Client Alert

June 25, 2014

California Supreme Court Upholds Class Action Waivers in Arbitration Agreements, but Invalidates Waivers of Representative Actions under the California Private Attorneys General Act

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On June 23, the California Supreme Court provided mixed blessings to California employers. In *Iskanian v. CLS Transportation*, No. S204032 (June 23, 2014), the Court upheld class action waivers in arbitration agreements, concluding that its so-called *Gentry* Rule, under which such waivers had generally been found unenforceable, was contrary to recent U.S. Supreme Court precedent under the Federal Arbitration Act (FAA). The Court also rejected arguments that class action waivers are unlawful under the National Labor Relations Act. These holdings are victories for the enforceability of class arbitration waivers in the employment context and beyond.

Offsetting these victories, however, the Court invalidated waivers of the right to bring representative actions under the California Private Attorneys General Act (PAGA) to enforce the California Labor Code, holding that such waivers are contrary to California public policy and that California's policy is not preempted by the Federal Arbitration Act.

The decision creates a procedural quandary. While arbitration agreements may preclude class actions, they may not preclude PAGA representative actions. Thus, California employers seeking to enforce arbitration agreements could find themselves simultaneously litigating closely related issues both in court and before an arbitrator. How such bifurcation will work out and whether it will survive scrutiny by the U.S. Supreme Court are uncertain at best.

I. BACKGROUND

Plaintiff Iskanian, who worked as a truck driver for Defendant CLS Transportation, filed a class action against his former employer, alleging various California Labor Code violations and seeking penalties under the PAGA. Iskanian had signed an arbitration agreement that provided that he would submit any and all claims arising out of his employment to binding arbitration, and that included a class and representative action waiver. CLS moved to compel arbitration, and the trial court granted CLS's motion.

Shortly thereafter, the California Supreme Court decided *Gentry v. Superior Court*, 42 Cal. 4th 443 (2007), which held that a class waiver provision in an arbitration agreement should not be enforced if "class arbitration would be a significantly more effective way of vindicating the rights of affected employees than individual arbitration." The court of appeal issued a writ of mandate directing the trial court to reconsider its ruling in light of *Gentry*, at which point CLS withdrew its motion to compel arbitration and the case proceeded in the trial court. Four years later, after the trial court had certified a class, the United States Supreme Court decided *AT&T Mobility LLC v.*

Concepcion, 131 S. Ct. 1740 (2011), and held that "[r]equiring the availability of classwide arbitration interferes with the fundamental attributes of arbitration and thus creates a scheme inconsistent with the [Federal Arbitration Act]." On this basis, CLS brought a renewed motion to compel arbitration and dismiss the class claims. The trial court granted the motion, and Iskanian appealed the order. The court of appeal affirmed the trial court's order.

The California Supreme Court granted review to consider (1) whether *Concepcion* implicitly overruled *Gentry* with respect to contractual class action waivers in the context of nonwaivable labor law rights; (2) whether a class action waiver is invalid under the National Labor Relations Act; (3) whether CLS waived its right to compel arbitration; and (4) whether the Supreme Court's decision in *Concepcion* permits arbitration agreements to override the statutory right to bring representative claims under PAGA.

II. CALIFORNIA'S *GENTRY* RULE INVALIDATING CLASS ACTION WAIVERS DOES NOT SURVIVE RECENT PRECEDENT UNDER THE FEDERAL ARBITRATION ACT

As expected, the California Supreme Court once and for all concluded that *Gentry* is dead. In other words, courts may not refuse to enforce class arbitration waivers merely because a class proceeding would be a more effective way to vindicate an employee's statutory rights than an individual action. As the California Supreme Court found, the FAA preempts *Gentry* under the logic of *Concepcion*, where the U.S. Supreme Court held that a class waiver is valid even if an individual proceeding would be an *ineffective* means to prosecute certain claims.

This ruling should mean that class arbitration waivers are always enforceable in California, but it may not be the end of the story. The California Supreme Court suggested that a court may still require arbitration to provide protections for employees, such as affordability and accessibility, as it noted in *Sonic-Calabasas A, Inc. v. Moreno*, 57 Cal. 4th 1109 (2013) (*Sonic II*), so long as those protections are not incompatible with arbitration. Judge Chin asserted in his concurrence that this carve-out is preempted by the FAA as construed by the U.S. Supreme Court. Both the substance of the carve-out and whether it is preempted will have to await further judicial review.

In the meantime, however, employers should continue to draft arbitration agreements for California employees that contain sufficient protections for employees to pass muster even under the *Sonic II* standard. Based on the California Supreme Court's guidance in *Iskanian*, this will mean at a minimum that arbitration agreements provide for employers to pay all costs beyond court filing fees for arbitrations and for arbitrations to proceed in a place near the employee's place of employment.

III. THE NATIONAL LABOR RELATIONS ACT DOES NOT INVALIDATE CLASS ACTION WAIVERS

In *D.R. Horton Inc.*, 357 NLRB No. 184 (2012), the National Labor Relations Board (NLRB) held that class action waivers in arbitration agreements violate the right of employees guaranteed by section 7 of the National Labor Relations Act (NLRA) to engage in collective concerted activity for mutual aid and protection. The Fifth Circuit refused to enforce the NLRB's decision in *D.R. Horton, Inc. v. NLRB*, 737 F.3d 344 (5th Cir. 2013), and a majority of other federal courts have come to a similar conclusion: that the NLRA does not overcome the FAA's "liberal policy favoring arbitration." (Slip op. at 21.) In *Iskanian*, the California Supreme Court adopted the majority view.

While concluding that the NLRA does not override the FAA's mandate that arbitration agreements be enforced in accordance with their terms, the Court also sounded a cautionary note: "Our conclusion does not mean that the NLRA imposes no limits on the enforceability of arbitration agreements." (Slip op. at 21.) "Notably," the Court continued, "while upholding the class waiver in *Horton* . . ., the Fifth Circuit affirmed the Board's determination that the arbitration agreement at issue violated section 8(a)(1) and (4) of the NLRA insofar as it contained language that would lead employees to reasonably believe they were prohibited from filing unfair labor practice charges with the Board." (*Id*.) In addition, the Court noted, the arbitration agreement in the case before it "still permits a broad range of collective action to vindicate wage claims." (*Id*.) Thus, the agreement "does not prohibit employees from filing joint claims in arbitration, does not preclude the arbitrator from consolidating the claims of multiple employees, and does not prohibit the arbitrator from awarding relief to a group of employees." (*Id*. at 22.)

While the Court expressly disclaimed deciding "whether an arbitration agreement that more broadly restricts collective activity would run afoul of [the NLRA]," (*id*.), California employers may wish to proceed cautiously pending further guidance from the courts. At a minimum, arbitration agreements should make clear that employees are not precluded from filing unfair labor practice claims with the NLRB.

IV. THE EMPLOYER DID NOT WAIVE ITS RIGHT TO ARBITRATE BY FORGOING A MOTION TO COMPEL ARBITRATION WHILE *GENTRY* WAS GOOD LAW

As noted above, the employer in *Iskanian* withdrew its motion to compel arbitration following a court of appeals remand to the trial court to reconsider its original order compelling arbitration in light of the then-recent *Gentry* decision. Four years later, after discovery and a ruling on the employee's motion for class certification, the employer renewed the motion to compel arbitration shortly after the U.S. Supreme Court decided *Concepcion*. The employee opposed the motion on the ground, among others, that the employer had waived its right to arbitrate by litigating the matter in court.

The California Supreme Court rejected the waiver argument. For the first time, the Court explicitly recognized futility as a reasonable justification for delay in bringing a motion to compel arbitration, and it agreed with the employer that bringing such a motion would have been futile while *Gentry* remained good law. Thus, having acted promptly once the U.S. Supreme Court's decision in *Concepcion* cast doubt on the continued validity of *Gentry*, the employer had not unreasonably delayed its motion nor otherwise waived its right to arbitrate.

In light of this ruling, employers presently in court who have deferred a motion to compel arbitration pending the outcome of *Iskanian* may want to assess bringing such a motion now.

V. EMPLOYEES APPARENTLY MAY NOT AGREE TO WAIVE REPRESENTATIVE ACTIONS UNDER THE CALIFORNIA PRIVATE ATTORNEYS GENERAL ACT

Offsetting the good news for employers, the Court also held that an arbitration clause in which an employee agrees to waive the right to bring "representative" actions under PAGA is contrary to public policy and unenforceable as a matter of state law. Under PAGA, an "aggrieved employee" may bring a representative action on his or her own behalf and on behalf of other "aggrieved employees" to recover civil penalties for violation of the California Labor Code. The Court viewed an employee's right to bring a representative action under PAGA as

unwaivable under California law, with the result that any agreement that compels such waiver is contrary to public policy and unenforceable.

California's public policy here is not preempted by the FAA, according to the Court, because "the rule against PAGA waivers does not frustrate the FAA's objectives[;] . . . the FAA aims to ensure an efficient forum for the resolution of private disputes, whereas a PAGA action is a dispute between an employer and the state Labor and Workforce Development Agency." (Slip Op. 36.) Thus, "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." (Slip Op. 40.)

Judge Chin's concurrence points out that the majority's view ignores the reality that a PAGA action arises, first and fundamentally, out of the plaintiff-employee's relationship with his or her employer and thus is not, as the majority found, for that reason outside the scope of the FAA. Nonetheless, Judge Chin concurred in the judgment, because he, too, opined that all PAGA claims are "representative" in the sense that an "aggrieved employee," whether seeking penalties on his or her own behalf individually or on behalf of others, is representing the state. Thus, a waiver of "representative" actions would leave an "aggrieved employee" without any forum to bring a PAGA claim, contrary to prior U.S. Supreme Court precedent precluding waivers of statutory rights.

It is too soon to know whether *Iskanian* will reach the U.S. Supreme Court and, if so, whether the majority's reasoning or Judge Chin's narrower ground will survive. For the moment, however, employers should be aware that "representative" action waivers as applied to PAGA claims appear to be unenforceable under the state law announced on Monday. Until courts provide further clarification, one approach to consider is to limit the PAGA waiver to claims on behalf of other employees, but permit the PAGA claim of the employee on his or her behalf to be arbitrated. That might not satisfy the majority's view in *Iskanian* but could satisfy the Chin rationale and thus provide a possible basis for enforceability of the waiver in a federal court, which would not be bound by the majority's view of the scope of the FAA.

VI. WHAT'S AN EMPLOYER TO DO?

Much uncertainty surrounds the Court's opinion. For example, as noted above, the scope of the possible *Sonic II* carve-out from enforcing class action waivers as written is unclear, as is the extent to which (in California at least) remnants of *D.R. Horton* may survive. Compounding this is the concluding section of the Court's opinion, cryptically remanding the matter to the trial court to determine if and how the PAGA claims should proceed. The Court suggests that the PAGA claims may be severed from the individual damages claims and that the arbitration may be stayed pending resolution of the trial court proceedings on PAGA. While it seems highly unlikely that the U.S. Supreme Court would find such bifurcation and delay consistent with the FAA, whether it will ultimately review (and if so reverse) the decision is of course unknown.

In the meantime, employers should review their arbitration agreements with counsel to see whether revision may be in order. For the time being at least, the unconscionability doctrine in California continues in force, and so employers should avoid agreements that are overly one-sided, that preclude remedies available in court, that overly limit discovery, or that impose costs an employee would not face in court. *Iskanian* does resolve, however, the enforceability of class action waivers, which employers should consider.

In regard to representative actions, employers may want to proceed cautiously. For example, employers may wish to make clear in the arbitration clause that they are not agreeing to arbitrate PAGA actions on behalf of anyone other than the individual signatory employee (and that the arbitrator has no authority to consider same), rather than precluding "representative" actions altogether. While this could result in bifurcation of the action as suggested in the *Iskanian* remand instructions, that may be preferable to having a class-like PAGA representation action before an arbitrator in its entirety, with the concomitant lack of judicial review. It might also provide grounds for staying the court proceeding rather than the arbitration. In addition, it may be prudent to consider including an explicit provision that any arbitration is not to be stayed pending court resolution of any PAGA claims not subject to arbitration.

The specifics of any revisions will likely vary depending on circumstances, so, as always, California employers should consult counsel for guidance through the twists of the *Iskanian* decision.

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