

California High Court: Class Action Waivers in Arbitration Valid, But Waivers of Representative Actions under State Law Are Not

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The Federal Arbitration Act preempts California law disfavoring enforcement of a class action waiver in employment arbitration agreements, the California Supreme Court has held, overruling its prior holding to the contrary in *Gentry v. Superior Court*, 42 Cal. 4th 443 (2007). *Iskanian v. CLS Transp. Los Angeles, LLC*, No. S204032 (Cal. June 23, 2014).

The Court also rejected the plaintiff's argument that class action waivers are unlawful under the National Labor Relations Act ("NLRA"), declining to follow the National Labor Relations Board's decision in *D.R. Horton*, 357 NLRB No. 184 (Jan. 3, 2012).

However, the Court ruled an arbitration agreement requiring employees as a condition of employment to give up the right to bring representative actions under the California Labor Code Private Attorneys General Act ("PAGA") in any forum is contrary to public policy. It held the right unwaivable as a matter of state law and not preempted by the FAA.

Accordingly, the Court reversed the judgment of the Court of Appeal and remanded the case for further proceedings.

Background

Arshavir Iskanian worked as a driver for CLS Transportation Los Angeles, LLC. Iskanian signed an agreement requiring that all claims arising out of his employment to be submitted to binding arbitration. The agreement also included a provision precluding class and representative actions in the arbitration proceeding. Iskanian filed a class action against the employer for alleged unpaid overtime and other California Labor Code violations. He also sought civil penalties, in a representative capacity, for Labor Code violations under the PAGA, which authorizes an employee to bring an action for civil penalties on behalf of the state against his or her employer for Labor Code violations committed against the employee and fellow employees, with most of the proceeds of that litigation going to the state.

The trial court granted the employer's request for an order requiring arbitration, and dismissed Iskanian's class action claims under *AT&T Mobility LLC v. Concepcion*, 131 S. Ct. 1740 (2011). The California Court of Appeal affirmed, concluding that *Concepcion* overruled *Gentry*. With respect to the PAGA claim, the Court of Appeal concluded the FAA precluded states from withdrawing claims from arbitration and that PAGA claims must be pursued individually.

Applicable Law

Arbitration agreements are enforced according to their terms, in the same manner as other contracts. The FAA's "saving clause" permits revocation of an arbitration agreement if "generally applicable contract defenses, such as fraud, duress, or unconscionability" apply. In *Concepcion*, the U.S. Supreme Court addressed whether the FAA prohibited California's rule conditioning the enforceability of certain consumer arbitration agreements on the availability of class-wide arbitration procedures set forth in *Discover Bank v. Superior Court*, 36 Cal. 4th 148, 153 (2005). It found that, although the savings clause preserved generally applicable contract defenses, "nothing in it suggests an intent to preserve state-law rules that stand as an obstacle to the accomplishment of the FAA's objectives." On this basis, the Supreme Court overruled *Discover Bank* as preempted because the rule interfered with the FAA's overarching purpose: "to ensure the enforcement of arbitration agreements according to their terms so as to facilitate streamlined proceedings."

In *Gentry*, the California Supreme Court ruled the right to receive overtime pay is unwaivable and, under certain circumstances, a class action waiver would "impermissibly interfere with employees' ability to vindicate unwaivable rights and to enforce the overtime laws." The *Gentry* Court held that a class action

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waiver must be invalidated if, after applying various factors, a court determines that class arbitration is “likely to be a significantly more effective practical means of vindicating the rights of the affected employees than individual litigation or arbitration.”

In *D.R. Horton*, the National Labor Relations Board held “employers may not compel employees to waive their NLRA right collectively to pursue litigation of employment claims in *all* forums, arbitral and judicial.”

Under the PAGA, an aggrieved employee may bring a civil action personally and on behalf of other current or former employees to recover civil penalties for Labor Code violations. Of the civil penalties recovered, 75 percent goes to the state Labor and Workforce Development Agency, leaving the remaining 25 percent for the aggrieved employees. “An employee plaintiff suing . . . under the [PAGA] does so as the proxy or agent of the state’s labor law enforcement agencies.” Further, an action under the PAGA “is fundamentally a law enforcement action designed to protect the public and not to benefit private parties.”

Class Action Waivers Enforceable

Iskanian argued that *Gentry* survived *Concepcion* because its rule against class action waivers was narrower than the *Discover Bank* rule challenged in *Concepcion*. The California Supreme Court rejected this argument. It observed, “The high court in *Concepcion* made clear that even if a state law rule against consumer class waivers were limited to ‘class proceedings [that] are necessary to prosecute small-dollar claims that might otherwise slip through the legal system,’ it would still be preempted because states cannot require a procedure that interferes with fundamental attributes of arbitration ‘even if it is desirable for unrelated reasons.’”

Further, the Court noted, “in practice,” *Gentry*’s rule “regularly resulted in invalidation of class waivers.” This was not “surprising,” the Court continued, since it was “unlikely that an individual action could be designed to approximate the inherent leverage that a class proceeding provides to employees with claims against a defendant employer.” Accordingly, the Court ruled that in light of *Concepcion*, the FAA preempted *Gentry*.

Iskanian further argued that, even if the FAA preempted *Gentry*, the class action waiver was invalid under the NLRA. The Court also rejected this argument, relying on and agreeing with the U.S. Court of Appeals for the Fifth Circuit’s analysis in *D.R. Horton, Inc. v. NLRB*, 737 F.3d 344 (5th Cir. 2013). In light of *Concepcion*, the NLRB’s rule was not arbitration-neutral and not covered by the FAA’s savings clause.

Class Action Waivers Unenforceable under PAGA

The Court next concluded the waiver of representative actions under the PAGA was not enforceable because it undermined the state’s public policy interest in enforcing the Labor Code. The Court stated, “[A] single-claimant arbitration under the PAGA for individual penalties will not result in the penalties contemplated under the PAGA to punish and deter employer practices that violate the rights of numerous employees under the Labor Code. That plaintiff and other employees might be able to bring individual claims for Labor Code violations in separate arbitrations does not serve the purpose of the PAGA, even if an individual claim has collateral estoppel effects.”

The Court then addressed whether the FAA nevertheless preempted this rule and concluded it did not. The Court reasoned that PAGA actions do not involve the employer-employee relationship; rather, they involve a dispute between the employer and the state. The employee serves as the state’s representative in a PAGA action, collecting penalties on behalf of the state. The Court concluded that “California’s public policy prohibiting waiver of PAGA claims, whose sole purpose is to vindicate the Labor and Workforce Development Agency’s interest in enforcing the Labor Code, does not interfere with the FAA’s goal of promoting arbitration as a forum for private dispute resolution.”

Thus, the California Supreme Court reversed the judgment enforcing the arbitration agreement in its entirety and returned the case to the trial court for further proceedings.

This case is a significant development for California employers, confirming that employers may develop and enforce employment arbitration agreements with class action waivers barring employees from bringing class actions in court or arbitration. However, employers cannot require employees to waive their right to a “representative” action under the PAGA for Labor Code penalties.

This case does not alter California’s evolving jurisprudence regarding unconscionability, and arbitration agreements remain subject to challenge on those grounds.

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