millbrae and
16 Santa Clara addresses of Perfect Day Spa. The Santa Clara location did not open
17 until 2007. The Millbrae location did not open until 2008. The Court does not find
18 Mr. Ma’s attempt to explain the Millbrae inconsistency in his testimony credible.
- 19 • The Court finds credible the consistent deposition testimony of five individual
20 Plaintiffs stating that they do not believe they ever signed Defendants’ ICA because
21 they do not remember signing a document containing a black box.
- 22 • The Court finds credible Plaintiffs’ testimony that they were asked to initial the
23 individual pages of the ICA that they signed. This discredits Defendants’ ICA
24 which contains no initials, but contains a black, redaction-style box over the footer
25 space where initials would otherwise appear.

26 Perfect Day’s practice of destroying original, signed agreements, and its failure to routinely
27 provide workers with copies of signed employment paperwork, have made it more difficult for
28 Perfect Day to carry its burden here. Without access to the original, signed agreements, the Court

1 and the Plaintiffs are left to take Perfect Day’s word about the origins and authenticity of
2 Defendants’ ICA. Because Perfect Day’s testimony on this subject is inconsistent and lacks
3 credibility, the Court concludes that it has not met its burden to show that a valid agreement to
4 arbitrate exists between Perfect Day and Plaintiffs. Contrary to Perfect Day’s argument, *Condee v.*
5 *Longwood Management Corp.*, 88 Cal. App. 4th 215, 219 (Cal. App. 2001) does not hold
6 otherwise. In *Condee*, the California Appellate Court found it was error to deny a motion to
7 compel arbitration based on a failure to authenticate the arbitration agreement *when the signature*
8 *on the alleged arbitration agreement was never challenged*. Obviously, Plaintiffs in this case
9 vigorously dispute that they ever signed Defendants’ ICA.

10 In its Reply in support of the Arbitration Motion, Perfect Day suggests that since Plaintiffs’
11 ICA contains an arbitration clause, and since Plaintiffs contend that they signed Plaintiffs’ ICA, the
12 Plaintiffs have suffered no prejudice by Perfect Day’s destruction of the original, signed ICAs, and
13 the Court should compel arbitration. This argument fails for at least two reasons. First, Perfect
14 Day cannot enforce the terms of a contract it denies ever signing or providing to workers to sign.
15 Indeed, no party has submitted signed versions of Plaintiffs’ ICA for the Court’s consideration on
16 this Arbitration Motion. Second, the arbitration clause in Plaintiffs’ ICA is likely unenforceable
17 due to unconscionability. Although the Court does not decide this issue now, because Perfect Day
18 has offered no evidence to show that Plaintiffs’ ICA was signed by any party in this case, the
19 arbitration provision in Plaintiffs’ ICA appears to be both procedurally and substantively
20 unconscionable. “A contract is procedurally unconscionable if it is a contract of adhesion, *i.e.*, a
21 standardized contract, drafted by the party of superior bargaining strength, that relegates to the
22 subscribing party only the opportunity to adhere to the contract or reject it.” *Ting v. AT&T*, 319
23 F.3d 1126, 1148 (9th Cir. 2003) (citing *Armendariz v. Found. Health Psychcare Servs., Inc.*, 6 P.3d
24 669, 690, (Cal. 2000). The parties appear to agree that Perfect Day workers must sign the
25 documents in the new hire paperwork if they wish to work at Perfect Day, and there is no
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1 meaningful opportunity to negotiate the terms of the agreements.² Therefore, the ICA and the
2 other new hire documents are very likely contracts of adhesion.

3 In addition, the “Dispute” provision in Plaintiffs’ ICA bears several hallmarks of
4 substantive unconscionability. First, it subjects only disputes “arising under this Agreement” to
5 binding arbitration; this excludes disputes arising under other agreements, such as the “Proprietary
6 Information Agreement,” from the arbitration provision. One-sided arbitration clauses that single
7 out matters primarily of interest to one party are often found to be unconscionable. *See, e.g., Ting*,
8 319 F.3d at 1151 (finding confidentiality provision, though facially neutral, unfairly favorable to
9 defendant and therefore unconscionable). Finally, the Plaintiffs’ ICA arbitration clause states that
10 “each party will be responsible for any fees and costs” of the arbitration. Under California law,
11 however, it is unconscionable to impose any fees on a plaintiff that she would not face if she filed
12 her complaint in court. *See Armendariz*, 6 P.3d at 687 (“[T]he arbitration process cannot generally
13 require the employee to bear any type of expenses that the employee would not be required to bear
14 if he or she were free to bring the action in court.”). Therefore, even if Perfect Day could rely on
15 Plaintiffs’ ICA to carry its burden, the arbitration clause would likely be unenforceable.³

16 **b. Sanctions**

17 A district court may impose sanctions for spoliation of evidence under its inherent powers,
18 or pursuant to Federal Rule of Civil Procedure 37. *Leon v. IDX Sys. Corp.*, 464 F.3d 951, 958 (9th
19 Cir. 2006). A party can be sanctioned via an adverse inference for destroying evidence if it is on
20 notice that the evidence is of “potential relevance” to litigation when it is destroyed. *Glover v. BIC*
21 *Corp.*, 6 F.3d 1318, 1329 (9th Cir. 1993); *United States v. Kitsap Physicians Serv.*, 314 F.3d 995,
22 1001 (9th Cir. 2002). The imposition of sanctions is within the court’s discretion. *Leon*, 464 F.3d
23 at 958.

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25 ² In Perfect Day’s Reply, it relies on statements by the Plaintiffs that nothing was told to workers
26 about the legal impact of the ICA, that workers did not read the agreements when they were signed,
27 and that workers were simply asked to sign the new hire paperwork. *See Reply ISO Arbitration*
28 *Mot.* at 7-8.

³ The Court does not reach the issue of whether or not the arbitration provision in Defendants’ ICA
are enforceable, but notes that Defendants’ ICA addresses some of the unenforceability issues
raised by Plaintiffs’ ICA.

