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When Is a Civil Penalty Not a Civil Penalty?

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Seyfarth Synopsis: *Plaintiffs cannot circumvent arbitration agreements by characterizing claims for statutory damages as claims for civil penalties. The purported PAGA exemption from arbitration agreements applies only to claims for civil penalties that go primarily to the State of California, and not entirely to employees.*

Background

The Federal Arbitration Act ("FAA") establishes the rule that arbitration agreements must be enforced, even if some state rule says otherwise. The California Supreme Court, in its 2014 decision in *Iskanian v. CLS Transportation Los Angeles, LLC*, created an exception to the rule when it declined to enforce arbitration agreements that waive representative claims brought under California's Private Attorneys General Act ("PAGA"). *Iskanian* reasoned that PAGA claims feature the plaintiff seeking civil penalties for the State of California, which never agreed to waive recovery of those penalties on a representative basis. Although there have been several attempts to have the U.S. Supreme Court reverse *Iskanian*, it remains the law in California.

After *Iskanian*, some employers abandoned efforts to get employees to waive the right to participate in representative actions. The Court of Appeal's decision in *Esparza v. KS Industries* teaches that this may have been an overreaction to *Iskanian*. *Esparza* concludes that some claims characterized as PAGA claims actually involve claims for "statutory damages," and not "civil penalties." Based on this distinction, *Esparza* holds that while PAGA suits to obtain "civil penalties" remain immune to an agreement to arbitrate, suits to obtain penalties that amount to "statutory damages" are subject to such an agreement.

The Facts

Richard Esparza, as an "aggrieved employee," sued his former employer, KS Industries. He brought a single cause of action under PAGA, in which he sought unpaid wages, civil penalties, and statutory penalties, for failures to provide meal and rest breaks, to pay wages in a timely manner, to provide accurate wage statements, and to reimburse business expenses.

KS moved to compel enforcement of the parties' arbitration agreement. Esparza countered that his suit, as a PAGA action, fell beyond the scope of the FAA and thus was not subject to arbitration, and that the PAGA penalties he sought included unpaid wages.

KS responded that Esparza was trying to circumvent his arbitration agreement by filing a single cause of action under PAGA and styling the monetary relief sought as civil penalties when, in fact, the relief amounted to victim-specific damages that

would go entirely to employees. KS contended that Esparza's claims were subject to the arbitration agreement and did not fall within *Iskanian*'s "PAGA exemption" from arbitration.

When the trial court sided with Esparza, KS appealed.

Appellate Decision

The Court of Appeal, reversing the trial court, agreed with KS that because some of Esparza's claims sought individualized, victim-specific relief, those claims were not subject to the "PAGA exemption" from arbitration that the Court of Appeal believed was created by *Iskanian*. (In fact, *Iskanian* did not exempt all PAGA claims from arbitration: *Iskanian* simply declined to enforce arbitration agreements that *waive* the ability to pursue PAGA civil penalties on a *representative* basis. *Iskanian* thus does not purport to prohibit PAGA claims from being arbitrated on a representative basis).

According to the Court of Appeal, the purported "PAGA exemption" from arbitration applies only to PAGA claims for "civil penalties"—monetary relief that goes 75 percent of the penalty to the State of California and 25 percent to aggrieved employees. The Court of Appeal reasoned that because PAGA "civil penalties" primarily go to the State, the right to waive seeking them on a representative basis cannot be waived by an employee, because the State is not a party to a private arbitration agreement. In contrast, penalties that would go entirely to aggrieved employees are not a "civil penalty" for purposes of the *Iskanian* rule. The ability to require Esparza to arbitrate on an individual basis thus turned on the extent to which his claims were truly PAGA claims for "civil penalties" (going largely to the State) rather than claims for "statutory damages" (going entirely to aggrieved employees).

Esparza argued that his claim for unpaid wages was really a PAGA claim for civil penalties because, under Labor Code section 558, civil penalties include the payment of unpaid wages. The Court of Appeal rejected this argument, noting that, while *Iskanian* did not expressly address whether such unpaid wages are a civil penalty, *Iskanian* distinguished civil penalties recovered on behalf of the State from statutory damages that go entirely to employees. In the context of the *Iskanian* rule, the Court of Appeal concluded, the test for a civil penalty is whether the money goes primarily to the State or whether employees could recover all the money in their individual capacities. Unpaid wages, being a victim-specific remedy that employees can recover in an individual capacity, thus cannot qualify as a civil penalty for purposes of the *Iskanian* rule.

Accordingly, under *Esparza*, PAGA claims for "civil penalties," when seeking money allocated primarily to the State, remain immune from mandatory pre-dispute arbitration. But claims for victim-specific "statutory damages"—whether or not they are called a "penalty"—can be directed to individual arbitration where an arbitration agreement so provides.

What *Esparza* means for employers

Plaintiffs cannot circumvent arbitration agreements simply by characterizing their representative claims for wages or for statutory damages as part of a PAGA action. Thus, plaintiffs still must honor agreements to arbitrate claims that are for individualized relief, even if they style their claim as a PAGA claim for civil penalties. As courts continue to grapple with whether employee arbitration agreements are enforceable as to claims for statutory damages—whether they appear in the guise of class, collective, or representative actions—employers should regularly review their arbitration procedures to ensure that they reflect the current state of the law.

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