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California Supreme Court Affirms Use of Class Action Waivers in Arbitration Agreements

On June 23, 2014, the California Supreme Court, in *Iskanian v. CLS Transportation Los Angeles, LLC*, upheld the use of class action waivers in pre-dispute arbitration agreements. The decision was not a complete victory for employers though as the court held that representative claims under the California Private Attorneys General Act of 2004 (PAGA) cannot be waived.

What Is This Case About?

Plaintiff Arkshavir Iskanian filed a class action lawsuit on behalf of himself and other current and former employees of CLS Transportation alleging the company failed to pay overtime and provide required rest and meal periods, among other claims. Iskanian signed a pre-dispute arbitration agreement containing an express waiver of class and representative action claims, meaning he waived the right to class proceedings and agreed to arbitrate any claims he had against the company on an individual basis.

CLS Transportation successfully moved to compel arbitration, but while the enforceability of the arbitration agreement was being reviewed on appeal, the court issued its decision in *Gentry v. Superior Court* (2007), 42 Cal.4th 443. *Gentry* directed trial courts to consider four factors in deciding whether to enforce class action waivers in overtime cases: "the modest size of the potential individual recovery, the potential retaliation against members of the class, the fact that absent members of the class may be ill informed about their rights, and other real word obstacles to the vindication of class members' right to overtime pay through individual arbitration." *Gentry* directed trial courts to invalidate class arbitration waivers if they found that a class arbitration was likely to be significantly more effective in vindicating employee rights than an individual arbitration or litigation, and if disallowing class arbitration would likely lead to less comprehensive enforcement of overtime laws.

CLS Transportation voluntarily withdrew its petition to compel arbitration in light of *Gentry*. The parties proceeded to litigate the case in court, and a class was certified. Nearly four years later, on April 27, 2011, the United States Supreme Court issued *AT&T Mobility LLC v. Concepcion* (2011) 131 S. Ct. 1740. *Concepcion* overturned the California Supreme Court's decision in *Discover Bank v. Superior Court* (2005) 36 Cal. 4th 148. *Discover Bank* held that class action waivers in consumer contracts

effectively exculpated a defendant from liability and were unconscionable unless the defendant could show individual arbitration provided an adequate substitute for the deterrent effects of a class action. *Concepcion* found that *Discover Bank* stood as an obstacle to and frustrated the purposes of the Federal Arbitration Act (FAA). Requiring class arbitration "sacrifices the principal advantage of arbitration – its informality – and makes the process slower, more costly, and more likely to generate a procedural morass than final judgment." It also "greatly increases the risks to defendants."

Shortly after *Concepcion* was issued, CLS Transportation renewed its motion to compel arbitration, arguing that *Concepcion* had invalidated *Gentry*. The trial court agreed, ordering Iskanian to arbitrate his individual claims and dismissing the class claims with prejudice. The Court of Appeal affirmed.

What Did The Court Hold?

The court agreed that *Concepcion* invalidated *Gentry*. The FAA preempted *Gentry* because *Gentry* interfered with the fundamental attributes of arbitration by creating a rule prohibiting class waivers unless individual arbitration was likely to be an effective dispute resolution mechanism when compared to a class action.

Iskanian argued that even if the FAA preempted *Gentry*, class action waivers are still invalid under the National Labor Relations Act (NLRA), citing *D.R. Horton Inc. v. Cuda* (2012) 357 NLRB No. 184, for the argument that class proceedings are a form of concerted activity under section 7 of the NLRA. The court rejected this argument, agreeing with the Fifth Circuit that *D.R. Horton*, like *Discover Bank*, is not arbitration neutral but has the effect of disfavoring arbitration and is preempted by the FAA.

The court rejected Iskanian's argument that CLS Transportation waived its right to arbitration by voluntarily withdrawing its petition when the court issued *Gentry* and found that any delay in renewing the petition was reasonable in light of the state of the law at the time.

Most significantly, the court held that California public policy prohibited waivers of representative PAGA actions, and that the FAA does not preempt this rule. The court distinguished PAGA claims from ordinary wage claims on the ground that PAGA claims are law enforcement actions in which the plaintiff stands in as a proxy for the government. A private agreement to waive the right to bring a PAGA representative action "serves to disable one of the primary mechanisms for enforcing the Labor Code," and is therefore against public policy and may not be enforced. The court concluded that the FAA did not preempt this holding because the FAA aimed to provide an efficient forum for resolving private disputes, while PAGA claims lie outside the FAA's coverage because they concern a dispute between an employer and the Labor Workforce Development Agency. Whether in *Iskanian* or another case, look for this aspect of the court's holding to eventually make its way to the United States Supreme Court as it has the undesirable effect of forcing employers seeking to enforce arbitration agreements to either agree to arbitrate PAGA claims on a representative basis or to seek bifurcation and defend against those claims in a different forum.

Finally, the court left open the question of how the parties should proceed given that the plaintiff must arbitrate all of his claims individually, except for his representative PAGA claims. The possibilities include agreeing on a single forum to handle both the PAGA and individual claims (either court or arbitration), or bifurcating the PAGA claims from the individual claims and pursuing the former in court

and the latter in arbitration, and perhaps staying one proceeding while the parties move forward with the other.

What Does This Mean For Employers?

Well drafted arbitration agreements with express class action waivers can be effective tools in defeating class actions and forcing employees to arbitrate wage and hour claims on an individual basis. Employers who do not use pre-dispute arbitration agreements should give careful consideration to adopting such agreements. Employers who currently have arbitration agreements should have them reviewed to make sure they are drafted to full take advantage of *Iskanian*. Arbitration agreements must still comply with the due process and mutuality standards set forth in *Armendariz v. Foundation Health Psychcare Services, Inc.* (2000) 24 Cal. 4th 83.

But arbitration agreements are not a panacea. Employers must bear the forum costs, meaning they must pay all of the arbitrator's fees and expenses. Arbitrator's decisions are also subject to limited review on appeal. In cases where an employer has a strong chance of prevailing on a motion for summary judgment, arbitration may be a less desirable forum.

Finally, as the law currently stands, employers cannot require employees to waive the right pursue PAGA claims on a representative basis. This means that an employer may find itself litigating claims in two forums, the employee's individual claims in arbitration and the employee's representative claims in court. Because PAGA claims have a one-year statute limitations, compared to up to four years for many wage claims, the risks associated with litigating potential class claims may outweigh the potential inconvenience of litigating representative PAGA claims in a separate forum.

Bryan Cave LLP has substantial experience advising employers regarding arbitration agreements and alternative dispute resolution programs.

For questions or further information on this topic, please speak to your regular Bryan Cave contact or a member of our Labor and Employment Client Service Group.