Iskanian v. CLS Transportation: California Supreme Court Gives Class Action Arbitration Waivers the Green Light

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Today, in a decision with significant ramifications for California employers seeking to use class action arbitration waivers as a deterrent to wage and hour class action litigation, the California Supreme Court issued its long-awaited decision in Iskanian v. CLS Transportation Los Angeles, LLC, S204032 (June 23, 2014).

The decision is generally good for employers seeking to use class action arbitration waivers as a deterrent to wage and hour class actions, but less helpful to employers attempting to fight “representative actions. First, the court addressed the question of whether California’s rule against enforcement of a class action waiver on the grounds that it is contrary to public policy or unconscionable is preempted by the Federal Arbitration Act (FAA). In a 48-page decision, the court concluded that the state policy is preempted, and that its prior holding to the contrary in Gentry v. Superior Court (2007) had been abrogated by recent precedent by the Supreme Court of the United States in Concepcion and Italian Colors. The court in Gentry had previously held that class arbitration waivers in many circumstances “would impermissibly interfere with employees’ ability to vindicate unwaivable rights and to enforce the overtime laws” and that such a result was contrary to public policy. The court further rejected arguments from the employee that the class action waiver at issue was unlawful under the National Labor Relations Act, which generally protects the rights of employees to engage in concerted activity.

In this case, the employee, a driver for CLS Transportation, sought to bring a class action lawsuit on behalf of himself and other employees based on his employer’s alleged failure to properly compensate employees for overtime hours worked and meal and rest periods, as well as for wage statement violations, waiting time violations, and other claims. The employee had entered into an arbitration agreement that waived the right to class proceedings. The arbitration agreement provided that “any and all claims” arising out of his employment were to be submitted to binding arbitration before a neutral arbitrator. The agreement also provided for reasonable discovery, a written award, and judicial review of the award. Costs unique to arbitration, such as the arbitrator’s fee, were to be paid by the employer.

The arbitration agreement contained class and representative action waivers. The waivers read:

[Except as otherwise required under applicable law, (1) EMPLOYEE and COMPANY expressly intend and agree that class action and representative action procedures shall not be asserted, nor will they apply, in any arbitration pursuant to this Policy/Agreement; (2) EMPLOYEE and COMPANY agree that each will not assert class action or representative action claims against the]
other in arbitration or otherwise; and (5) each of EMPLOYEE and COMPANY shall only submit their own, individual claims in arbitration and will not seek to represent the interests of any other person.

The employee also sought to bring a "representative action" under the Labor Code Private Attorneys General Act of 2004 (PAGA) (Lab. Code, § 2698 et seq.). As many California employers know, this statute 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 75 percent of the proceeds of that litigation going to the state. Unlike class arbitration waivers, the court concluded that an arbitration agreement requiring an employee as a condition of employment to give up the right to bring representative PAGA actions in any forum is contrary to public policy and is not preempted by the FAA. The court emphasized that the FAA's goal of promoting arbitration as a means of private dispute resolution, "does not preclude our Legislature from deputizing employees to prosecute Labor Code violations on the state's behalf." Therefore, the FAA does not preempt a state law that prohibits waiver of PAGA representative actions in an employment contract.

Finally, the court held that PAGA does not violate the principle of separation of powers under the California Constitution.

According to a shareholder in the Orange County office of Ogletree Deakins, "The impact of Iskanian is potentially far reaching for employers doing business in California and may depend on how California's trial courts and intermediate appellate courts apply Iskanian. For example, Iskanian left many key practical questions unanswered, some of which employers may seek to address when drafting future arbitration agreements. Specifically, the California Supreme Court did not answer: (1) whether a named claimant's individual wage and hour claims are to be arbitrated at the same time that non-arbitrable PAGA claims proceed in court; (2) if individual wage and hour claims and PAGA claims do not proceed concurrently, whether the employee's PAGA claims should be stayed pending arbitration of his or her individual wage and hour claims or vice versa; (3) whether any determination in arbitration of the employee's individual wage and hour claims will have res judicata effect on pending PAGA claims or vice versa; and (4) whether an employee is "free to forgo" a PAGA claim if an arbitration agreement provides the employee with the voluntary option to do so as opposed to requiring the employee to do so as a condition of employment?

"Trial courts that are mindful of judicial resources may use their discretion to stay litigation of an employee's PAGA claim pending arbitration of the employee's individual wage and hour claims. Resolution of individual claims first could determine whether the individual is an 'aggrieved employee' or 'representative' sufficient to proceed with a PAGA action. In this scenario, an employer may obtain favorable findings during arbitration which would have res judicata effect as to the employee's PAGA claims.

"On the other hand," Nendel-Flores continued, "trial courts that are hostile to arbitration agreements may utilize their discretion to stay arbitration of the employee's individual wage and hour claims pending resolution of the employee's PAGA claim in court. In this scenario, employers could be forced to expend significant fees and costs despite the existence of a valid class action waiver. This is so because most PAGA claims are merely derivative of an employee's underlying wage and hour claims. Put differently, employers in this scenario may be forced to
litigate the merits of the employee’s underlying wage and hour claims (which should be subject to arbitration) just to defend against the employee’s derivative PAGA claims.

“Finally, depending on their overall view of arbitration agreements, California’s trial courts and intermediate appellate courts may be receptive to arbitration agreements where employees are presented with the option to voluntarily forgo PAGA claims as opposed to being required to do so as a condition of their employment.”

With all of this in mind, California employers are advised to incorporate class action arbitration waivers into their arbitration programs. Employers with existing class action arbitration waivers should carefully review those agreements to determine whether the requirements of Iskanian have been met and open questions raised by the court have been addressed. When drafting new agreements or interpreting current agreements, employers should consider the following:

(1) Is there or should there be a class action arbitration waiver? If so, employers may be able to avoid many of the downsides of class arbitration.

(2) If the class action waiver is enforced, then the named plaintiff’s individual claims will stay in arbitration.

(3) Since PAGA representative actions may not be waived in arbitration, does the employer want PAGA claims to be litigated in court? Employers may wish to consider including language specifically stating that PAGA representative actions must be litigated in court (rather than before an arbitrator). Otherwise, employers may be forced to litigate PAGA representative actions before an arbitrator.

(4) Since PAGA and individual wage and hour claims may be in different forums, employers should consider whether they want PAGA claims to be stayed pending arbitration of individual claims. This may be advantageous to employers, and employers may wish to build this order into their agreements.

In addition, employers should continue to audit rigorously their wage and hour practices for compliance with California law. Even though PAGA claims permit employees to retain only 25 percent of the proceeds from such actions, plaintiffs’ counsel will continue to be incentivized to bring PAGA claims due to the attorneys’ fees provisions of PAGA.

Additional Information

This article was written by Douglas Farmer, a shareholder in the San Francisco, California office of Ogletree Deakins and author of California Employment Law: The Complete Survival Guide to Doing Business in California. Should you have any questions about the California Supreme Court decision or need assistance drafting or revising a class action arbitration waiver that complies with the requirements of this case, contact the author, the Ogletree Deakins attorney with whom you normally work, or the Client Services Department at clientservices@ogletreedeakins.com.