SEYFARTH SHAW

# Management Alert

## California Supreme Court Upholds Mandatory Class Action Waivers in Arbitration Agreements While Holding that PAGA Waivers Are Unenforceable

*By David D. Kadue and Geoffrey C. Westbrook*

In *Iskanian v. CLS Transportation Los Angeles*, LLC, the California Supreme Court settled years of uncertainty regarding the permissibility of waivers of class actions and representative actions in mandatory employment arbitration agreements. The *Iskanian* court acknowledges that California's *Gentry* rule (which often precluded the enforcement of class action waivers) is no longer valid after the U.S. Supreme Court's 2011 decision in *AT&T Mobility LLC v. Concepcion*.

The court now recognizes that an employee's right to initiate a class lawsuit may be waived in an arbitration agreement, because a rule invalidating such waivers would interfere with the key purposes of arbitration under the Federal Arbitration Act ("FAA"). At the same time, however, the *Iskanian* court held that employees may pursue Labor Code violations, on behalf of the state, in a proceeding under the Private Attorneys General Act of 2004 ("PAGA"), notwithstanding an arbitration agreement providing to the contrary.

The *Iskanian* court's reasoning brings some much needed clarification, but itself raises questions about how lawsuits with class *and* representative claims will be managed in future cases involving valid arbitration agreements.

### The Facts

Arshavir Iskanian worked as a driver for CLS Transportation Los Angeles from March 2004 to August 2005. As a condition of his employment, Iskanian signed an arbitration agreement providing that "any and all claims" arising out of his employment were to be submitted to binding arbitration before a neutral arbitrator. The arbitration agreement also contained a class and representative action waiver that expressly provided that neither "class action [nor] representative action" procedures or claims could be asserted in any arbitration.

### The Lower Court Decisions

In August 2006, Iskanian filed a class action against CLS for failure to pay overtime and for failure to provide meal and rest breaks. The trial court granted CLS's motion to compel arbitration, finding that the arbitration agreement was neither procedurally nor substantively unconscionable.

When Iskanian sought redress from the Court of Appeal, the court remanded the action to the trial court for reconsideration in light of then-recent California Supreme Court authority, *Gentry v. Superior Court*. In *Gentry*, the Supreme Court held that a class waiver provision in an arbitration agreement should not be enforced if certain factors indicate that class arbitration would be more effective than individual arbitration.



©2014 Seyfarth Shaw LLP. All rights reserved. "Seyfarth Shaw" refers to Seyfarth Shaw LLP (an Illinois limited liability partnership). Prior results do not guarantee a similar outcome.

On remand, CLS voluntarily withdrew its motion to compel arbitration. Iskanian added representative claims under California's Unfair Competition Law ("UCL") and the PAGA. The trial court certified the case as a class action in October 2009.

In April 2011, the United States Supreme Court decided *AT&T Mobility LLC v. Concepcion*, holding that California's "*Discover Bank* rule"—a state law establishing the unenforceability of class action waivers (as contained in arbitration agreements) in certain contexts—was preempted by the FAA. Soon thereafter, relying on *Concepcion*, CLS renewed its motion to compel arbitration and to dismiss the class claims, and moved to compel arbitration of the representative claims. The trial court ruled for CLS and required arbitration of Iskanian's claims. Iskanian then filed his second appeal.

The Court of Appeal held that *Concepcion* effectively invalidated the California Supreme Court's decision in *Gentry* and affirmed the order to compel arbitration. Further, the court rejected Iskanian's argument that his right to bring a representative action under PAGA was unaffected by FAA preemption. The court acknowledged that it was disagreeing with a recent appellate ruling in *Brown v. Ralphs Grocery Co.,* but reasoned that its conclusion was mandated by Concepcion and other binding precedent.

With key issues pertaining to arbitration agreements left unsettled, the California Supreme Court granted Iskanian's petition for review on September 12, 2012.

## The Supreme Court's Holding

The Supreme Court ruled that the FAA preempts California law prohibiting the waiver of class action claims in employment arbitration agreements. Such a waiver is fully enforceable under *Concepcion*. At the same time, however, a waiver of the right to pursue a representative claim under the PAGA is not enforceable, as that claim, being on behalf of the state, is beyond the scope of the FAA, which covers only private agreements.

Iskanian asserted two general arguments on class action waivers. First, he contended that the California Supreme Court's decision in *Gentry*—invaliding class waivers in certain circumstances—survived the U.S. Supreme Court's decision on FAA preemption in *Conception*. Iskanian argued that *Gentry*'s limitations on class waivers were narrower than the *Discovery Bank* rule that the U.S. Supreme Court criticized in *Concepcion*. The California Supreme Court rejected this and similar arguments on the ground that the FAA broadly prevents states from mandating or promoting procedures incompatible with the fundamental attributes of arbitration. Because the *Gentry* rule violates this principle, it is preempted by the FAA.

Second, Iskanian argued that the class action waiver was an unfair labor practice forbidden by the National Labor Relations Act ("NLRA"), which protects concerted activity. The California Supreme Court rejected this argument because the arbitration agreement still permitted a broad range of activity to vindicate employee wage claims and because neither the NLRA's text nor legislative history contained any expression of a congressional intent to prohibit class action waivers. In reaching this conclusion, the court rejected the holding by the National Labor Relations Board in *D.R. Horton*, that mandatory class action waivers violate the NLRA.

While Iskanian could not salvage his assertion of a class action, he prevailed on this argument that his representative action under the PAGA is nonwaivable. The California Supreme Court reasoned that the PAGA empowers employees to sue to enforce the Labor Code on behalf of the State of California. As to an action brought on the state's behalf, the California Supreme Court reasoned, the FAA does not apply.

In reaching this conclusion, the Supreme Court acknowledged that the FAA preempts state law whenever it "stands as an obstacle to the accomplishment of the FAA's objectives." But the California Supreme Court distinguished between those disputes between private parties and disputes involving a public entity.

The California Supreme Court concluded that the FAA does not govern disputes initiated by the government in its law enforcement capacity, and characterized PAGA actions as claims between an employer and the State of California, in the form of the California Workforce Development Agency. According to the California Supreme Court, PAGA claims directly enforce the State's interest in penalizing and deterring employers who violate California's labor laws. Accordingly, the *Iskanian* Court held that California law prohibiting waivers of PAGA claims does not interfere with the FAA's goal of promoting arbitration and is, therefore, not preempted.



©2014 Seyfarth Shaw LLP. All rights reserved. "Seyfarth Shaw" refers to Seyfarth Shaw LLP (an Illinois limited liability partnership). Prior results do not guarantee a similar outcome.

## What *Iskanian* Means for Employers

*Iskanian* is without question one of the most significant pro-employer class action rulings since Concepcion. It unequivocally holds that class action waivers in employment arbitration agreements are fully enforceable in California and strongly encourages utilization of alternative dispute resolution procedures in connection with employee-employer grievances.

Nonetheless, *Iskanian* leaves many questions unanswered. For example, it is unclear how claims asserting both class and PAGA allegations will be managed in cases involving valid arbitration agreements. The California Supreme Court had no answer and remanded the case in a bifurcated fashion with Iskanian's individual claims to be heard in arbitration and the PAGA action in an unidentified forum. As the case proceeds, this and other interesting manageability issues may come to surface.

And of course, a valid class action waiver will not immunize an employer from widespread Labor Code violations in any event. Nothing in *Iskanian* protects an employer against a slew of individual claims in arbitration.

*David D. Kadue* is a partner in Seyfarth's Los Angeles office and *Geoffrey C. Westbrook* is an associate in Seyfarth's Sacramento office. If you would like further information, please contact your Seyfarth Shaw LLP attorney, David D. Kadue at *dkadue@seyfarth.com* or Geoffrey C. Westbrook at *gwestbrook@seyfarth.com*.



Attorney Advertising. This Management Alert is a periodical publication of Seyfarth Shaw LLP and should not be construed as legal advice or a legal opinion on any specific facts or circumstances. The contents are intended for general information purposes only, and you are urged to consult a lawyer concerning your own situation and any specific legal questions you may have. Any tax information or written tax advice contained herein (including any attachments) is not intended to be and cannot be used by any taxpayer for the purpose of avoiding tax penalties that may be imposed on the taxpayer. (The foregoing legend has been affixed pursuant to U.S. Treasury Regulations governing tax practice.)



©2014 Seyfarth Shaw LLP. All rights reserved. "Seyfarth Shaw" refers to Seyfarth Shaw LLP (an Illinois limited liability partnership). Prior results do not guarantee a similar outcome.