SAN FRANCISCO
Daily Journal
www.dailyjournal.com
WEDNESDAY, JULY 16, 2014
PERSPECTIVE

Concepcion's continuing fallout in the Golden State

By Matthew Schechter

Arbitration agreements. Depending on whether you are an employer, employee or their counsel, those two little words can make you cringe, cheer or both. For years, California courts were hostile to arbitration agreements, finding various ways to deem them unenforceable. Then, in 2011, the U.S. Supreme Court shocked the system in its ruling in *AT&T Mobility LLC v. Concepcion*, 131 S.Ct. 1740 (2011). *Concepcion* held that, under the Federal Arbitration Act (FAA), parties are free to limit arbitration agreements to claims involving individual plaintiffs and, as a result, the FAA preempts California case law.

Following *Concepcion*, California courts issued different opinions, some favorable to arbitration, others not. Within the last few of months, three decisions — two from the courts of appeal addressing delegation clauses in arbitration agreements, and one from the state Supreme Court overruling its prior decision in *Gentry v. Superior Court*, 42 Cal. 4th 443 (2007) — demonstrate *Concepcion*'s impact and that arbitration agreements in California may yet have a place in the legal landscape.

In *Tiri v. Lucky Chances Inc.*, 2014 DJDAR 6103 (May 15, 2014), and *Malone v. Superior Court*, 2014 DJDAR 7703 (June 17, 2014), the question before each court was the validity of a delegation clause. Both involved an employee bringing an action against her former employer, after which the respective employer petitioned to compel arbitration pursuant to an arbitration clause. The arbitration agreements each contained a "delegation clause," under which any issue as to the enforceability of the arbitration agreement was delegated to the arbitrator for resolution. While the trial courts split on granting the petition to compel arbitration — *Lucky Chances* denied the petition while *Malone* upheld it — the appellate courts in both cases found the clauses to be enforceable. Although the appellate courts took different paths to reach their respective results, both acknowledged the effect of *Concepcion* on how courts consider arbitration agreements, particularly as to questions about unconscionability.

Following the decision in *Concepcion*, the state Supreme Court addressed its effect in *Sonic-Calabasas A Inc. v. Moreno*, 57 Cal. 4th 1109 (2013). While unconscionability remained a valid defense to arbitration agreements, the FAA imposed limitations on that doctrine: First, "such rules must not facially discriminate against arbitration and must be enforced evenhandedly," and second, "such rules, even when facially nondiscriminatory, must not disfavor arbitration *as applied* by imposing procedural requirements that 'interfere[] with fundamental attributes of arbitration.'"

As a result, the *Malone* court found that earlier cases such as *Murphy v. Check 'N Go of California Inc.*, 156 Cal. App. 4th 138 (2007), and *Ontiveros v. DHL Express* (USA) Inc., 164 Cal. App. 4th 494 (2008), "which concluded that delegation clauses are substantively unconscionable due to the financial interest of the arbitrators who would be deciding the delegated issues," were no longer valid because such an analysis "discriminates against arbitration, putting agreements to arbitrate on a lesser footing than agreements to select any judicial forum for dispute resolution, and it is therefore preempted." The *Lucky Chances* court reached a similar conclusion.

While the *Lucky Chances* and *Malone* decisions are certainly significant, the Supreme Court's decision in *Iskanian v. CLS Transportation Los Angeles LLC*, 2014 DJDAR 8037 (June 23, 2014), is a game changer. *Concepcion* overruled the state Supreme Court's decision in *Discover Bank v. Superior Court*, 36 Cal. 4th 148 (2005), but made no mention of the decision in *Gentry* — a wage and hour case that provided the test for determining when class action waivers in employment arbitration agreements are enforceable. Although *Gentry* did not explicitly prohibit such class action waivers, in practice, the result was many courts invalidating class waiver provisions in arbitration agreements in wage and hour cases. With *Concepcion* overruling *Discover Bank*, and with *Gentry* being an extension of *Discover Bank*, it was an open question as to whether *Gentry* remained good law. With *Iskanian*, the state Supreme Court provided an answer to that question, and the answer was "no."

Per the state Supreme Court, while *Gentry*'s rule against class waiver is stated more narrowly than *Discover Bank*'s rule, that doesn't save it from FAA preemption under *Concepcion*. *Concepcion* made it clear that even if a state law rules 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 is still preempted since states can't require a procedure that interferes with fundamental attributes of arbitration "even if it is desirable for unrelated reasons."

The *Iskanian* court also rejected the alternative argument that the class action waiver must fail as it violated his rights under the National Labor Relations Act, as set forth in *D.R. Horton Inc. & Cuda*, 357 NLRB No. 184 (2012). Although limiting itself to the specific arbitration at issue in the case, the court followed the lead of the 5th U.S. Circuit Court of Appeals, as well as the majority of federal circuit and district courts that considered the issue, and found that, "in light of *Concepcion*, the [National Labor Relations Board's] rule is not covered by the FAA's savings clause. *Concepcion* makes clear that even if a rule against class waivers applies equally to arbitration and non-arbitration agreements, it nonetheless interferes with fundamental attributes of arbitration and, for that reason, disfavors arbitration in practice."

The *Iskanian* decision wasn't all "pro-employer." While the court did strike down the rule it promulgated in *Gentry*, and rejected the NLRB's finding in *D.R. Horton*, it also held that an employment agreement that required a waiver of representative claims under the Private Attorney General Act (PAGA) violated public policy and was unenforceable under state law. Moreover, prohibiting such PAGA waivers doesn't run afoul of the FAA since a PAGA claim lies outside the FAA's coverage because it is not a dispute between an employer and employee arising out of their contractual relationship. It is instead a dispute between an employer and the state, which alleges that the employer violated the Labor Code.

So, where do we stand now? Well, after what appeared to be the death knell for arbitration agreements just a few short years ago, they remain viable. Indeed, arbitration agreements that contain class action waivers or delegation clauses are now valid and enforceable. And yet, employees can still invoke an unconscionability defense, albeit one that has been narrowed somewhat because of *Concepcion*, so arbitration agreements need to be drafted with that in mind. At the same time, PAGA representative actions that seek to recover statutory penalties under the Labor Code remain alive and well. While *Concepcion* certainly had an impact on arbitration in California, it is unlikely to be the last word on the subject — either at the state or federal level. The "fight" about employment arbitration agreements is far from over, and individuals on both sides of the issue will need to continue to keep track of decisions from the courts in the years ahead.

Matthew Schechter *is a partner at McManis Faulkner. He has a varied civil litigation practice with a particular emphasis in employment law and can be reached at (408) 279.8700 or mschechter@mcmanislaw.com.*

MATTHEW SCHECHTER
McManis Faulkner