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Client Alert Commentary

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California Employees may Waive Right to Arbitrate on Behalf of a Class, but not PAGA Claims

California Supreme Court rules the Federal Arbitration Act preempts State's refusal to enforce class arbitration waivers on public policy or unconscionability grounds; holds PAGA claims unwaivable.

On June 23, 2014, the California Supreme Court issued its long-awaited decision in *Iskanian v. CLS Transportation of Los Angeles, LLC*.[1] The *Iskanian* decision addressed the enforceability of class arbitration waivers in employment contracts in the aftermath of the U.S. Supreme Court's decision in *AT&T Mobility LLC v. Concepcion*, which upheld class arbitration waivers in consumer contracts. *Iskanian* clarifies the California high court's view that *Concepcion* applies equally to employment agreements and overrules that court's earlier opinion in *Gentry v. Superior Court*,[2] which held that class arbitration waivers in employment agreements were unenforceable under California law if class arbitration would be a significantly more effective way of vindicating the rights of affected employees than individual arbitration. Although the decision will undoubtedly limit employment class actions seeking to vindicate private rights, *Iskanian* also held that the right to bring a representative Private Attorney General Act (PAGA)[3] claim may not be waived. This may open the door to arguments that arbitration agreements containing PAGA waivers are unconscionable in their entirety as a result of the impermissible PAGA waiver.[4] The decision may also result in a flurry of representative PAGA claims against employers in which the employees have otherwise given up the right to bring private claims on behalf of a class.

Background

In the 2005 *Discover Bank v. Superior Court* decision, the California Supreme Court held that most class arbitration waivers in consumer adhesion contracts were unconscionable and thus per se unenforceable when the disputes were likely to involve a small amount of damages and the party with inferior bargaining power alleged a deliberate scheme to defraud.[5] Two years later, in *Gentry*, the court set a stringent test for determining whether class action waivers in the employment context were unenforceable because they were exculpatory and contrary to public policy.

In *Gentry*, the court found that class arbitration waivers in employment contracts were unenforceable if the waiver would otherwise undermine the vindication of unwaivable statutory wage and hour rights.[6] *Gentry* required state courts to refuse to enforce a class arbitration waiver if class arbitration would likely be a significantly more effective and practical means of vindicating these rights based on a case-by-case consideration of the following factors:

- The systematic denial of proper overtime pay to a class of employees

- The size of the potential individual recovery
- The potential for retaliation against members of the class
- Whether absent class members would be ill-informed about their rights
- Other real-world obstacles to vindication of the right to overtime pay

Before *Concepcion*, California courts routinely relied on *Gentry* to invalidate class arbitration waivers in employment contracts.[7]

In 2011, the U.S. Supreme Court issued its *Concepcion* decision, which held that contractual arbitration provisions waiving class actions are generally enforceable and that the Federal Arbitration Act (FAA) preempts state law to the contrary. *Concepcion* involved a consumer contract, and while the decision explicitly overruled *Discover Bank*, it did not address *Gentry*.[8]

Post-*Concepcion*, California courts of appeal issued inconsistent rulings about the effect of *Concepcion* on *Gentry*, and particularly on the enforceability of class action waivers as applied to representative PAGA claims. Prior to *Iskanian*, employees could still potentially advance arguments grounded in the need to vindicate state statutory rights and/or the need to safeguard National Labor Relations Act (NLRA) protections in order to avoid the effect of a class arbitration waiver. However, the state Supreme Court decisively rejected both of these avenues in *Iskanian*.

The *Iskanian* Decision

Arshavir Iskanian signed an arbitration agreement as part of his employment with CLS Transportation of Los Angeles, LLC. The arbitration agreement provided for the arbitration of all claims and included an explicit class action and representative action waiver. Iskanian filed wage and hour individual, class and PAGA claims against CLS in state court. In the aftermath of *Gentry*, CLS withdrew its motion to compel arbitration and proceeded with the litigation. After class certification, the U.S. Supreme Court published its *Concepcion* decision and CLS renewed its motion to compel arbitration. Based on this new authority, the trial court granted the motion to compel arbitration and the Court of Appeal affirmed, finding that the terms of the arbitration agreement extended even to the PAGA claims.

The California Supreme Court granted the petition to review to determine whether *Concepcion* overruled *Gentry* with respect to contractual class arbitration waivers in the context of unwaivable labor law rights. In a six to one decision, with two justices concurring with the majority's decision, the state Supreme Court found that *Concepcion* unquestionably abrogated *Gentry* and ruled that California's refusal to enforce class arbitration waivers on public policy or related unconscionability grounds is preempted by the FAA. In upholding the class arbitration waiver at issue, the court also found that an employment contract that requires individual arbitration is not an unfair practice under the National Labor Relations Act (NLRA). The court did hold, however, that employees may not agree to waive their right to bring representative PAGA actions.

Class-wide Arbitration Inconsistent with FAA

The *Iskanian* majority rejected the contention that the *Discover Bank* rule was distinguishable from *Gentry* on the ground that *Discover Bank* did not require a case-specific showing that the class waiver was exculpatory whereas *Gentry* required an evidentiary showing that enforcing a class-action ban would result in a waiver of substantive rights. The *Iskanian* decision acknowledged that the enforcement of class waivers may result in a de facto waiver of rights because some employer violations will go unprosecuted. The *Iskanian* majority found, however, that this policy outcome was of no consequence in the aftermath of *Concepcion*. *Concepcion* found that class proceedings interfere with the fundamental attributes of arbitration and thus held that a state rule invalidating class waivers based on a comparison to the

procedural advantages of a class action was inconsistent with the FAA's promotion of the fundamental attributes of arbitration. Because *Gentry* resulted in state courts mandating procedures incompatible with arbitration, the FAA preempted the rule.

Class Arbitration Waivers and Unfair Labor Practices

The National Labor Relations Board (NLRB) has taken the position that the NLRA generally prohibits employers from requiring employees, as a condition of employment, to waive their rights to participate in class proceedings to resolve wage and hour claims.[9] Following the Fifth Circuit's rejection of the NLRB precedent,[10] the *Iskanian* majority concluded that the NLRA's protection of concerted activity and ban against unfair labor practices could not be construed as forbidding employers from compelling employees to waive class arbitration because (1) the NLRA's text and legislative history does not contain a command prohibiting class waivers; (2) the court found no conflict between the FAA and the NLRA; and (3) the court doubted that the NLRA's general protection of concerted activity could properly be construed as an implied bar to class action waivers based on U.S. Supreme Court precedent. The *Iskanian* majority was careful to note, however, that the arbitration agreement at issue still permitted a broad range of collective activity to vindicate wage claims. *Iskanian* thus leaves open the possibility that an arbitration agreement that more broadly restricts collective activity might run afoul of the NLRA.[11]

Representative Action Waivers and PAGA Claims

PAGA authorizes an employee to bring a civil action on behalf of the state against his or her employer to recover civil penalties for Labor Code violations committed against the employee and fellow current or former employees. Case law distinguishes between statutory damages that are recoverable directly by employees bringing private claims and civil penalties recoverable on behalf of the state under PAGA.[12] PAGA provides that 75 percent of the recovered penalties go to the Labor and Workforce Development Agency and 25 percent go to the aggrieved employees. Where no civil penalty is provided for a specific Labor Code violation, PAGA generally provides for civil penalties of US$100 for each aggrieved employee per initial pay period and US$200 for each aggrieved employee per pay period for each subsequent violation.

The *Iskanian* majority found that because PAGA functions as a substitute for an action brought by the government itself, a type of *qui tam* action, any representative claim waiver that banned PAGA claims would impermissibly frustrate PAGA's objectives — deterring violations and remedying the shortage of government resources available to pursue enforcement. Thus PAGA would not run afoul of the FAA's objectives – ensuring an efficient forum for the resolution of *private* disputes. The *Iskanian* majority concluded that PAGA lied outside of the FAA's focus since PAGA ensured the effective resolution of public disputes by deputizing employees to prosecute Labor Code violations on the state's behalf. Accordingly, *Iskanian* holds that any such waiver is unenforceable as contrary to public policy.

Take-aways From the *Iskanian* Decision

The enforcement of class waivers in arbitration agreements may result in some individual wage and hour claims not being pursued due to the relatively small amount of damages at stake in an individual versus class action. Moreover, where they are, the stakes will be significantly less for employers since the claims will be brought only on behalf of individuals as opposed to a class. Even if a class is not ultimately certified, the expenses of defending against a purported class action are much greater than the expense of defending against only individual claims. However, the *Iskanian* decision still may result in courts finding entire arbitration agreements that contain PAGA waivers unconscionable on the ground that the inclusion of a PAGA waiver renders the agreement so one-sided as to shock the conscience. In this situation, the employer could be exposed to defending class claims in court.

The *Iskanian* decision's holding that arbitration agreements cannot waive PAGA claims raises potential procedural dilemmas for employers defending against individual and PAGA wage and hour claims where the parties' agreement requires arbitration of individual claims and precludes bringing those claims on a class-wide basis. PAGA claims may be a viable class action alternative in this situation, and employers should expect to face more of these claims in the near future. As a relatively new law, many questions about PAGA remain unanswered, *e.g.*, can an employer be forced to defend against multiple, identical PAGA claims in different actions at the same time? If combined in an action with individual wage and hour claims involving a valid arbitration agreement and class arbitration waiver, should the individual and PAGA claims be bifurcated if the parties cannot agree on a single forum for both claim types? And, if bifurcated, should one of the proceedings be stayed until the other is resolved, and if so, which one? The parties in *Iskanian* did not appear to have contemplated that the court would find part, but not all, of the waiver at issue valid. The *Iskanian* decision notes, but does not resolve, these issues, and remands them for the parties to address below. In making strategic decisions about defending against both individual and PAGA claims, employers should note that any PAGA settlement requires court approval.[13]

Additionally, although rules like those articulated in *Gentry* and *Discover Bank* are dead in the aftermath of *Concepcion*, some forms of unconscionability arguments remain defenses to the enforcement of arbitration agreements that may contain class action waivers.[14] Although including a class action waiver should not be considered an indication of substantive unconscionability, other aspects of an arbitration agreement may cause a court to view the agreement as a whole both procedurally and substantively unconscionable and thus invalidly formed.[15] As a result of *Iskanian*, plaintiffs may attempt to prove procedural unconscionability on a more frequent basis and be more creative with their substantive unconscionability arguments. Accordingly, employers should use caution in drafting and presenting these agreements and should consider revising existing agreements which raise any concerns. A recent Ninth Circuit Court of Appeals decision, *Davis v. Nordstrom, Inc.*, found that employers can unilaterally change these employment terms so long as reasonable notice is provided and the change does not interfere with vested employee benefits.[16] Under this guidance, employers specifically should consider removing any PAGA waivers — or representative action waivers that may be interpreted as PAGA waivers — from arbitration agreements until the courts have clarified whether the inclusion of such a waiver renders the agreement unconscionable. Since the law is clear such waivers themselves are invalid, employers appear to gain no upside to leaving them in.

Finally, while reviewing their arbitration agreements, employers should consider making class action waivers explicit, if not already, and revise as appropriate to attempt to avoid disputes over whether there was a waiver down the road.

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Endnotes

1 *Iskanian v. CLS Transp. of L.A., LLC*, No. S204032 (Cal. June 23, 2014).

2 *AT&T Mobility LLC v. Concepcion*, 131 S. Ct. 1740 (2011); Gentry v. Super. Ct., 42 Cal. 4th 443 (2007).

3 Cal. Lab. Code § 2698 *et seq.*

4 *See, e.g.*, Pls.' Mot. Recons., *Fardig et al. v. Hobby Lobby Stores Inc.*, No. 8:14-cv-00561-JVS-AN (C.D. Cal. June 24, 2014).

5 *Discover Bank v. Super. Ct.*, 36 Cal. 4th 148 (2005).

6 *Gentry*, 42 Cal. 4th at 464-64.

[7] *See, e.g.*, *Olvera v. El Pollo Loco, Inc.*, 173 Cal. App. 4th 447 (2009); *Sanchez v. W. Pizza Enters., Inc.*, 172 Cal. App. 4th 154 (2009); *Jackson v. S.A.W. Entm't Ltd.*, 629 F. Supp. 2d 1018 (N.D. Cal. 2009).

[8] *Concepcion*, 131 S. Ct. at 1746, 1750-51 (citing Discover Bank v. Super. Ct., 36 Cal. 4th 148 (2005)).

[9] *D.R. Horton, Inc. & Cuda*, 357 NLRB No. 184, 2012 NLRB LEXIS 11 (2012).

[10] *D.R. Horton, Inc. v. NLRB*, 737 F.3d 344 (5th Cir. 2013).

[11] *See, e.g.*, *Johnmohammadi v. Bloomingdale's*, No. 12-55578 (9th Cir. June 23, 2014) (holding that because employee freely elected to arbitrate employment-related disputes, without employer interference, employee could not claim that enforcement of the arbitration agreement violated either the NLRA or the Norris-La Guardia Act).

[12] *See, e.g.*, *Caliber Bodyworks, Inc. v. Super. Ct.*, 134 Cal. App. 4th 365, 377-78 (2005); Murphy v. Kenneth Cole Prods., Inc., 40 Cal. 4th 1094 (2007).

[13] Cal. Lab. Code § 2699(l).

[14] *Sonic-Calabasas A, Inc. v. Moreno*, 57 Cal. 4th 1109, 1145 (2013) ("After *Concepcion*, courts may continue to apply unconscionability doctrine to arbitration agreements.").

[15] *See. e.g.*, *Carmona v. Lincoln Millennium Car Wash, Inc.*, No. B248143, 2014 BL 110386 (Cal. Ct. App. Apr. 21, 2014) (refusing to enforce an employment arbitration agreement that was found to be procedurally and substantively unconscionable).

[16] *Davis v. Nordstrom, Inc.*, No. 12-17403 (9th Cir. June 23, 2014).