California Supreme Court Upholds
Enforceability of Class Action Waivers in
Mandatory Arbitration Agreements

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The California Supreme Court has upheld the use of class action waivers in mandatory arbitration agreements. In Iskanian v. CLS Transportation of Los Angeles (June 23, 2014), the court held that a state’s refusal to enforce class waivers on the grounds of public policy or unconscionability is preempted by the Federal Arbitration Act (FAA).

Companies will generally welcome the decision and likely increase their use of class waivers as a result. Still, Iskanian is somewhat of a mixed bag for employers. Though it eliminates existing uncertainty as to the permissibility of class waivers, it also establishes that the scope of class waivers cannot extend to employee claims brought under the California Private Attorneys General Act of 2004 (PAGA). As a result, employees retain a potent weapon with which to pursue troublesome and costly wage-and-hour lawsuits.

Class Action Waivers Pre-Iskanian

In several recent decisions pre-dating Iskanian, the United States Supreme Court upheld the enforceability of class waivers in arbitration agreements. In AT&T Mobility LLC v. Concepcion, for example, the Court found that the FAA preempted a state law invalidating class waivers. The Supreme Court has “rigorously enforce[d] arbitration agreements according to their terms,” including in those situations where the cost of individually pursuing a federal statutory claim in arbitration will exceed the potential recovery and notwithstanding the fact that the arbitration agreement may have the practical effect of denying an aggrieved party’s effective vindication of his or her federal rights. Absent fraud or duress in the formation of the agreement, or other such grounds as exist at law or in equity for the revocation of any contract, the Court has instructed the lower courts to enforce class action waivers.

Nevertheless, in California, an employer’s ability to enforce a class waiver has been uncertain, and the use of class waivers has been somewhat risky given the potential for invalidating an otherwise enforceable pre-employment mandatory arbitration agreement. Specifically, in its 2007 decision in Gentry v. Superior Court, the California Supreme Court made it clear that a class waiver would be unenforceable where it would lead to a de facto waiver of the statutory right to receive overtime pay and would therefore impermissibly interfere with employees’ ability to vindicate rights and to enforce the overtime laws.

Background

In Iskanian, a former employee brought a class action lawsuit on behalf of himself and other current and former employees, alleging failure to pay overtime and provide meal and rest periods. In addition, Iskanian alleged a representative action under PAGA. The plaintiff, however, had signed a Proprietary Information and Arbitration Policy/Agreement that required him to arbitrate “any and all claims” arising out of his employment. That agreement included an express waiver of class and representative actions, whereby the employee agreed not to assert “class action or representative action claims.”

The employer successfully moved to compel arbitration, and the employee appealed the decision. Before the appeal was heard, the California Supreme Court issued its above-described decision in Gentry. After returning to the lower court, the employer withdrew its motion to compel arbitration.

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Continued on page 2…
arbitration, but later renewed it after the U.S. Supreme Court issued its Concepcion decision generally upholding class action waivers. After the trial court granted the employer’s motion to compel and to dismiss the class claims, the employee appealed the order compelling arbitration.

The Decision

In generally upholding the class waiver at issue, the Iskanian court first addressed its prior Gentry decision. The California Supreme Court determined that in light of the U.S. Supreme Court’s Concepcion and American Express decisions, Gentry could not survive. It determined that Gentry’s rule (prohibiting class waivers if class arbitration is likely to be a significantly more effective means of vindicating the rights of the affected employees than individual litigation or arbitration) had resulted in the lower courts invalidating class waivers on a regular basis. Since Concepcion made it clear that the FAA prevents states from mandating or promoting procedures incompatible with arbitration “even if it is desirable for unrelated reasons,” the court determined that the FAA similarly preempts the Gentry rule.

Also of significance to employers, Iskanian rejected the argument that class waivers violate the National Labor Relations Act (NLRA) as determined by the National Labor Relations Board in D.R. Horton Inc. & Cuda. After analyzing that decision, as well as that of a federal appellate court considering that decision, the court determined that “in light of Concepcion, the Board’s rule is not covered by the FAA’s savings clause,” and that given the FAA’s “liberal federal policy favoring arbitration,” the NLRA sections at issue did not represent “a contrary congressional command” that trumped the FAA’s pro-arbitration mandate.

Finally, the court addressed whether, under the facts of the case, the employer had waived its right to compel arbitration. In rejecting the waiver argument, it concluded that the employer had failed to establish that the employer’s delay in pursuing arbitration was unreasonable, or that the pretrial proceedings that had occurred prior to the employer seeking to compel arbitration of the dispute had caused employee prejudice.

PAGA Claims Do Not Have to Be Arbitrated

The class waiver at issue in Iskanian waived not only class actions but also “representative actions.” Iskanian, therefore, also addressed whether the class waiver required the arbitration of the employee’s PAGA claim. That statute permits employees, acting as private attorneys general, to pursue and recover civil penalties for violations of the California Labor Code. The court found that PAGA authorizes such a “representative action,” explaining that an aggrieved employee’s PAGA action “functions as a substitute for an action brought by the government itself,” and that under PAGA, plaintiffs “act as a proxy or agent of state labor law enforcement agencies.” Iskanian also determined that employers cannot use an employment agreement to eliminate an aggrieved employee’s choice of whether or not to bring a PAGA action by eliminating the choice altogether “by requiring employees to waive the right to bring a PAGA action before any dispute arises.” An agreement that does so, the court stated, “is contrary to public policy and unenforceable as a matter of state law.”

As a result of its PAGA ruling, Iskanian leaves the door open for employees to bring PAGA claims in court on a representative basis.

What Should Employers Do After Iskanian?

Iskanian makes it clear that class waivers generally will be enforced under California law. Given the uncertainty created by the court’s earlier Gentry decision, many employers opted not to include an explicit class waiver, fearing that it might serve to invalidate an otherwise permissible mandatory arbitration agreement or that it might support an unfair competition claim. Those fears are no longer justified. A class waiver, properly drafted, will be enforced in California. As a result, employers should do the following:

- Consider adopting an arbitration agreement if they have not already done so. Iskanian’s endorsement of class waivers may tip the scales for employers who previously decided against mandatory arbitration of employment-related disputes.


Under PAGA, of the civil penalties recovered, 75 percent goes to the Labor and Workforce Development Agency, with the remaining 25 percent going to the aggrieved employees.
California Supreme Court Upholds Enforceability . . .

Continued from page 2...

- Carefully review any arbitration agreements (and related policy statements in handbooks or elsewhere) currently in use to ensure that the agreement is enforceable under applicable law, in particular the court’s requirements in *Amendariz v. Foundation Health Psychcare Services, Inc.*

- Consider adding a class waiver to the employer’s existing mandatory arbitration agreement. Care should be taken not to prohibit a representative action such as that permitted by PAGA. Doing so post-*Iskanian* may reduce significantly the risk of potential class litigation involving wage-and-hour matters (and the potential liability accompanying such actions), as well as class actions for other employment-related claims.

- Confirm that they have a robust system in place to ensure that all employees actually have signed arbitration agreements, and that they are retained appropriately. An employer’s decision to adopt an enforceable arbitration agreement is meaningless if the employer does not ensure that its employees sign the agreement or that it can be found when needed.

- Together with counsel, be vigilant in enforcing an arbitration agreement where circumstances warrant doing so.

Wilson Sonsini Goodrich & Rosati is actively following developments around the country with respect to all aspects of employment and trade secrets law, including arbitration agreements. The firm is available to assist employers with employment and trade secrets litigation and counseling. For more information, please contact Rico Rosales, Marina Tsatalis, Laura Merritt, Charles Tait Graves, or another member of the firm’s employment and trade secrets litigation practice.