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California Supreme Court Enforces Class Action Waivers in Employee Arbitration Agreements

However, the court found PAGA representative action waivers unenforceable; employers should consider practical implications with respect to arbitration agreements.

On June 23, the California Supreme Court issued its much-anticipated decision in *Iskanian v. CLS Transportation Los Angeles, LLC*,[1] addressing the enforceability of class and Private Attorneys General Act (PAGA) action waivers in employee arbitration agreements. A 6–1 majority affirmed the Court of Appeal decision that class action waivers in employee arbitration agreements are enforceable because recent U.S. Supreme Court precedent on the Federal Arbitration Act (FAA) had abrogated the California Supreme Court's prior holding in *Gentry v. Superior Court*.[2] The majority also rejected arguments that class action waivers are unlawful under the National Labor Relations Act (NLRA) and that CLS waived the right to compel arbitration. The court, however, ruled 7–0 that CLS's waiver barring representative actions under California's Labor Code PAGA is contrary to public policy, unenforceable, and not saved by FAA preemption. PAGA allows aggrieved employees in California to bring actions on behalf of themselves and other aggrieved employees for civil penalties and attorney fees for violation of many provisions of the California Labor Code. The State of California is paid 75% of any penalty recovered.

Background

As a driver for CLS, Arshavir Iskanian signed a "Proprietary Information and Arbitration Policy/Agreement," providing that any and all employment-related disputes would be submitted to binding arbitration. The arbitration agreement contained a waiver of the right to bring claims on behalf of a class or as a representative of others.

Iskanian filed a class and representative action complaint against CLS, alleging that the company failed to pay overtime, provide meal and rest breaks, reimburse business expenses, provide accurate and complete wage statements, and pay final wages in a timely manner.

Soon after the U.S. Supreme Court issued its opinion in *AT&T Mobility LLC v. Concepcion*,[3] which overruled California law regarding class action waivers in commercial contracts, CLS renewed its motion to compel arbitration. The trial court granted the motion, and the Court of Appeal affirmed, finding that *Concepcion* invalidated the California Supreme Court's decision in *Gentry* as to class action waivers. The Court of Appeal also enforced the representative action waiver based on *Concepcion*. The California Supreme Court granted review in September 2012.

Class Action Waivers Enforceable

The California Supreme Court affirmed the Court of Appeal's holding that the CLS class action waiver was enforceable, agreeing that *Gentry* "has been abrogated by recent United States Supreme Court precedent" and,

1. No. S204302 (Cal. June 23, 2014), *available at* http://www.courts.ca.gov/opinions/documents/S204032A.PDF.
2. 165 P.3d 556 (Cal. 2007).
3. 131 S. Ct. 1740 (2011).

therefore, "the FAA preempts the *Gentry* rule."[4] The court also rejected the National Labor Relations Board's (NLRB's) view that the NLRA bars class action waivers. Agreeing with the U.S. Court of Appeals for the Fifth Circuit in *D.R. Horton, Inc. v. NLRB*,[5] and recognizing the "liberal federal policy favoring arbitration," the court found that neither the NLRA's text nor its legislative history contains a "congressional command" overriding the FAA mandate, thereby siding with "all the federal circuit courts and most of the federal district courts that have considered the issue."[6]

Court Rules That PAGA Waivers Violate Public Policy and Are Unenforceable

Overturning the Court of Appeal, the court found that the parties' agreement not to assert representative action claims violated public policy as to PAGA and was not enforceable.[7] The court concluded that a PAGA representative action to recover civil penalties "is fundamentally a law enforcement action designed to protect the public and not to benefit private parties" and thus "a type of *qui tam* action."[8] Making comparisons to the Federal False Claims Act, the court found that the right to bring a PAGA action was unwaivable because "an agreement by employees to waive their right to bring a PAGA action serves to disable one of the primary mechanisms for enforcing the Labor Code."[9] The court left open the question of whether or not an individual PAGA claim is permissible, but it concluded that this did not matter because "a prohibition of *representative* claims frustrates the PAGA's objectives."[10] The court therefore found that the waiver of PAGA representative claims was "contrary to public policy and unenforceable as a matter of state law."[11]

The court then ruled that this state law is not preempted by the FAA because a PAGA claim "is not a dispute between an employer and an employee arising out of their contractual relationship. It is a dispute between an employer and the *state*[.]"[12] The court viewed the FAA as only applying to **private** disputes because "[t]here is no indication that the FAA was intended to govern disputes between the government in its law enforcement capacity and private individuals."[13] The court conceded that only "an aggrieved employee" can bring a PAGA action but asserted that this "does not change the character of the litigant or the dispute."[14] In the court's view, PAGA representative actions, "unlike class action suits for damages, do not displace the bilateral arbitration of private disputes between employers and employees over their respective rights and obligations toward each other. Instead, they directly enforce *the state's* interest in penalizing and deterring employers who violate California's labor laws."[15]

The court also rejected CLS's argument that, by authorizing financially interested private citizens to prosecute claims on the state's behalf without governmental supervision, PAGA violates the principle of separation of powers under the California Constitution.[16]

The court did not address the fact that a PAGA action can only be based on claims that involve employee-employer disputes over Labor Code rights and obligations. The concurring opinion by Justice Ming Chin made this point in disagreeing with the majority and stating that, in a PAGA action, "the dispute arises, first and fundamentally, out of [the employment] relationship."[17] However, because the CLS representative action waiver

4. *Iskanian*, No. S204302, slip op. at 1, 1.1
5. 737 F.3d 344 (5th Cir. 2013).
6. *Iskanian*, No. S204302, slip op. at 19, 21 (internal quotations omitted).
7. *Id.* at 36.
8. *Id.* at 32, 33 (internal quotations omitted).
9. *Id.* at 34–35.
10. *Id.* at 36 (emphasis in original).
11. *Id.*
12. *Id.* at 40 (emphasis in original).
13. *Id.* at 37–38.
14. *Id.* at 40.
15. *Id.* at 41 (emphasis in original).
16. *Id.* at 46.
17. *Id.* at 6 (Chin, J., concurring).

barred all representative actions, Justice Chin reasoned that it provided no forum to hear PAGA claims and, therefore, was invalid under an exception to the FAA for arbitration agreement provisions forbidding the assertion of certain statutory rights.[18]

The majority opinion concluded that the employee must individually arbitrate his damages claims and the employer must defend the PAGA claims "in some forum." The court left open several questions, including whether the claims should be bifurcated between arbitration and court and, if so, whether the arbitration should be stayed under California procedural law.

Conclusions

It is likely that a petition for certiorari to the U.S. Supreme Court will be filed that challenges the California Supreme Court's ruling that PAGA claims are not governed by the FAA. In the meantime, we expect to see more lawsuits asserting only PAGA representative claims where employee arbitration agreements exist.

Although the California Supreme Court has now joined many other courts in rejecting the NLRB's decision in *D.R. Horton* that class action waivers violate the NLRA, the NLRB will continue to prosecute unfair labor practice charges against employers that have class action waivers in their arbitration agreements. Even though the Fifth Circuit refused to enforce the NLRB's decision in *D.R. Horton*, the agency continues to apply that decision. The California Supreme Court did not completely reject *D.R. Horton*, but rather distinguished it because CLS's arbitration agreement did not prohibit employees from filing joint claims or consolidating multiple claims in arbitration and did not prohibit the arbitrator from awarding group relief. On June 23, the U.S. Court of Appeals for the Ninth Circuit, in *Johnmohammadi v. Bloomingdale's Inc.*,[19] rejected *D.R. Horton* on narrow grounds, where it enforced an arbitration agreement that had a class action waiver but allowed employees to opt out of the arbitration program.

California law still requires arbitration agreements to not be unconscionable, and there are many California cases that discuss the types of provisions in arbitration agreements that make them substantively unconscionable. Employers should discuss with their counsel both the best way to provide arbitration agreements to their applicants and employees and the terms that should be included and not included in an arbitration agreement under California law.

Practical Implications

For California employers that already have an arbitration agreement with a class, collective, and representative action waiver: According to *Iskanian*, representative action waivers are not enforceable as to PAGA, which raises the issue of what employers should do if they have such waivers in their arbitration agreements. Any petition for certiorari will likely be filed within the next 90 days, but it may not be ruled on by the U.S. Supreme Court for three months. If the Supreme Court agrees to hear the case, there would likely be a decision by June 2015. Thus, employers will need to decide whether to revise their arbitration agreements now, in light of the *Iskanian* decision, or wait for the outcome of the expected certiorari petition. At a minimum, employers with representative action waivers should ensure that there is a severability clause in their arbitration agreements as well as clear language stating the forum for a PAGA action if the waiver is unenforceable.

For employers that have arbitration agreements that are silent on whether they preclude arbitration of class, collective, and representative actions: The U.S. Supreme Court in *Stolt–Nielsen S.A. v. AnimalFeeds Int'l Corp*.[20] held that employers could not be compelled to arbitrate class actions unless they expressly agreed to do so. There has been litigation in California on this issue and on the issue of who decides whether the arbitration agreement encompasses class and collective claims. Employers should discuss with their counsel whether to revise their arbitration agreements to expressly include class, collective, and/or representative action waivers;

18. Id. at 5.

19. No. 12-55578 (9th Cir. June 23, 2014), *available at* http://cdn.ca9.uscourts.gov/datastore/opinions/2014/06/23/12-55578.pdf.

20. 559 U.S. 662 (2010).

how to word them in light of *Iskanian*; and whether to give employees the option to opt out of such arbitration agreements.

Should employers without arbitration agreements adopt an arbitration agreement with waiver provisions, and, if so, should they be rolled out to existing employees? If so, how? There are many pros and cons to arbitration, which employers should consider carefully. There also are challenges to rolling out arbitration programs while class, collective, or representative actions already are pending. For all arbitration agreements, employers should work closely with experienced counsel, particularly if they have employees in California, to draft an enforceable arbitration agreement. Employers should also consider having a separate agreement for California employees. California law has many pitfalls for unwary employers on what an arbitration agreement must say and must not say. The issue of whether to include representative action waivers in light of *Iskanian* must also be carefully considered.

Should an arbitration agreement give the employee the right to file a claim with the Labor Commissioner? The California Supreme Court, in *Sonic-Calabasas A, Inc. v. Moreno*,[21] held that arbitration agreements can preclude employees from filing claims before the California Department of Labor Standards Enforcement (the DLSE or Labor Commissioner), so long as they provide employees with an accessible and affordable arbitral forum for resolving wage disputes. However, employers should decide whether they prefer arbitration over the DLSE forum, particularly when employers must pay the fees of the arbitrator and any arbitration association selected by the parties.

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21. 57 Cal. 4th 1109, 1141 (Cal. 2013).

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