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Case Report – October 2014

***Iskanian v. CLS Transportation Los Angeles, LLC*, 59 Cal. 4th 348 (2014), *petition for cert. filed*, No. 14-341 (September 22, 2014).**

The United States Supreme Court has recently been asked to again weigh in on whether the Federal Arbitration Act ("FAA") preempts a state law restricting the enforcement of terms in an arbitration agreement.

On September 22, 2014, CLS Transportation Los Angeles, LLC ("CLS") petitioned the highest judicial body in the United States for a writ of certiorari to review the California Supreme Court's June 23, 2014 decision – finding that Private Attorneys General Act ("PAGA") claims cannot be waived in connection with an employment arbitration agreement because the employee is acting as a proxy for the state in bringing the PAGA claims.

Notwithstanding the U.S. Supreme Court's almost incessant enforcement of the FAA, has the California Supreme Court found the FAA to have a soft underbelly?

Because arbitration provisions encompass much of our day-to-day activities as franchise practitioners – both in litigation and drafting – the California Supreme Court's analysis and narrowing of the all-encompassing FAA, followed by CLS's subsequent petition to the U.S. Supreme Court, provides us with a solid case study for review and discussion.

Relevant Factual Background

A. The Employment Relationship and Arbitration Agreement

CLS is a limousine service company. From March 2004 to August 2005, Respondent Arshavir Iskanian worked as a chauffeur for CLS. During his employment, Iskanian entered into a "Proprietary Information and Arbitration Policy/Agreement" as part of a $1,350 settlement with CLS.

The arbitration agreement provided that "any and all claims" arising out of the employment relationship would be submitted to binding arbitration before a neutral arbitrator, and that the arbitration "shall be governed by and construed and enforced pursuant to the Federal Arbitration Act […] and not individual state laws regarding enforcement of arbitration agreements." Also, by accepting the settlement amount and entering into the arbitration agreement, Iskanian agreed to waive his right to participate in class and representative actions.

B. Iskanian Files Class Action Lawsuit

Notwithstanding the arbitration agreement or class action waiver, on August 4, 2006, Iskanian filed a class action lawsuit against CLS in California Superior Court. The lawsuit asserted various wage and hour and business expense reimbursement claims. In response, CLS moved to compel arbitration pursuant to the parties' agreement. The trial court agreed, issuing an order compelling arbitration. Iskanian appealed.

C. California Supreme Court Decides *Gentry v. Superior Court*

While Iskanian's appeal was pending, the California Supreme Court decided *Gentry v. Superior Court* [1] ("*Gentry*") – finding that class action waivers in arbitration agreements were unenforceable under California law if "a 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." [2]

In light of the California Supreme Court's ruling in *Gentry*, on May 27, 2008, the Court of Appeal in *Iskanian* issued a writ of mandate directing the trial court to reconsider its order compelling arbitration. On remand, CLS conceded that its motion to compel arbitration would not be successful under the test set forth in *Gentry* and voluntarily withdrew its motion. The case was then allowed to move forward in the Superior Court.

[1] *Gentry v. Superior Court*, 42 Cal. 4th 443 (2007).
[2] *Id*. at 463.

D. Iskanian Commences Separate Lawsuit Under California Private Attorneys General Act of 2004 ("PAGA") [3]

On November 21, 2007, while his appeal was stalled out in the Court of Appeal, Iskanian filed a separate, representative action under the PAGA alleging violations of the California Labor Code. In short, the PAGA authorizes an employee to pursue a civil action on behalf of the state against the employer for Labor Code violations committed against the employee and fellow employees, with most of the recovery of the lawsuit going to the state.[4] Both lawsuits were later consolidated and, on September 15, 2008, Iskanian filed a consolidated first amended complaint.

After engaging in some discovery, Iskanian moved to certify the class, and CLS opposed the motion. On October 29, 2009 – more than three years after the initial complaint was filed – the trial court granted Iskanian's motion to certify the class.

E. The U.S. Supreme Court Decides *AT&T Mobility v. Concepcion* [5] ("*Concepcion*")

On April 27, 2011, while *Iskanian* was still tolling around at the trial court level, the U.S. Supreme Court issued a ruling on *Concepcion* – finding that class action waivers in arbitration agreements are enforceable under the Federal Arbitration Act ("FAA"). As part of its rationale, the Court found 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."[6]

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[3] California Labor Code § 2698 *et seq.*

[4] *Iskanian v. CLS Transportation Los Angeles, LLC*, 59 Cal. 4th 348, 360 (2014); *see also, Arias v. Superior Court*, 46 Cal.4th 969, 980-81 (2009)("In September 2003, the Legislature enacted the Labor Code Private Attorneys General Act of 2004 […]. The Legislature declared that adequate financing of labor law enforcement was necessary to achieve maximum compliance with state labor laws, that staffing levels for labor law enforcement agencies had declined and were unlikely to keep pace with the future growth of the labor market, and that it was therefore in the public interest to allow aggrieved employees, acting as private attorneys general, to recover civil penalties for Labor Code violations, with the understanding that labor law enforcement agencies were to retain primacy over private enforcement efforts.")(Internal citations omitted).

[5] AT&*T Mobility LLC v. Concepcion*, 131 S. Ct. 1740 (2011)(internal citations omitted).

[6] *Iskanian v. CLS Transportation Los Angeles*, *LLC*, 59 Cal. 4th at 364 (citing AT&*T Mobility LLC v. Concepcion*, 131 S. Ct. at 1753).

The Court's decision in *Concepcion* explicitly overruled *Discover Bank v. Superior Court* [7] ("*Discover Bank*") – the decision upon which *Gentry* was based.

Following the Court's decision in *Concepcion*, on May 16, 2011, CLS renewed its motion to compel individual arbitration of Iskanian's claims. The motion to compel was again granted by the trial court and the class claims were dismissed with prejudice. Iskanian's second appeal ensued.

F. The California Court Of Appeal Affirms Order Compelling Arbitration and Dismissing Class Claims

On June 4, 2012, California's intermediate appellate court unanimously affirmed the trial court's order compelling arbitration, concluding that *Concepcion* invalidated *Gentry*. In its ruling, the court held that the FAA precludes state laws that withdraw claims from arbitration, requiring Iskanian's PAGA claims to be arbitrated individually. Also of note, the court declined to follow a National Labor Relations Board ("NLRB") ruling that class action waivers in employment adhesion contracts violate the National Labor Relations Act.

Thereafter, Iskanian petitioned the California Supreme Court for review. The court granted his petition.

G. Iskanian's Arguments Before The California Supreme Court

On appeal, Iskanian raised four primary arguments before the California Supreme Court. The arguments are summarized as follows:

First, Iskanian argued that *Gentry* survived *Concepcion* (and is therefore not preempted by the FAA) because *Gentry*, unlike *Discover Bank*, was not a categorical rule against class action waivers.[8] Instead, "*Gentry* held only that when a statutory right is unwaivable because of its 'public importance,' banning class actions would 'in some circumstances' 'lead to a de facto waiver and would impermissibly interfere with employees' ability to vindicate unwaivable rights and to enforce the laws.'" [9]

Second, Iskanian argued that even if *Gentry* was preempted by the FAA, the class action waiver is invalid under the decision of the NLRB in *In re D.R.*

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[7] *Discover Bank v. Superior Court*, 36 Cal. 4th 148 (2005).

[8] *Iskanian v. CLS Transportation Los Angeles, LLC*, 59 Cal. 4th 348, 363 (2014)(citing *Brewer v. Missouri Title Loans*, 364 S.W.3d 486, 489, 494 (Mo. 2012).

[9] *Iskanian v. CLS Transportation Los Angeles, LLC*, 59 Cal. 4th at 363 (internal citation omitted).

Horton Inc.[10] – which found that the National Labor Relations Act "generally prohibits contracts that compel employees to waive their rights to participate in class proceedings to resolve wage claims."[11]

Third, Iskanian argued that CLS had waived its right to compel arbitration "by failing to diligently pursue arbitration" and, instead, chose to pursue substantial pre-trial discovery.[12]

Finally, because the arbitration agreement at issue required Iskanian to waive not only class actions but also "representative actions" – *i.e.*, representative actions brought under the PAGA – Iskanian argued that the FAA does not preempt such representative state law claims.[13]

H. The California Supreme Court Issues Controversial Ruling

On June 23, 2014, the California Supreme Court issued a controversial – and split – decision that appears to have strengthened the enforceability of class action waivers in arbitration agreements under the FAA, but then unexpectedly carved out an exception for state representative actions. In a majority opinion written by Justice Goodwin Liu, California's highest court addressed Iskanian's four arguments as follows:

First, the court nearly summarily disposed of Iskanian's first argument finding that, "the fact that *Gentry's* rule against class waiver is stated more narrowly than *Discover Bank's* rule does not save it from FAA preemption under *Conception.*"[14] Instead, "*Concepcion* holds that *even* if a class waiver is exculpatory in a particular case, it is nonetheless preempted by the FAA."[15] Therefore, "in light of *Concepcion*," the court found that the FAA preempted *Gentry*.[16]

Next, the court, again "in light of *Concepcion*," overruled the NLRB's contrary finding that arbitration agreements may not require an employee to "forgo the substantive rights afforded by the statute."[17] Similarly, the court found that the National Labor Relations Act did not take precedence over the FAA with

[10] In re D.R. Horton Inc., 2012 NLRB LEXIS 11 (Jan. 3, 2012).
[11] *Iskanian v. CLS Transportation Los Angeles, LLC*, 59 Cal. 4th at 3367-368.
[12] *Id.*, p. 374.
[13] *Id.*, p. 377.
[14] *Id.*, p. 364.
[15] *Id*.
[16] *Id.*, p. 366.
[17] *Iskanian v. CLS Transportation Los Angeles, LLC*, 59 Cal. 4th at 372.

respect to the enforceability of class action waivers in employment arbitration agreements.[18]

Third, after conducting a thorough waiver analysis, the court rejected Iskanian's third argument, concluding that CLS had not engaged in any unreasonable or unjustified conduct that resulted in any substantial expense or delay. Instead, the court found that CLS's participation in pretrial litigation did not cause it to waive its right to arbitrate "when a later change in the law permits arbitration."[19]

Finally, and most notably, the court addressed Iskanian's PAGA argument. After first analyzing the legislative history giving rise to private civil actions under the PAGA, the court then examined whether an employee's right to bring a PAGA action is waivable under California law. Relying upon California Civil Code §§ 1668 and 3513 – codifying California's public policy against waving certain legal rights – the court concluded that, an employment agreement that compels the waiver of representative claims under the PAGA "is contrary to public policy and unenforceable as a matter of state law."[20]

The court also found that a PAGA litigant's status as the agent for the state "is not merely semantic; it reflects a PAGA litigant's substantive role in enforcing our labor laws on behalf of state law enforcement agencies."[21] As a claim brought on behalf of a state agency, a PAGA action is not preempted by the FAA because the FAA "aims to ensure an efficient forum for the resolution of *private* disputes, whereas, a PAGA action is a dispute between an employer and the state Agency."[22] Citing to the FAA's legislative history and the U.S. Supreme Court's FAA jurisprudence, the court concluded that the FAA was intended for "private disputes," and not to circumvent actions by a public enforcement agency.[23]

In sum, the California Supreme Court held that Iskanian's class action claims must be arbitrated while the PAGA action could go forward in Superior Court. As mentioned above, on September 22, 2014, CLS petitioned the U.S. Supreme Court for a writ of certiorari to review the California Supreme Court's decision as it relates to the PAGA claim.

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[18] *Id.*
[19] *Id.*, p. 377.
[20] *Id.*, p. 384.
[21] *Id.*, p. 387.
[22] *Id.*, p. 384 (emphasis in original).
[23] *Id.*, pp. 386-387.

Issues Before The U.S. Supreme Court

Generally, CLS argues that California has purportedly created a statue that gives rise to a private right of action that is immune from the preemptive sweep of the FAA. Under the court's analysis, "in order to avoid FAA preemption, all a state need do is 'deputize' its citizens to sue private parties notwithstanding valid arbitration agreements to the contrary."[24] For purposes of the petition, CLS has narrowed its arguments to the following six points:

First, CLS argues that, under *Concepcion*, the FAA preempts all state laws, including California's laws that purport to render the waiver of the PAGA action unenforceable.[25] The fact that the employee must split any recovered penalties with the State does not change this analysis. "[A]nything a state legislature does is supposedly for a public reason. Such is not enough to avoid scrutiny under the FAA."[26] Absent arbitration of all claims, "the majority opinion leads to the absurd result that part of the case is arbitrated while the PAGA representative claim for civil penalties is separately litigated."[27]

Second, CLS argues that an employee's waiver in an arbitration agreement of a collective or "representative action" under the PAGA is not so distinguishable from a "class action" waiver that it is immune from the otherwise preemptive effect of the FAA.[28] In other words, there "is no principal difference" between a class action and a representative action under PAGA" – thus, the court was wrong in treating them differently in its application of the FAA.[29]

Third, CLS argues that the PAGA action is not "a type of qui tam action" – *i.e.*, an action that cannot be waived by an arbitration agreement under the premise that, "a law established for a public reason cannot be contravened by a private agreement."[30] Again, CLS contends that all state laws are predicated on a public reason, and the Court has never wavered from finding such laws invalid when they frustrate the FAA.

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[24] Iskanian v. CLS Transportation Los Angeles, LLC, 59 Cal. 4th 348 (2014), petition for cert. filed, No. 14-341, p. 15 (September 22, 2014).
[25] *Id.*, p. 16.
[26] *Id.*
[27] *Id.*, pp. 19-20.
[28] Iskanian v. CLS Transportation Los Angeles, LLC, 59 Cal. 4th 348 (2014), petition for cert. filed, No. 14-341, p. i (September 22, 2014).
[29] *Id.*, p. 20.
[30] *Id.*, p. 22.

Fourth, CLS argues that, even if the PAGA action is a "qui tam action," Congress has not allowed for a PAGA exception to the FAA.[31] Until Congress has decided otherwise, PAGA – as a "qui tam action" or not – is preempted by the FAA.

Fifth, citing to numerous California District Court cases, CLS argues that the federal courts strongly disagree with the California Supreme Court's decision for the various reasons stated above.[32]

Finally, CLS petitions the Court to overturn the California court's decision under the principle that the "state proxy" distinction will encourage other states to enact legislation that undermines the FAA.[33]

While we will likely have to wait for some time before hearing from the Court, the California Supreme Court's decision shows that – even in light of *Concepcion* – the debate concerning the breadth of the FAA is alive and well.

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[1] *Gentry v. Superior Court*, 42 Cal. 4th 443 (2007).
[1] *Id*. at 463.
[1] California Labor Code § 2698 *et seq.*
[1] *Iskanian v. CLS Transportation Los Angeles, LLC*, 59 Cal. 4th 348, 360 (2014); *see also, Arias v. Superior Court*, 46 Cal.4th 969, 980-81 (2009)("In September 2003, the Legislature enacted the Labor Code Private Attorneys General Act of 2004 […]. The Legislature declared that adequate financing of labor law enforcement was necessary to achieve maximum compliance with state labor laws, that staffing levels for labor law enforcement agencies had declined and were unlikely to keep pace with the future growth of the labor market, and that it was therefore in the public interest to allow aggrieved employees, acting as private attorneys general, to recover civil penalties for Labor Code violations, with the understanding that labor law enforcement agencies were to retain primacy over private enforcement efforts.")(Internal citations omitted).
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[1] *Discover Bank v. Superior Court*, 36 Cal. 4th 148 (2005).

[31] *Id.*, p. 24-25.
[32] *Id.*, p. 26.
[33] *Id.*, p. 29.

[1] *Iskanian v. CLS Transportation Los Angeles, LLC*, 59 Cal. 4th 348, 363 (2014)(citing *Brewer v. Missouri Title Loans*, 364 S.W.3d 486, 489, 494 (Mo. 2012).
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[1] *Id.*, p. 374.
[1] *Id.*, p. 377.
[1] *Id.*, p. 364.
[1] *Id*.
[1] *Id.*, p. 366.
[1] *Iskanian v. CLS Transportation Los Angeles, LLC*, 59 Cal. 4th at 372.
[1] *Id.*
[1] *Id.*, p. 377.
[1] *Id.*, p. 384.
[1] *Id.*, p. 387.
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[1] *Id.*, p. 20.
[1] *Id.*, p. 22.
[1] *Id.*, p. 24-25.
[1] *Id.*, p. 26.
[1] *Id.*, p. 29.