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WHAT'S INSIDE

ARBITRATION

Real estate agent must arbitrate wage claims, California appeals court says

A California man's claims that he and other real estate agents were misclassified as independent contractors are subject to arbitration under a brokerage firm's agent contract because the claims arise from the agreement, a state appeals court has ruled.

Galen v. Redfin Corp., No. A138642, 2014 WL 3564056 (Cal. Ct. App., 1st Dist. July 21, 2014).

The 1st District Court of Appeal also said defendant Redfin Corp.'s agreement requiring arbitration of employment disputes is not unconscionable and should be enforced, reversing a trial court's denial of the company's motion to compel arbitration.

Attorney **Ronald Novotny** of **Atkinson, Andelson, Loya, Ruud & Romo** in Cerritos, Calif., who was not involved in the case, said the decision is significant.

"It is one of the first cases in which a California appellate court has required a contractor to actually arbitrate such a claim against the company that he contends is his employer, as opposed to invalidating the arbitration agreement on unconscionability grounds," Novotny said.

He applauded the ruling when compared with two other recent decisions out of the state's appeals courts: *Hoover v. American Income Life*, 206 Cal. App. 4th 1193 (Cal. Ct. App., 4th Dist. 2012), and *Elijahjuan v. Superior Court*, 210 Cal. App. 4th 15 (Cal. Ct. App., 2d Dist. 2012).

REUTERS/Jonathan Ernst

The lawsuit claims a real estate brokerage company misclassified its workers as independent contractors rather than as real estate agents in order to avoid some California labor laws.

"It is a welcome relief from the *Hoover* and *Elijahjuan* cases, which bent over backwards to save so-called 'employees' from having to

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COMMENTARY

Class-action waivers in employment arbitration agreements are now permissible in California

Leo V. Leyva of Cole, Schotz, Meisel, Forman & Leonard, co-counsel for the defendant in a recent California Supreme Court ruling, with colleagues Randi W. Kochman and Michael N. Morea, review the decision in favor of individual arbitration in employment contracts and discuss its impact on the state's workforce.

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Class-action waivers in employment arbitration agreements are now permissible in California

By Leo V. Leyva, Esq., Randi W. Kochman, Esq., and Michael N. Morea, Esq.
Cole, Schotz, Meisel, Forman & Leonard

California has long had a well-deserved reputation as a pro-employee state through both its statutory laws and judicial doctrines. In *Iskanian v. CLS Transportation of Los Angeles LLC*, 59 Cal. 4th 348 (Cal. June 23, 2014), California employers obtained a rare victory when the state Supreme Court held that the Federal Arbitration Act, 9 U.S.C. § 1, and U.S. Supreme Court precedent preempted California's judicially created prohibition of class-action waivers in employment agreements, which was enunciated in *Gentry v. Superior Court*, 42 Cal. 4th 443 (Cal. 2007).

However, the California Supreme Court has held that arbitration agreements requiring employees to give up their rights under the state Private Attorneys General Act, Cal. Lab. Code § 2698, remain unenforceable as contrary to public policy.

To a certain extent, *Iskanian* now provides some certainty as to the enforceability of certain class-action waivers in California.

REUTERS/Paul Sakuma/Pool

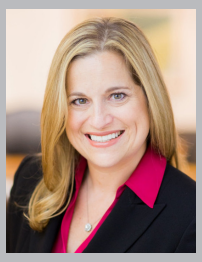
A recent California Supreme Court decision provides some certainty as to the enforceability of certain class-action waivers in California, write Leo V. Leyva, Randi W. Kochman and Michael N. Morea. Here, the court hears oral argument in a 2008 case.

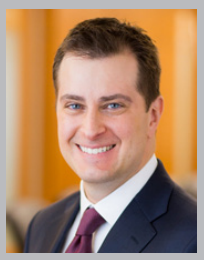
THE LAW ON CLASS-ACTION WAIVERS UNFOLDS

Arshavir Iskanian worked as a limousine driver for CLS Transportation of Los Angeles from March 2004 through August 2005. In connection with his employment, he signed a "proprietary information and arbitration policy/agreement." The agreement contained broad language, providing for arbitration of "any and all disputes" arising from the parties' employment relationship. The agreement further provided that the parties waived their right to participate in class or representative actions, stating that:

> [E]xcept 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 (3) 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.

Despite the arbitration agreement and class-action waiver, Iskanian filed a putative class-action complaint against CLS on Aug. 4, 2006, alleging that CLS "failed to pay overtime, provide meal and rest breaks, reimburse business expenses, provide accurate and complete wage statements, or pay final wages in a timely manner" in violation of California law. *Iskanian,* 59 Cal. 4th at *2. CLS answered the complaint and moved to compel arbitration relying upon the arbitration agreement. The trial court granted the company's motion in March





Leo V. Leyva (L) is the co-chair of the litigation department of **Cole, Schotz, Meisel, Forman & Leonard** in Hackensack, N.J., and co-counsel of record for CLS Transportation with David Faustman of Fox Rothschild LLP in the case of *Iskanian v. CLS Transportation of Los Angeles*. **Randi W. Kochman** (C) is a member and the chair of Cole Schotz's employment law department. **Michael N. Morea** (R) is special counsel in the firm's employment law department.

2007, and Iskanian filed a timely appeal of the order to the 2nd District Court of Appeal.

During the pendency of the appeal but before the Court of Appeal rendered a decision, the California Supreme Court decided *Gentry,* invalidating a class-action waiver in an employment contract.

Although *Gentry* did not create a blanket prohibition against class-action waivers, it held that such waivers are invalid if "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 and ... the disallowance of the class action will likely lead to a less comprehensive enforcement of ... laws for the employees alleged to be affected by the employer's violations." *Gentry,* 42 Cal. 4th at 463. *Gentry* subsequently "regularly resulted in invalidation of class waivers." *Iskanian*, at *6.

In light of the *Gentry* decision, the Court of Appeal issued a writ of mandate directing the trial court to reconsider its ruling. Based upon *Gentry*'s broad prohibition of class-action waivers, CLS voluntarily withdrew its motion to compel arbitration, and the parties proceeded with the litigation. Iskanian amended his complaint Sept. 18, 2008, to include, among others, a claim under the Private Attorneys General Act. Iskanian later moved for class certification, which the trial court granted Oct. 29, 2009.

As the litigation closed in on five years, another decision drastically altered the landscape of class lawsuits, namely the April 27, 2011, decision by the U.S. Supreme Court in *AT&T Mobility v. Concepcion*, 131 S. Ct. 1740 (2011).

Concepcion invalidated the rule created by the California Supreme Court in *Discover Bank v. Superior Court*, 36 Cal. 4th 148 (2005), which prohibited class-action waivers in consumer arbitration agreements as being unconscionable and, thus, unenforceable.

In the *Discover Bank* rule, the California Supreme Court held that class-action waivers in arbitration agreements were invalid:

> [w]hen the waiver is found in a consumer contract of adhesion in a setting in which disputes between the contracting parties predictably involve small amounts of damages, and when it is alleged that the party with the superior bargaining power has carried out a scheme to deliberately cheat large numbers of consumers out of individually small sums of money.

Discover Bank, 36 Cal.4th at 162.

The U.S. Supreme Court held that the *Discover Bank* rule "'stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress' [in enacting the Federal Arbitration Act] ... [and] is preempted by the FAA." *Concepcion*, 131 S. Ct. at 1753 (*quoting Hines v. Davidowitz*, 61 S. Ct. 399 (1941)).

Relying on *Concepcion*, CLS moved in May 2011 to dismiss the class claims and renewed its motion to compel individual arbitration. The trial court granted CLS' motion, dismissing the class claims with prejudice and ordering individual arbitration of Iskanian's and the other class plaintiffs' claims. Iskanian appealed the trial court's order, while 61 of the former class members pursued individual arbitration of their claims.

The Court of Appeal affirmed the lower court's ruling. Iskanian continued his appeal to the California Supreme Court, which granted review.

Federal Arbitration Act, 9 U.S.C. § 2

A written provision in any maritime transaction or a contract evidencing a transaction involving commerce to settle by arbitration a controversy thereafter arising out of such contract or transaction, or the refusal to perform the whole or any part thereof, or an agreement in writing to submit to arbitration an existing controversy arising out of such a contract, transaction, or refusal, shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract.

CLS DEFENDS THE APPEALS COURT'S DECISION

Iskanian proffered four principal arguments seeking reversal of the Court of Appeal's decision:

- *Concepcion* did not preempt *Gentry.*
- Even if *Gentry* were preempted by the Federal Arbitration Act, the class-action waiver is invalid under the National Labor Relations Act, 29 U.S.C. § 151.
- CLS waived its right to arbitration.
- The FAA did not preempt Iskanian's PAGA claim.

In *Iskanian,* the state Supreme Court held that the Federal Arbitration Act and U.S. Supreme Court precedent preempted California's judicially created prohibition of class-action waivers in employment agreements.

In its decision, the state Supreme Court first addressed Iskanian's argument that *Gentry* survived *Concepcion*. Iskanian argued that *Gentry*, unlike *Discover Bank*, was not a categorical rule and thus distinguishable. *Iskanian,* 59 Cal. 4th at *4.

According to Iskanian, *Concepcion* invalidated the *Discover Bank* rule because *Discover Bank* was a categorical rule that applied to all consumer cases. Iskanian argued that the narrower *Gentry* rule was not preempted because the *Gentry* prohibition applied only when the "class-action ban would result in a waiver of substantive rights." *Id.* However, the California Supreme Court rejected Iskanian's argument, noting "*Concepcion* holds that *even if* a class waiver is exculpatory in a particular case, it is nonetheless preempted by the FAA." *Id.*

The court also rejected Iskanian's argument that the class-action waiver in the arbitration agreement violated the National Labor Relations Act. Iskanian relied upon the National Labor Relations Board's decision in *D.R. Horton Inc. v. Cuda,* 2012 WL 36274 (2012), that the NLRA generally prohibits waivers of employees' rights to participate in class-action wage-and-hour proceedings.

The California Supreme Court rejected the NLRA argument, noting the 5th U.S. Circuit Court of Appeals, in *D.R. Horton Inc. v. NLRB*, 737 F.3d 344 (5th Cir. 2013), relying on *Concepcion*, "recently refused to enforce that portion of the NLRB's opinion."

The state Supreme Court found that in light of *Concepcion*, the FAA preempted the NLRB's rule prohibiting waivers of class-action wage and hour claims.

Next, the California Supreme Court addressed Iskanian's argument "that CLS waived its right to arbitration by failing to diligently pursue arbitration." *Iskanian,* 59 Cal. 4th at 13. In rejecting this argument, the court found that any "delay was reasonable in light of the state of the law at the time and Iskanian's own opposition to arbitration." *Id*. at *15. The court went on to explain that:

> Where, as here, a party promptly initiates arbitration and then abandons arbitration because it is resisted by the opposing party and foreclosed by existing law, the mere fact that the parties then proceed to engage in various forms of pretrial litigation does not compel the conclusion that the party has waived its right to arbitrate when a later change in the law permits arbitration.

Id.

Finally, the California Supreme Court addressed Iskanian's PAGA argument. After analyzing PAGA's legislative history, the court concluded "[a] PAGA representative action is ... a type of *qui tam* action." *Id.* at *19.

California Private Attorneys General Act of 2004

California Labor Code § 2699

(a) Notwithstanding any other provision of law, any provision of this code that provides for a civil penalty to be assessed and collected by the Labor and Workforce Development Agency or any of its departments, divisions, commissions, boards, agencies, or employees, for a violation of this code, may, as an alternative, be recovered through a civil action brought by an aggrieved employee on behalf of himself or herself and other current or former employees pursuant to the procedures specified in Section 2699.3.

§ 2699.3

(a) A civil action by an aggrieved employee pursuant to subdivision (a) or (f) of Section 2699 alleging a violation of any provision listed in Section 2699.5 shall commence only after the following requirements have been met:

(1) The aggrieved employee or representative shall give written notice by certified mail to the Labor and Workforce Development Agency and the employer of the specific provisions of this code alleged to have been violated, including the facts and theories to support the alleged violation.

(2)(A) The agency shall notify the employer and the aggrieved employee or representative by certified mail that it does not intend to investigate the alleged violation within 30 calendar days of the postmark date of the notice received pursuant to paragraph (1). Upon receipt of that notice or if no notice is provided within 33 calendar days of the postmark date of the notice given pursuant to paragraph (1), the aggrieved employee may commence a civil action pursuant to Section 2699.

After concluding that an agreement waiving PAGA representative rights violates state law, the majority in *Iskanian* then analyzed whether the Federal Arbitration Act preempted that rule. They found there was no FAA preemption because the FAA governs private disputes while PAGA "is a dispute between an employer and the *state*, which alleges directly or through its agents — either the Labor and Workforce Development Agency or aggrieved employees — that the employer has violated the Labor Code." *Id*.

The *Iskanian* court found that, in light of the U.S. Supreme Court's *Concepcion* decision, the Federal Arbitration Act preempted the NLRB's rule prohibiting waivers of class-action wage-and-hour claims.

The court further concluded that in a PAGA action, "[t]he government on whose behalf the plaintiff files suit is always the real party in interest in the suit." *Id.* Consequently, the court held that "an employment agreement [which] compels the waiver of representative claims under the PAGA, is contrary to public policy and unenforceable as a matter of state law." *Id*. at 21.

In reaching these conclusions, the California Supreme Court relied partly upon PAGA permitting a plaintiff to recover civil penalties as opposed to the statutory damages that would be available to a plaintiff in a private action and that 75 percent of any civil penalties recovered in a PAGA case "go to the state's coffers." *Id.* at *23.

Thus, the majority found that "California's public policy prohibiting the waiver of PAGA claims ... does not interfere with the FAA's goal of promoting arbitration as a forum for private dispute resolution." *Id*. at 24. The majority believed they found support in the U.S. Supreme Court decision of *EEOC v. Waffle House Inc.*, 122 S.Ct. 754 (2002), in which the court found the Equal Employment Opportunity Commission was not bound by the terms of an employee's arbitration agreement with his employer.

Justice Ming W. Chin (with Justice Marvin R. Baxter concurring) agreed with the majority on the PAGA issue, but did not agree with the majority's analysis that PAGA falls outside the FAA's scope.

The concurring opinion agreed that the arbitration agreement's waiver of representative actions was unenforceable as it related to PAGA. However, according to Justice Chin, the problem with the arbitration agreement lay with the fact that it prohibited the plaintiff from asserting his PAGA rights in any forum. Justice Chin explained that in his view, that broad waiver prevented Iskanian from enforcing his statutory PAGA rights, so the waiver fell within the FAA's exception for arbitration agreements that preclude the assertion of statutory rights. *Iskanian,* 59 Cal. 4th at 29.

Thus, Justices Chin and Baxter found that although the FAA governed the PAGA waiver, it was unenforceable. Significantly, the concurring opinion disagreed with the majority that *Waffle House* supported the majority's decision, noting that in *Waffle*

House, the EEOC was not a party to the arbitration agreement in question and could not be bound by the agreement's terms under the FAA. *Id.* at *30.

THE IMPACT OF *ISKANIAN* ON CALIFORNIA EMPLOYERS

Iskanian is a significant victory for employers in California. It clarifies that most class-action waivers in employment arbitration agreements are enforceable.

Although the *Iskanian* decision left open employees' ability to bring PAGA actions on a class-wide basis, many employers, including CLS, contend the issue should be subject to further review by the U.S. Supreme Court. CLS intends to appeal the ruling as to PAGA because the *Iskanian* majority's reasoning and concurring opinions leave many issues open for review.

First, the court's contention that PAGA was a dispute between the state and an employer (and not between private parties) appears subject to challenge. In the concurring opinion, Justice Chin noted the majority's conclusion that PAGA is not a dispute between an employer and an employee was "novel" as the statute clearly requires "employment." Of course, the employment relationship the statute expressly requires for a PAGA claim would lead to the conclusion that the FAA, which governs relationships between private parties, preempts PAGA.

The majority's finding that a PAGA action is akin to a *qui tam* action and for that reason, cannot be waived as a matter of public policy, is also subject to challenge. Unlike a typical *qui tam* action, in a PAGA claim the employee is entitled to retain 25 percent of any amounts recovered. Moreover, as the majority itself recognizes, there is no authority definitively holding that *qui tam* actions are outside the scope of the FAA as the Supreme Court's FAA jurisprudence is limited to private disputes. In fact, *Waffle House* relied upon by the majority as not supporting the claim that the FAA preempts a PAGA action, presents a distinct situation as it involved the EEOC as a party and not as an employee signing an arbitration agreement.

Even if PAGA remains a viable avenue for representative litigation, either due to lack of Supreme Court review or an affirmation of the California Supreme Court's ruling regarding PAGA, it remains unclear how attractive PAGA claims will be to potential plaintiffs. As the court noted, under PAGA an employee-plaintiff seeks to recover "civil penalties, 75 percent of which will go the state's coffers." *Id.* at *23. WJ