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California Supreme Court allows class action waivers — but with exception for PAGA

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With a major shift in California law, the California Supreme Court has held that the court's previous refusal to enforce class action waivers in arbitration agreements has been "abrogated" by more recent U.S. Supreme Court decisions under the Federal Arbitration Act ("FAA"). The court has now recognized that the FAA bars California from adopting a rule prohibiting waiver of most class action claims. However, the court refused to extend FAA preemption to representative actions for civil penalties under the California Labor Code Private Attorneys General Act ("PAGA").

The decision in *Iskanian v. CLS Transportation Los Angeles, LLC* comes after a protracted back-and-forth on the enforceability of class action waivers in arbitration agreements. In *Discover Bank v. Superior Court* in 2005, a sharply divided California Supreme Court held that class arbitration waivers are unconscionable and unenforceable—at least when included in a mandatory, take-it-or-leave-it agreement with small amounts at issue. The *Discover Bank* decision reasoned that impediments to consumers pursuing small individual claims would essentially immunize a defendant from claims.

In 2007, in *Gentry v. Superior Court*, the California Supreme Court considered class arbitration waivers in the employment context. There, the court held, again 4–3, that class arbitration waivers were invalid, taking into account the potentially modest size of the individual recoveries, the potential for retaliation against members of the class and other obstacles to the vindication of class members' rights through individual arbitrations.

However, in 2011, the United States Supreme Court issued *AT & T Mobility LLC v. Concepcion*, invalidating the decision in *Discover Bank*, and holding that the FAA preempts state rules conditioning the enforceability of certain arbitration agreements on the availability of class arbitration procedures. The Supreme Court emphasized that "arbitration is a matter of contract," and held that courts may not re-write a contract to provide for class arbitration in cases where the agreement provides otherwise. The Supreme Court rejected the California court's policy grounds: "States cannot require a procedure that is inconsistent with the FAA, even if it is desirable for unrelated reasons."

The litigation began when an employee filed a class and representative action against CLS Transportation, his former employer, seeking recovery for unpaid overtime and related wage and hour claims. CLS moved to compel arbitration, invoking an arbitration agreement signed by Iskanian that did not permit arbitration on a class or representative basis. The trial court eventually granted CLS's motion and ordered the matter to arbitration on an individual basis. The court of appeal affirmed.

The California Supreme Court held, in a 6–1 decision, that the waiver signed by Iskanian was valid in light of *Concepcion* and other recent U.S. Supreme Court decisions, overturning California case law to the contrary. The court also rejected the argument that, even if the FAA preempted *Gentry*, the class action waiver was invalid under the National Labor Relations Board's ("NLRB") decision in *D.R. Horton*. There, the NLRB held that mandatory arbitration agreements requiring that workers give up their right to pursue class claims are at odds with the National Labor Relations Act's ("NLRA") protection of concerted activity. The court adopted the reasoning of the U.S. Fifth Circuit Court of Appeal, which held that the NLRA does not override the FAA's mandate. Other cases raising that same issue as in *D.R. Horton* have been pending before the NLRB and in federal courts.

However, the court's decision was not an unequivocal endorsement of arbitration waivers of class and representative actions. The court went on to uphold the California rule that individual waivers of the right to bring representative PAGA claims are *invalid*. The court reasoned that permitting representative PAGA actions to proceed would not frustrate the purpose of the FAA, because the FAA aims to ensure an efficient forum for the resolution of private disputes. In contrast, a PAGA action essentially is a dispute between an employer and the state, with a private party authorized to pursue recovery of civil penalties on the state's behalf. Simply put, a PAGA claim lies outside the FAA's coverage because it is not a dispute between an employer and an employee limited to their contractual relationship.

What's next?

The *Iskanian* decision represents a decisive victory for employers and class action arbitration waivers. Employers can now feel comfortable implementing arbitration agreements with class action prohibitions. However, employers should bear in mind the continuing controversy before the NLRB and in federal courts concerning the interplay between the FAA and NLRA. While the federal courts have rejected the NLRB's position, the issue has not yet been settled and may eventually reach the U.S. Supreme Court. Employers are advised to consult with counsel in preparing any arbitration agreement, whether or not it includes a class arbitration waiver, to assure that it complies with California's complex rules governing arbitration agreements.

In light of *Iskanian*, class arbitration waivers provide employers with a potentially powerful tool for resisting the wave of class action wage and hour lawsuits that have plagued California employers over the past decade. California employers should consider whether to adopt a well-designed arbitration program that specifies that all employment claims must be arbitrated on an individual, non-class basis.

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