Can Private Attorney General Actions Be Forced Into Arbitration?

By Marc D. Alexander

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The Arbitration Juggernaut

Professor Imre Szalai, in his recent history of arbitration in the United States, *Outsourcing Justice: The Rise of Modern Arbitration Laws in America* (2013), has shown that progressive reform efforts to expand the use of arbitration in the early 20th century, culminating in the Federal Arbitration Act of 1925 (FAA), contemplated a speedy, efficient, final, and binding method to resolve disputes between merchants. But arbitration has expanded since 1925 to include disputes with employees, disputes with consumers, and small disputes between parties other than merchants.

This expansion has led to an ongoing push and pushback where businesses have used arbitration as a means to reduce or eliminate class actions by inserting class action waivers into their agreements, channeling employee and consumer grievances into arbitration where individual claims only will be resolved. They have been aided by the United States Supreme Court, which has made it clear that arbitration clauses governed by the FAA are to be enforced wherever possible. Plaintiffs' attorneys and state courts (notably California's) have pushed back, scrutinizing arbitration agreements for fairness under unconscionability standards.

The most recent "pushback" involves actions brought under California's Private Attorney General Act of 2004 (PAGA), providing employees with a private representative right of action, and allowing them to collect penalties, 75% of which go to the Labor and Workforce Development Agency, and 25% of which go to the private attorney general.

Before considering PAGA's future in light of FAA preemption, let's step

back and review some milestones affecting arbitration in California.

— California Arbitration Milestones —

In 2005, the Supreme Court ruled in *Discover Bank v. Superior Court* (2005) 36 Cal.4th 148, 153 that "under some circumstances, the law in California is that class action waivers in consumer contracts of adhesion are unenforceable, whether the consumer is being asked to waive the right to class action litigation or the right to class-wide arbitration."

In 2007, the Supreme Court extended the consumer contract limitations on class-wide arbitration to certain workplace arbitration agreements. *Gentry v. Superior Court* (2007) 42 Cal.4th 443. *Gentry* considered "whether class arbitration waivers in employment arbitration agreements may be enforced to preclude class arbitrations by employees whose statutory rights to overtime pay pursuant to Labor Code sections 500 et seq. and 1194 allegedly have been violated." The Court concluded, "at least in some cases, the prohibition of classwide relief would undermine the vindication of the employees' unwaivable statutory rights and would pose a serious obstacle to the enforcement of the state's overtime laws. Accordingly, such class arbitration waivers should not be enforced if a trial court determines…that class arbitration would be a significantly more effective way of vindicating the rights of affected employees than individual arbitration." (*Id.* at 450.)

In quick succession, the United States Supreme Court expanded the role of arbitration, potentially if not actually undercutting limitations California placed upon waivers of classwide arbitration.

The most significant case was *AT&T Mobility v. Concepcion* (2011) 131 S.Ct. 1740, where five justices expressly overruled *Discover Bank*, holding that class action waivers in consumer contracts are not per se unconscionable. In addition, the Court ruled that silence about class arbitration in an arbitration does not result in class action arbitration (*Stolt Nielsen S.A. v. AnimalFeeds Int'l Corp.* (2010) ____); that the FAA preempts the public policy of a state barring predispute arbitration agreements that apply to claims of personal injury or wrongful death against nursing homes (*Marmet Health Care Center, Inc. v. Brown* (2012) 132 S.Ct. 1201); and that a contractual waiver of class arbitration is enforceable under the FAA even when the plaintiff's cost of individually arbitrating a federal statutory claim exceeds the potential recovery. (*American Express Co. v. Italian Colors Restaurant* (2013) 133 S.Ct. 2304.)

In addition to *Discover Bank* and *Gentry*, other California cases have run counter to the U.S. Supreme Court's trend. For example, the California Supreme Court carved out the so-called "*Broughton-Cruz*" rule, relying on a public interest exception to compelled arbitration. Under that rule, arbitration provisions

were unenforceable if they required arbitration of Unfair Competition Law, False Advertising Law, or Consumer Legal Remedies Act injunctive relief claims brought for the public's benefit.

However, the Fourth District, Division 3, has now held that *Concepcion* preemption sweeps away the earlier *Broughton-Cruz* public interest exception, while taking pains to distinguish between that public interest exception, and the exception to PAGA arbitration of representative claims. (*McGill v. Citibank* (2014) 232 Cal.App.4th 753.) The nub of the explanation is that while the statutes that were subject to the *Broughton-Cruz* exception are to some extent private attorney general schemes, the state's role is more prominent in the case of PAGA, and the civil penalties accrue directly to the state. The PAGA dispute is between the state and the employer, and the employee acts as a proxy for the state, unable to waive the state's enforcement scheme. The final determination of the fate of the *Broughton-Cruz* rule will be made by the California Supreme Court, which granted review of McGill on April 1.

__ *Iskanian*: Most Recent __ Example of the Push/Pushback

Enter *Iskanian v. CLS Transportation Los Angeles* (2014) 59 Cal.4th 348. In *Iskanian*, the employee and employer waived the right to assert class action and representative action claims against each other, in arbitration or otherwise. The employee brought a putative class action lawsuit for employment related overtime, meal, rest period claims, as well as a representative action under PAGA. Following *Concepcion*, *Iskanian* held that the FAA preempted *Gentry's* rule against employment class waivers. However, *Iskanian* left open the door for employees to bring statutory representative actions under PAGA.

PAGA civil remedies are recovered on behalf of the state, and are thus distinct from civil statutory remedies that an employee may recover for wage and hour violations. *Iskanian* analogized a PAGA representative action to a qui tam action because both involve citizen enforcement. The hallmarks of a qui tam action are, "(1) that the statute exacts a penalty; (2) that part of the penalty be paid to the informer; and (3) that, in some way, the informer be authorized to bring suit to recover the penalty." *Iskanian*, 59 Cal.4th at 382.

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Iskanian concluded that where "an employment agreement compels the waiver of representative claims under the PAGA, it is contrary to public policy and unenforceable as a matter of state law." (*Iskanian*, 59 Cal.4th at 384.) First, contrary to policy of the law, waiver exempts the employer from its own wrongdoing. (Civ. Code, § 1688.) Second, because PAGA was created for a public reason, namely to harness private resources to enforce labor

law, waiver "also violates Civil Code section 3513's injunction that 'a law established for a public reason cannot be contravened by a private agreement.'" (*Id.* at 383.) Consequently, *Iskanian* concluded that FAA preemption does not apply to a PAGA claim, because the purpose of the FAA is to ensure an efficient forum for resolution of *private* disputes, "whereas a PAGA action is a dispute between an employer and the state Labor and Workforce Development Agency." (*Ibid.*)

'Now consider the implications of adhering to the rule that PAGA actions, akin to qui tam actions, are really disputes involving the state as a real party in interest that cannot be forced into arbitration unless it is a party to the arbitration agreement.'

In PAGA actions, the state has an overriding interest: Written notice of the alleged code violation must be given to the employer and the Workforce Development Agency; if the Agency does not respond timely or provide notice of its intention to investigate, the employee may then sue. The Agency receives 75% of the civil penalties recovered. Despite its overriding interest in enforcement under PAGA, the state is not a party to the waiver agreement — and thus the state has not waived its interest in having private parties enforce labor laws.

Federal district courts, which need not follow California law when interpreting a federal statute to decide whether there is federal preemption by the FAA, have reached mixed conclusions.

Following *Iskanian, Martinez v. Leslie's Poolmart*. (C.D.Cal. 2014) 2014 WL 5604974 held that "the FAA 'does not preempt a state law that prohibits waiver of PAGA representative actions in an employment contract.'"

However, *Ortiz v. Hobby Lobby Stores* (E.D.Cal. 2014) 2014 WL 4961126 found that PAGA actions are representative actions that "cannot exist on an individual basis." *Ortiz* found that the parties had entered into a valid agreement requiring the employee to submit her claims to arbitration on an individual basis. Because all plaintiff's claims were subject to arbitration, but the representative PAGA action could not be prosecuted on an individual basis in arbitration, the claims were dismissed without prejudice. Consequently, it appears in Ortiz that only the state could enforce the PAGA claims, and that the purpose of the PAGA statute, to harness private resources to enforce state labor laws by a plaintiff acting in a representative capacity, has been effectively frustrated in Ortiz.

At odds with both *Ortiz* and *Iskanian*, is *Fardig v. Hobby Lobby Stores* (C.D.Cal. 2014) 2014 WL 4782618, which concluded that representative PAGA action waivers are enforceable under the FAA, but that Fardig could individually pursue PAGA claims on his own behalf in arbitration. The sole issue on

which plaintiffs sought reconsideration of the court's ruling in *Fardig* was whether "the Agreements are not substantively unconscionable for containing a waiver of the right to bring collective claims under the Private

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Attorney General Act." Importantly, this was not the key issue addressed in *Iskanian*, namely whether PAGA addressed private disputes that would be preempted by a waiver, or public disputes in which the real party in interest, the state, was not a party to the waiver, such that preemption would not apply. (See also *Langston v. 20/20 Companies, Inc*. (C.D.Cal. 2014) 2014 WL 5335734 [following *Fardig* and concluding "that the FAA preempts California's rule against arbitration agreements that waive an employee's right to bring representative PAGA claims"].)

Iskanian's arbitration issues are politically charged, as evidenced by the political split in *Concepcion* and *American Express*. Justice Scalia wrote for the majority; Justices Ginsberg, Breyer, Kagan, and Sotomayor dissented in *Concepcion*. The lineup was nearly identical in *American Express*, except that Justice Sotomayor did not participate.

The *Iskanian* defendant filed a certiorari petition seeking to reverse the PAGA ruling. That petition was denied, perhaps because there are no splits yet among the federal circuits, and because the decision below was not final (as was argued in Iskanian's opposition to the cert petition). Given the decisions percolating through the federal district courts, the future of *Iskanian's* holding remains uncertain.

__ The Uncertain Future of __ Statutory Representative Rights

Most immediately, if the U.S. Supreme Court were to rule FAA preemption requires enforcing agreements to arbitrate all PAGA claims on an individual basis, then California's statutory scheme for encouraging private attorneys general to enforce the state's labor laws would be frustrated if not subverted completely.

Going a step further, and applying the reasoning of Ortiz, if an arbitration agreement must be enforced, and PAGA representative claims cannot exist in individual arbitrations, then PAGA claims become an example of rights without remedies.

Furthermore, because California courts have closely analogized PAGA claims to qui tam claims, a Supreme Court ruling that PAGA claims must be arbitrated could have serious consequences for qui tam claims in California. California's qui tam statutory scheme is the California False Claims Act, Government Code, §§ 12650 to 12656. California's Office of the Attorney General boasts:

> "The Attorney General works to protect the state against fraud and other financial miscon-

duct through the enforcement of the California False Claims Act. Investigations and prosecutions brought pursuant to the Act have resulted in the recovery of hundreds of millions of dollars in wrongfully obtained public funds." (*State of California, Department of Justice, Office of the Attorney General, Corporate Fraud Section, False Claims Unit*, www.oag.ca.gov./cfs/falseclaims.)

The False Claims Act allows the Attorney General to bring a civil enforcement action "to recover treble damages and civil penalties against any person who knowingly makes or uses a false statement or document to either obtain money or property from the State or avoid paying or transmitting money or property to the State." And the Act also allows a whistleblower to file an action to enforce the Act.

Suppose the whistleblower is a disgruntled employee subject to an arbitration provision, and the wrongdoer conducts interstate commerce. Must the whistleblower claim now be privately arbitrated, because federal preemption and the FAA require enforcement of arbitration clauses? If the answer is "no way — effective qui tam actions require sunlight, publicity, and transparency, not privacy," will the courts be able to draw a principled distinction between PAGA claims and qui tam claims, both of which are highly regulated statutory enforcement schemes, in which private attorneys general represents the state's interests? One does not know how this will go, much less whether a principled delineation can be drawn. In order to find that the FAA, which requires enforcement of arbitration agreements, preempts litigation of PAGA or qui tam cases, presumably the High Court would need to explain how litigating private attorney general actions such as these frustrate the purposes and objectives of the FAA — and whether the FAA's purposes and objectives contemplated compelling arbitration of disputes in which a private party is acting as a proxy for the state.

Now consider the implications of adhering to the rule that PAGA actions, akin to qui tam actions, are really disputes involving the state as a real party in interest that cannot be forced into arbitration unless it is a party to the arbitration agreement.

The PAGA arbitration exception, intended to promote the enforcement of labor laws, is, in essence, a legislative creation. PAGA, like the False Claims Act, is a statutory scheme subject to notice and other provisions the state regulates, giving the state the "first bite" to act through its Attorney General, and defaulting to allow a private attorney general to act as proxy to enforce statutory rights that benefit the public. Thus, if private attorney general schemes can be exempted from arbitration, such schemes could be narrowed — or expanded — by the state legislature in other areas of public concern, such as consumer protection, housing, insurance, privacy laws, and health laws. As with PAGA and qui tam laws, private attorney general schemes intended to enhance statutory enforcement for the benefit of the public, can provide for civil monetary recovery and penalties, split between the state and the plaintiff.

The Supreme Court punted on *Iskanian*. However, the same issue is also pending before the Ninth Circuit in *Hopkins v. BCI Coca Cola Bottling Co*., No. 13-56126. The ultimate outcome could significantly impact other laws relying on a private attorneys general to enforce statutory schemes for the public's benefit. It is possible that only the "bounty" actions will escape the arbitration dispute resolution net in California, but even this is unclear. Because the future of *Iskania's* holding remains uncertain today, the future of statutory representative actions brought for the benefit of the public remains uncertain in California.

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