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Iskanian v. CLS Transportation: Mixed Bag for Employers

In a long-awaited decision, the California Supreme Court ruled on Monday that the Federal Arbitration Act (FAA) preempts a California state rule invalidating class arbitration waivers. ***Iskanian v. CLS Transportation LLC*** answered the question of whether the California Supreme Court's 2007 decision in ***Gentry v. Superior Court*** was still good law. (Cal. Supreme Court S24032, Filed 6/23/14.) The court in ***Gentry*** had concluded that class arbitration waivers in the employment context could run afoul of public policy and interfere with employees' rights, and established a rule restricting the enforcement of such waivers in California. 42 Cal. 4th 443 (Cal. 2007).

Referencing the United States Supreme Court decision of ***AT&T Mobility LLC v. Concepcion*** (2011), the ***Iskanian*** court found that the FAA preempts the ***Gentry*** rule. The ***Iskanian*** court specifically held that ***Concepcion*** provides that the FAA prevents states from mandating or promoting procedures incompatible with arbitration, and that the ***Gentry*** rule runs afoul of this later principal.

However, the ***Iskanian*** court also held that an arbitration agreement requiring an employee, as a condition of employment, to give up the right to bring representative Private Attorneys General Act (PAGA) actions in any forum is contrary to public policy.

The Court Abrogates the *Gentry* Rule

The ***Iskanian*** court acknowledged that ***Gentry*** held class action waivers in employment arbitration agreements were invalid under certain circumstances. The focus in ***Gentry*** was on whether class action waivers would undermine the vindication of employees'"unwaivable statutory [overtime] rights." The U.S. Supreme Court's ***Concepcion*** decision, however, focused on class action waivers in consumer arbitration agreements. Until Monday's decision, it remained unclear whether the ***Concepcion*** rule—that the FAA preempts class arbitration waivers in consumer contracts—also applied to employment arbitration agreements.

In holding that ***Concepcion*** overrules ***Gentry,*** the ***Iskanian*** court noted that state law rules, such as the ***Gentry*** rule, are preempted by the FAA because states cannot require a procedure that interferes with fundamental attributes of arbitration "even if it is desirable for unrelated reasons." Discussing the practical effect of the ***Gentry*** unconscionability rule, the ***Iskanian*** court noted that the rule considered whether individual arbitration was an effective dispute resolution mechanism by directly comparing the effectiveness of such

arbitration to the advantages of a class action procedural device. Such an analysis, the court found, had the practical result of regularly invalidating class waivers, and thus functioned to mandate or promote procedures incompatible with arbitration. Thus, the ***Iskanian*** court concluded, the FAA preempts the ***Gentry*** rule.

The Court Discounts the *DR Horton* Decision

In addition, the court addressed whether the class action waiver case was invalid under the National Labor Relations Act (NLRA) and specifically under ***D.R. Horton, Inc. & Cuda***, 357 NLRB No. 184 (2012). The National Labor Relations Board (NLRB) in ***D.R. Horton*** found that the NLRA generally prohibits contracts that compel employees to waive their right to participate in class proceedings to resolve wage claims. However, the ***Iskanian*** court noted the Fifth Circuit recently refused to enforce the ***D.R. Horton*** rule. ***See D.R. Horton, Inc. v. NLRB***, 737 F. 3d 344 (5th Cir. 2013). The ***Iskanian*** court agreed with the Fifth Circuit's rejection of the argument that the NLRB's rule fell within the savings clause of the FAA. Citing favorably to ***Concepcion***, the court held that by substituting class proceedings for individual arbitration, the ***D.R. Horton*** rule "would significantly undermine arbitration's fundamental attributes by requiring procedural formality and complexity, and by creating greater risk to defendants."

The court concluded the ***D.R. Horton*** rule is not covered by the FAA's savings clause. Moreover, ***Concepcion*** makes clear that, even if a rule against class waivers applies equally to arbitration and non-arbitration agreements, it nonetheless interferes with fundamental attributes of arbitration and, for that reason, disfavors arbitration in practice and is therefore preempted by the FAA.

No FAA Preemption of PAGA Claims

The most disappointing section of the ***Iskanian*** decision addresses waivers of representative actions in the context of claims brought under the PAGA (Cal. Labor Code § 2968 *et seq*.). The issue before the court was whether the FAA preempted a state law rule prohibiting such waivers. The court reviewed PAGA's legislative history, pointing out that adequate financing of labor law enforcement was necessary to achieve maximum compliance with state labor laws, hence the need to deputize the plaintiffs' bar. The court characterized the aggrieved employee's action under the PAGA as a functional substitute for an action by the government itself and focused on the fact that the Act authorizes a representative action only for the purpose of seeking statutory penalties.

From the ***Iskanian*** court's majority perspective, PAGA actions are fundamentally law enforcement actions designed to protect the public and not to benefit private parties. Noting the distinction between claims for statutory damages, to which employees may be entitled, and a request for statutory penalties, the court likened the PAGA representative action to a type of *qui tam* action, concluding that it is the government entity on whose behalf the plaintiff filed suit that is always the "real party in interest" in the suit.

The ***Iskanian*** court also concluded that PAGA claims are unwaivable pursuant to California Civil Code § 1668 and Civil Code § 3513, holding that an agreement to waive the right to bring a PAGA action serves to disable one of the primary mechanisms for enforcing the Labor Code. Such an agreement violates Civil Code § 1668 because it has as its object, "indirectly, to exempt [the employer] from responsibility for [its] own…violation of law," and is therefore against public policy and unenforceable. Secondly, with respect to

Civil Code § 3513, which holds that a law established for a public reason cannot be contravened by a private agreement, the court concluded that PAGA was clearly established for a public reason and agreements requiring the waiver of PAGA rights would harm the state's interests in enforcing the Labor Code and in receiving the proceeds of civil penalties used to deter violations.

Citing favorably to ***Arias v. Superior Court***, 46 Cal. 4th 969 (2009), the court noted that even if a single claim in arbitration under the PAGA is authorized, a prohibition of representative claims frustrates the PAGA's objectives. Therefore, the ***Iskanian*** court concluded that where, as in this case, an employment agreement compels the waiver of representative claims under the PAGA in any forum, it is contrary to public policy and unenforceable as a matter of state law.

The PAGA and the FAA

The court also concluded that the rule against PAGA waivers does not frustrate the FAA's objectives because the FAA is applicable to the resolution of private disputes, whereas a PAGA action is a dispute between an employer and California's Labor and Workforce Development Agency. According to the court, a PAGA claim lies outside the FAA's coverage because it is not a dispute between an employer and an employee arising out of their contractual relationship, but a dispute between an employer and the state through its agents, either the Labor and Workforce Development Agency or aggrieved employees. The Court often focused on a PAGA litigant's status as the proxy or agent of the state to ostensibly reflect a PAGA litigant's substantive role in enforcing California Labor Laws on behalf of its state law enforcement agencies.

Deferring and citing to the historic police powers of the states, the California Supreme Court concluded that it can discern in the FAA no purpose, much less a clear manifest purpose, to curtail the ability of states to supplement their enforcement capability by authorizing willing employees to seek civil penalties for Labor Code violations traditionally prosecuted by the state.

The court therefore concluded that California's public policy prohibiting waiver of PAGA claims, whose sole purpose is to vindicate the Labor and Workforce Development Agency's interests in enforcing the Labor Code, "does not interfere with the FAA's goal of promoting arbitration as a forum for private dispute resolution." Similarly, the court concluded that PAGA does not violate the principal of separation of powers under the California constitution and distinguished ***Iskanian*** from cases where the government had retained a private law firm or attorneys as outside counsel, concluding that by deputizing employee plaintiffs to enforce the Labor Code the PAGA does not present the same risks of abuse as when a city or county hires outside counsel to do its bidding.

Justice Chin's Concurrence

While Justice Chin concurred that the PAGA waiver is unenforceable, he disagreed with the majority's conclusion that a PAGA claim is not a dispute between an employer and an employee arising out of their contractual relationship, noting that while the plaintiff may recover civil penalties for violations as to other employees, the dispute arises first and fundamentally out of that employer-employee relationship. Most importantly, Justice Chin pointed out that the majority's conclusion that the FAA permits either California or its courts to declare private agreements to arbitrate PAGA claims categorically unenforceable, is doubtful.

Justice Chin also noted that if contracting parties agree to include certain claims within the issues to be arbitrated, the FAA insures that their agreement will be enforced according to their terms even if a rule of state law would otherwise exclude such claims from arbitration. (Citing to ***Mastrobuono v. Shearson Lehman Hutton*** (1995) 514 U.S. 52, 58.) Thus, requiring an arbitration provision to preserve some forum for bringing PAGA actions does not exceed the court's power.

The Procedural Path Forward

The court held that ***Iskanian*** must proceed with bilateral arbitration of his individual damages claims but that CLS must answer the representative PAGA claims in some forum. The court then remanded the case to determine whether the parties will agree on a single forum for resolving the PAGA claim and other claims and if not, whether it is appropriate to bifurcate the claims with the individual claims going to arbitration and the representative PAGA claim litigation.

Questions remain whether the preemptive reach of ***Concepcion*** is as narrow as the California Supreme Court holds and whether an arbitration agreement where the parties have agreed to arbitrate their statutory PAGA claims is enforceable. As a practical matter, the issue of whether arbitrations will be stayed while the PAGA claim is litigated opens a procedural morass, which runs counter to the basic goal of a speedy and efficient resolution of the underlying claims in arbitration. Those issues will likely be tested, perhaps on appeal to the U.S. Supreme Court.

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