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California Supreme Court: *Gentry* is Gone. PAGA Lives On.

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Compelled by U.S. Supreme Court precedent advancing arbitration as a method of dispute resolution, the California Supreme Court in Iskanian v. CLS Transportation Los Angeles, LLC (No. S20432, June 23, 2014) *held that its decision in* Gentry v. Superior Court *is no longer good law and that arbitration agreements with mandatory class action waivers are generally enforceable. However, the court carved out an exception for representative actions brought under California's Private Attorneys General Act of 2004 ("PAGA"), holding that employers cannot force employees to waive their right to bring representative PAGA actions in any forum.*

The court's decision in Iskanian *means that while employers may limit their exposure to wage and hour class actions by using arbitration agreements that include class action waivers, employers still face representative actions based on unwaivable PAGA claims, much of which remain uncharted territory.*

The case arose when plaintiff Arshavir Iskanian, who worked as a driver for defendant CLS Transportation Los Angeles, LLC, signed an employment agreement providing that all employment disputes would be submitted to binding arbitration. The agreement also contained a class and representative action waiver. In 2006, Iskanian filed a class action complaint against CLS, alleging wage and hour violations under the California Labor Code. During a lengthy procedural process, which included two separate appeals pertaining to the enforcement of the arbitration agreement, two major cases bearing on the enforceability of arbitration agreements were decided by the U.S. Supreme Court and the California Supreme Court.

In 2007, the California Supreme Court handed down its decision in *Gentry v. Superior Court*, 42 Cal. 4th 443 (2007), which found class action waivers to be unenforceable where proceeding as a class would be a "significantly more effective practical means of vindicating the rights" of affected employees than individual

arbitration. The rule announced by *Gentry* directed lower courts evaluating class waivers to consider "the modest size of the potential individual recovery, the potential for retaliation against members of the class, the fact that absent members of the class may be ill informed about their rights, and other real world obstacles to the vindication of class members' right to overtime pay through individual arbitration." In practice, application of these *Gentry* factors meant that class waivers in employment agreements were frequently struck down as unenforceable. This included both waivers pertaining to discrimination actions (*Gentry* involved a putative age discrimination class action) and wage and hour class actions.

On April 27, 2011, the U.S. Supreme Court decided *AT&T Mobility LLC v. Concepcion*, 131 S. Ct. 1740 (2011), invalidating a California rule prohibiting class action waivers in consumer arbitration agreements as unconscionable. The high court held that the rule was preempted by the Federal Arbitration Act ("FAA"). Soon after *Concepcion* was decided, CLS renewed its motion to compel arbitration in the *Iskanian* case on the grounds that *Concepcion* invalidated the rationale underpinning *Gentry*.

The FAA Preempts *Gentry*

In *Iskanian*, the California Supreme Court held that a state's refusal to enforce an arbitration agreement containing a class action waiver on grounds of public policy or unconscionability is preempted by the FAA. *Concepcion* made clear that the FAA preempts state rules that interfere with the fundamental attributes of arbitration, even if those rules are limited to class proceedings "necessary to prosecute small-dollar claims that might otherwise slip through the legal system." Thus, *Gentry* is no longer good law.

California Rejects the NLRB's Reasoning in *Horton*

Iskanian argued that even if the FAA preempts *Gentry*, his class action waiver was invalid under the National Labor Relations Act ("NLRA"). This was the position taken by the National Labor Relations Board ("NLRB") in *D.R. Horton Inc. & Cuda*, 357 NLRB No. 184 (2012). There, the NLRB decided that a mandatory arbitration agreement waiving the right to participate in class or collective actions interfered with employees' rights under the NLRA to engage in concerted activity for their mutual aid or protection, and was therefore an unfair labor practice.

In *Iskanian*, the California Supreme Court rejected this argument, siding with the Fifth Circuit (and numerous other federal courts) in holding that the NLRB's rule disfavors arbitration. Nothing in the text or legislative history of the NLRA prohibits the enforcement of class action waivers consistent with the FAA.[1]

PAGA Claims Are Not Waivable

In a PAGA action, the employee acts as a "private attorney general" on behalf of the state, bringing a representative action to enforce specified provisions of the Labor Code. Civil penalties recovered by aggrieved employees are divided, with 75% going to the state and 25% going to the employees. Where the specific Labor Code provision does not otherwise provide for a penalty, the court can assess a penalty of $100 for each aggrieved employee per pay period for the initial violation and $200 for each aggrieved employee per pay period for each subsequent violation. Aggrieved employees can also recover attorneys' fees and costs.

[1] There was some speculation that *D.R. Horton* would be invalidated by the U.S. Supreme Court's recent decision in *NLRB v. Noel Canning*, --S.Ct.--, 2014 WL 2882090 (June 26, 2014) addressing the validity of the presidential recess appointment power because the President had appointed one of the NLRB members deciding *D.R. Horton* during a congressional intra-session recess and had filled a vacancy that had come into existence prior to the recess. However, the Court affirmed the President's power to do so, and *D.R. Horton* survives on appointment powers grounds.

The California Supreme Court held in *Iskanian* that the FAA's goal of promoting arbitration does not preclude the state from deputizing employees to prosecute Labor Code violations on the state's behalf. The focus of the FAA is on private disputes between employers and employees arising out of their contractual relationship, whereas PAGA involves a dispute between an employer and the state. The court found nothing in the FAA or the U.S. Supreme Court's interpretation of the FAA suggesting that the FAA preempts a state law procedure that provides for enforcement of state law.

The Implications of *Iskanian* for Employers

Iskanian provides substantial relief to employers who have attempted to address the onslaught of employment class actions by requiring employees to enter into arbitration agreements containing class action waivers. Such waivers may, in the future, eliminate class-wide discrimination lawsuits, and limit, but not eliminate, collective wage and hour actions.

The enforcement of a class action waiver as to wage and hour matters is significant: most such cases involve a four-year statute of limitations (three years for claims under the Labor Code and four years for actions to recover wages under Business and Professions Code section 17200). They also involve a host of claims for which damages or civil penalties attach, such as waiting time penalties for failure to pay all wages due at the time of termination of employment. Given the relatively long statute of limitations and the host of claims that can be made, possible liability for a wage and hour class action can be exorbitant.

Thus, employers will be well served by ensuring that they have valid arbitration agreements with class actions waivers in place. Employers should review their arbitration agreements now and continue to do so on a regular basis to ensure that they are enforceable. Given the ruling in *Iskanian*, it is highly likely that there will continue to be challenges to arbitration agreements.

However, the court's ban on PAGA waivers in *Iskanian* demonstrates that even a well-written arbitration agreement is not a panacea for employers with respect to claims based on violation of Labor Code provisions. Although PAGA penalties are subject to a relatively favorable one-year statute of limitations, they can be significant, particularly for large employers, as penalties may be assessed per employee and per pay period for each Labor Code violation or wage order violation not otherwise covered by a Labor Code provision. In addition, at least one court of appeal has held that represented employees can recover lost wages as well as statutory penalties for claims brought under Labor Code section 558. Perhaps most importantly, PAGA also permits the award of attorneys' fees, which creates the incentive for plaintiffs' attorneys to bring these claims even though the employees they represent have relatively little to gain from the PAGA action.

In the past, plaintiffs and their attorneys have often asserted PAGA claims along with class claims in wage and hour matters. Plaintiffs do not have to satisfy class action requirements to proceed with a representative PAGA act. Thus, plaintiffs and their attorneys often used PAGA not only as another source of possible damages but also as a "back up plan" so that they could recover attorneys' fees and other amounts if class certification were denied. Typically, such claims were settled for relatively nominal

amounts when a putative or certified class action was settled, because of plaintiffs' desire to see payments go to employees instead of the government.[2]

The upshot of *Iskanian* is that employers are likely to see an increase in PAGA claims that are aggressively litigated and which employers will not be able to resolve through payment of a nominal sum. This will now be the primary way to bring representative actions in California, as more employers implement class action waivers in their employment agreements.

Questions Raised by *Iskanian* and the Relative Dearth of Law on PAGA

Iskanian also raises several procedural questions, which the California Supreme Court acknowledged when it remanded the case for further proceedings. Should PAGA claims proceed in court while other employment claims proceed simultaneously in arbitration? If the claims are bifurcated, should the arbitration (or the PAGA action) be stayed while the other proceeds? The California Code of Civil Procedure gives the trial court significant discretion as to the stay of court proceedings while related claims are in arbitration, so the answer to these questions can vary case to case.

There are other important issues that remain:

1. Given that class action requirements do not need to be met in a PAGA action, what is the standard by which courts will determine which employees are represented by a PAGA class action?

2. How can PAGA representative actions be effectively settled? Under PAGA, the "represented" employees are not parties to the settlement. Thus, statutory penalties can be recovered without the employees being subject to a release of wage claims.

3. To what extent can an employer reduce PAGA recovery through individual settlement in accordance with *Chindarah v. Pick Up Stix, Inc.*, 171 Cal. App. 4th 796 (2009)? In *Chindarah*, the California Court of Appeal held that an employee can release state wage claims in a general release of claims, so long as the release is obtained in settlement of a bona fide dispute over those wages and the employer has unconditionally paid all wages concededly due.

4. What limitations will courts place on plaintiffs' counsel to prevent them from using PAGA claims as a jumping board to solicit other employees to pursue individual arbitrations?

It is possible that the parties will seek U.S. Supreme Court review of *Iskanian*. The U.S. Supreme Court has demonstrated a broad view of the scope of FAA preemption, so it may be disposed to overturn the PAGA portion of the decision. On the other hand, the court may decline to take up the case on grounds that the PAGA issue is a California-specific wrinkle that lacks broad national import.

In sum, while *Iskanian* gives a large measure of relief that arbitration agreements with class waivers are generally enforceable, the ban on PAGA waivers, unless overturned by the U.S. Supreme Court, means

[2] Brief for the Chamber of Commerce of the United States as Amici Curiae Supporting Defendant and Respondent, *Iskanian v. CLS Transportation Los Angeles, LLC*, No. S20432 (June 23, 2014) (citing *Franco v. Ruiz Food Prods., Inc.*, 2012 WL 5941801 (E.D. Cal., Nov. 27, 2012) ($10,000 allocated to PAGA claim out of $2.5 million settlement); *Garcia v. Gordon Trucking, Inc.*, 2012 WL 5364575 (E.D. Cal. Oct. 31, 2012) ($10,000 allocated to PAGA claim out of $3.7 million settlement); *McKenzie v. Fed. Express Corp.*, 2012 WL 2930201 (C.D. Cal. July 2, 2012) ($82,500 allocated to PAGA claim out of $8.25 million settlement); *Chu v. Wells Fargo Inv., LLC*, 2011 WL 672645 (N.D. Cal. Feb. 16, 2011) ($7,500 allocated to PAGA claim out of $6.9 million settlement); *see also Nordstrom Comm'n Cases*, 186 Cal. App. 4th 576, 589 (2010) (upholding multi-million dollar settlement agreement that allocated zero dollars to the PAGA claim)).

that employers are still going to be subject to wage and hour collective actions that may be expensive and difficult to resolve.

If you have any questions about the content of this alert, please contact the Pillsbury attorney with whom you regularly work, or the authors below.

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