Does the Federal Arbitration Act Preempt a California State Law That Permits Aggregate Litigation in a Labor Dispute, Precluding an Arbitration Agreement Signed by the Plaintiff?

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Does the Federal Arbitration Act Preempt a California State Law That Permits Aggregate Litigation in a Labor Dispute, Precluding an Arbitration Agreement Signed by the Plaintiff?

CASE AT A GLANCE

This appeal from the California Court of Appeal addresses whether the Federal Arbitration Act preempts California's Private Attorneys General Act (PAGA) when a plaintiff, as an individual, seeks to pursue relief for hundreds of individuals and the state of California in a labor dispute, pursuant to a bilateral arbitration agreement that the plaintiff signed.

Viking River Cruises, Inc. v. Angie Moriana
Docket No. 20-1573

Argument Date: **March 30, 2022** From: **The California Court of Appeal**

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Issue

Does California's Private Attorneys General Act (PAGA) permit a plaintiff in a labor dispute to seek relief on behalf of hundreds of claimants and the state of California despite the Court's prior arbitration precedents holding that the Federal Arbitration Act (FAA) preempts California state law that would preclude bilateral arbitration and permit aggregate litigation?

Facts

The facts in *Viking River Cruises, Inc.* are simple and straightforward. Viking employed Angie Moriana as a sales representative for its cruises for approximately one year, from May 2016 to June 2017. Before she began working for Viking, she signed a bilateral arbitration agreement and agreed to arbitrate any dispute that arose out of or related to her employment. The agreement provided that, if a dispute arose, she would use individualized arbitration rather than class, collective, representative, or private attorney general action proceedings—essentially a broad class action waiver. The agreement specified that Moriana could opt out of the collective redress limitation by checking a box. She did not.

After Moriana left Viking's employment, she filed an action in California state court pursuant to California's Private Attorneys General Act of 2004. Her complaint against Viking stated that it was a representative action brought on behalf of all current and former aggrieved employees, seeking recovery of civil penalties for Viking's violation of numerous provisions of the California Labor Code. Moriana's complaint sought relief for herself including but not limited to ocean specialists, outbound sales agents, inbound sales agents, travel agent desk, inside sales, direct group sales, reservation sales agents, and air department agents "as well as any other job title with substantially similar duties and responsibilities."

For herself, Moriana alleged a Labor Code violation, asserting that Viking failed to timely pay her final wages after her employment ended. On behalf of the other employees that she represented in the PAGA action, Moriana brought claims alleging that Viking failed to comply with Labor Code provisions for minimum wages, overtime wages, meal periods, rest periods, timing of pay, and pay statements. Her one-count complaint alleged a

single PAGA representative claim for civil penalties on behalf of California.

The California legislature enacted PAGA in 2003 to address problems with lax state enforcement of the Labor Code. Cal. Lab. Code § 2699(a). It essentially empowered aggrieved employees to act as the state's agent or proxy to bring suit as a private attorney general to recover civil penalties on behalf of the state. The government entity on whose behalf the plaintiff files a PAGA action is the real party in interest. Pursuant to PAGA, an employee may seek civil penalties not only for herself for violation of Labor Code provisions, but for all employees of the same employer. Prior to filing a PAGA lawsuit, an employee must first pursue relief through the state Labor Workforce and Development Agency. If the administrative agency declines to pursue the employee's complaint or fails to respond, the aggrieved employee may then file a PAGA lawsuit, which the private plaintiff controls entirely without any state action.

PAGA provides for civil penalties of $100 for each aggrieved employee for each pay period for the first violation of a Labor Code provision and $200 for any subsequent violation. If the employees prevail, they are entitled to 25 percent of any assessed penalties with the 75 percent remitted to the state. A prevailing plaintiff's attorney is entitled to reasonable fees and costs, but in practice, plaintiffs' attorneys pursing PAGA litigation typically take their fees off the original aggregated award, rather than just the 25 percent awarded to the employees. If a plaintiff prevails, accumulated penalties may be sizeable. The California Supreme Court has described the PAGA representative action as a type of *qui tam* action. *Iskanian v. CLS Transp. Los Angeles LLC*, 327 F.3d 129, 148 (Cal. 2014).

In response to Moriana's complaint, Viking moved to compel bilateral arbitration under her employment agreement and to stay the court proceedings. The state court denied the motion. The court relied on the California "*Iskanian*" rule, *supra*. In *Iskanian* the California Supreme Court determined that an arbitration agreement in which an employee agrees to bilateral arbitration and to forgo a representative PAGA claim amounted to a kind of class action waiver and was unenforceable as a violation of state public policy.

The court further held that a state PAGA claim was outside the FAA coverage and was not impliedly preempted by federal law. Following *Iskanian*, the Ninth Circuit agreed with the California Supreme Court that the FAA does not preempt California law prohibiting waiver of the right to pursue PAGA claims. *Sakkab v. Luxottica Retail N. Am., Inc.*, 803 F.3d 425 (9th Cir. 2015). On appeal, the California Court of Appeal affirmed the trial court's denial of bilateral arbitration, and the California Supreme Court declined to exercise its discretionary review on December 9, 2020.

Case Analysis

Viking's appeal implicates the intersection of the FAA with California's PAGA statute and the considerable body of federal and state case law concerning the enforceability of bilateral arbitration clauses that contain class action or any form of collective redress waiver. The Supreme Court has considered the issue of class action waivers multiple times in the past twenty years. The Court consistently has invalidated such class action waivers and held that the FAA preempts and overrides state law that would restrict or prohibit collective arbitration or litigation. The Court consistently has found in favor of defendants' rights to enforce bilateral arbitration.

The Court's various arbitration cases have been decided in the context of broad federal arbitration principles. After many years in which courts disfavored arbitration, the Court at the beginning of the 21st century reversed course and held that the FAA embodied a legislative preference for settling disputes through arbitration. *Green Tree Fin. Corp.-Alabama v. Randolph,* 531 U.S. 79 (2000). In 2010, the Court reaffirmed its view that arbitration agreements are binding contracts that courts should construe and apply according to their terms, typically through bilateral arbitration. *Stolt-Nielsen S.A. v. AnimalFeeds Int'l Corp.*, 559 U.S. 662 (2010).

The FAA provides that any contractual provision to settle a dispute "shall be valid, irrevocable, and enforceable, save on such grounds as exist at law or in equity for the revocation of any contract." 9 U.S.C. § 2. In construing Section 2, the Court has indicated that courts should rigorously enforce arbitration agreements according to their terms, including the agreed arbitration parties and arbitration rules. *Am. Express Co. v. Italian Colors Rest.*, 570 U.S. 228 (2013). The act provides that courts shall stay any litigation pending the resolution of arbitral claims. 9 U.S.C. § 3. Furthermore, the Court has held that the FAA preempts state law rules that would interfere with enforcement of bilateral arbitration. *Id.*

The latter language of Section 2 is known as the FAA "savings" clause because it permits courts to invalidate

arbitration agreements for common contract defenses, such as fraud, duress, or unconscionability. However, the Court in construing the Section 2 savings clause has indicated that this provision offers plaintiffs no asylum from other purported defenses that disfavor arbitration, such as class action waivers. *Epic Systems Corp. v. Lewis*, 138 S.Ct. 1612, 1622 (2018).

Plaintiffs contend that class action waivers are particularly objectionable in circumstances where bad actor defendants harm large numbers of consumers involving small sums of damages. In such instances, bilateral arbitration unfairly favors defendants, while class action litigation empowers groups of plaintiffs with small individual damages. Therefore, the waiver of class action litigation in arbitration agreements unfairly impacts potential plaintiffs who should be able to pursue class litigation rather than be bound to bilateral litigation.

The California Supreme Court agreed with this view and ruled that an arbitration clause that contained a class action waiver was unenforceable because it would exculpate the defendant from liability for wrongdoing involving small sums of damages. *Discover Bank v. Superior Court*, 30 Cal. Rptr.3d 76 (Cal. 2005). Under the *Discover Bank* rule, a class action waiver contained in an arbitration agreement would be unenforceable when the agreement was a consumer contract of adhesion, when the dispute involved predictably small amounts of damages, and where the plaintiff 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." 30 Cal. Rptr. at 87.

The Supreme Court overruled *Discover Bank* in a 5–4 decision in *AT&T Mobility LLC v. Concepcion*, 563 U.S. 333 (2011). In *Concepcion*, two consumers sued AT&T, claiming that the cell phone company deceptively advertised that they would receive a free cell phone as part of their wireless plan. They filed a class action lawsuit in California federal court, and AT&T asked the court to dismiss the action because the plaintiffs had signed a contract agreeing to individual arbitration rather than a class action. AT&T's arbitration provision was designed to facilitate the resolution of small claims through arbitration. The district court and Ninth Circuit upheld the plaintiff's right to pursue class action relief based on California's *Discover Bank* rule.

On appeal, the Supreme Court, in a 5–4 decision, held that the FAA preempts state laws that prohibit contracts disallowing classwide arbitration. Consequently, businesses may require consumers to bring claims only through bilateral arbitration rather than in court as class litigation. Writing for the majority, Justice Antonin Scalia focused on the impact of California's *Discover Bank* rule, which he opined had caused courts to invalidate many arbitration agreements since its pronouncement. The rule violated the federal policy in favor of bilateral arbitration, and therefore, the FAA preempted the *Discover Bank* rule.

The Court returned to its analysis of the enforceability of class action waivers in litigation that plaintiffs pursued under the National Labor Relations Act (NLRA) of 1935. *Epic Systems Corp. v. Lewis*, 584 U.S. ___ (2018); 29 U.S.C. § 157. In another 5–4 split decision, the Court again ruled that arbitration agreements requiring individual arbitration were enforceable under the FAA, regardless of the collective action provisions set out in the NLRA and the Fair Labor Standards Act (FLSA) of 1938. The statutes empowered employees to form trade unions and to take collective actions against employers for unfair labor practices. Epic Systems, a Wisconsin health-care software company, required employees to agree to a policy that required individual arbitration of any disputes. An employee sued the company in federal court as a collective action under the FLSA. Epic moved to dismiss based on the arbitration agreement, but the district and appellate courts refused this request. The Supreme Court reversed, mandating bilateral arbitration. The Court rejected the plaintiffs' arguments that the FAA's savings clause invalidated the prohibition against collective action.

In the Court's most recent consideration of class action waivers in arbitration clauses, the Court turned to the problem of ambiguous language in these agreements that did not authorize or disallow classwide arbitration. *Lamps Plus, Inc. v. Varela*, 587 U.S. ___ (2019). The Ninth Circuit invoked the doctrine that, in such circumstances, any ambiguity was to be resolved against the provision's drafter. In yet another 5–4 decision, the Court's majority reversed and held that the FAA preempted the application of the common-law contract doctrine governing ambiguous language. This contravened the FAA, because applying the doctrine would interfere with the fundamental attributes of arbitration.

In the context of these recent arbitration decisions, Viking now asks the Court to determine whether a plaintiff can avoid bilateral arbitration by recourse to California's Private Attorneys General Act. Viking contends that California state courts follow the *Concepcion* and *Epic*

decisions when a party to an arbitration agreement tries to assert class action claims, but have refused to do so when a party asserts representative claims under PAGA. Viking suggests that the effect of PAGA is to circumvent the Court's *Concepcion* and *Epic* decisions and have "merely caused FAA-defying representational litigation to shift form." The core teachings of the Court's *Concepcion* and *Epic* decisions are that courts may not use state-law defenses to declare individualized arbitration off limits when the parties agreed to bilateral arbitration.

Viking claims that the only noticeable factual difference between this case and *Concepcion* is that instead of pursuing a class action, Moriana pursued litigation on behalf of hundreds of other individuals as a representative action under PAGA. Indeed, Viking contends that there is no meaningful difference between the class action in *Concepcion*, the collective action in *Epic*, and the representative action under PAGA. Consequently, the Court "has repeatedly made clear that state laws that target arbitration in general, or traditional bilateral arbitration in particular, for disfavored treatment are preempted by the FAA." Brief at 16.

Viking advances a wholesale attack against California's *Iskanian* decision and strenuously argues that the *Iskanian* rule is incompatible with the FAA. The defendant's core argument is that the FAA preempts the *Iskanian* rule. According to Viking, that decision has denied California employers the benefits of agreed bilateral arbitration and the guarantees of the FAA. Under *Iskanian*, plaintiffs who should be arbitrating their individual claims in bilateral arbitration instead are just amending their class action complaints to assert representative PAGA claims and proceeding "as if *Concepcion* and *Epic* never happened." Brief at 18.

The chief consequence of the *Iskanian* rule has been to vastly expand the scope of employment disputes. Given PAGA's provision for substantial statutory penalties and damage awards, PAGA actions have greatly increased defendants' risks for those sued under the statute. Thus, the central question is whether California "may circumvent *Concepcion* and *Epic* by authorizing functionally identical representative actions and declaring such actions 'outside the FAA's coverage.'" *Id*.

As a policy matter, Viking and its numerous business amici note the deleterious effects of PAGA and the *Iskanian* rule in California, citing an abundance of statistics in the rate of PAGA filings. The *Iskanian* rule has encouraged lawyers to file hundreds of PAGA demands "at a 17-a-day clip, initiating lawsuits implicating tens of thousands of employees at a time, and extracting millions of dollars from employers for whom representative PAGA claims have become another tax for doing business in California." Brief at 3. Viking suggests that this is not what the Court intended in *Concepcion* and *Epic* or what Congress intended in the FAA; therefore, the Court should once again hold that the FAA preempts state laws that interfere with the enforcement of bilateral arbitration agreements.

In response, Moriana argues that although the Court has held that the FAA requires courts to enforce agreements to arbitrate claims bilaterally, the Court has never held that the FAA requires enforcement of agreements that flatly bar statutory causes of action in the public interest, such as PAGA. Recasting the dispute, the respondent argues that the case is not about whether a California party may be required to arbitrate a PAGA claim. Instead, the appeal concerns whether an arbitration contract can forfeit a PAGA claim. The respondent contends that California law prohibits contractual waivers of statutory protections that are enacted for public reasons, including the right to bring a PAGA action. Nothing in the FAA text or purposes empowers corporate defendants with superior bargaining power to immunize themselves from all such claims.

The respondent asserts that California has a long-standing anti-waiver rule, and nothing in the FAA's language invalidates the anti-waiver rule. The FAA favors the enforcement of arbitration agreements, not provisions to preclude them. This principle applies to Viking's preclusion of all PAGA claims, even if they are asserted in arbitration. Various provisions of the FAA confirm Congress's intent for deciding arbitrable controversies, not precluding them. The FAA says nothing about agreements to strip parties of the right to pursue state public policy claims in all forums. The respondent rejects Viking's contention that the FAA impliedly preempts California's anti-waiver rule. There is no intent in the FAA to immunize defendants from state law liabilities.

Further, the plaintiff contends that PAGA creates no conflicts with the purposes and objectives of the FAA. PAGA actions are bilateral proceedings in which a single plaintiff asserts a claim as the state's representative. PAGA actions do not require any special procedures that are incompatible with the fundamental attributes of arbitration. PAGA suits do not aggregate the claims of multiple individuals, nor do they trigger procedural due process

protections required in class actions or other collective procedures. If a PAGA claim goes to arbitration, it proceeds in the same way as any bilateral arbitration, thus ensuring streamlined, cost-efficient resolution of grievances.

Moreover, the FAA does not authorize waivers of claims, including PAGA claims, merely because they are complex or involve potentially sizeable penalties or damages, or may require evidence about the impact of the defendant's conduct on others. The respondent notes that for decades the Court has recognized that arbitration is well suited for resolving complex, high-stakes cases such as antitrust and securities fraud as well as claims related to the Racketeer Influenced and Corrupt Organizations Act (RICO) and the Age Discrimination in Employment Act (ADEA). The arbitration of such complex litigation may entail, and has already entailed, consideration of evidence bearing on the effects of a defendant's conduct on third parties.

The FAA does not preempt California's anti-waiver rule because it comes within the Section 2 savings clause of the FAA. California has a long-standing rule prohibiting waivers of laws enacted for a public purpose. PAGA is just such a law, enacted for a public purpose. PAGA therefore is encompassed by the Section 2 savings clause, which exempts from FAA preemption any neutral, non-discriminatory state ground for revocation of any contract. The respondent argues that no arbitration contract—or any other contract—may waive public policy rights. In addition, the respondent points to the Court's repeated pronouncements that the savings clause creates a federal equal-treatment rule for arbitration agreements; that is, that the enforceability of arbitration agreements is subject to all generally applicable contract defenses. California's rule prohibiting contractual waivers, as applied to PAGA, is just such a generally applicable contract defense.

Moreover, PAGA claims belong to the state. If the FAA preempted the state from asserting those claims through its agent because of preemption, that would bind the state to a contract to which it was not a party. "Extending the FAA to impose such a limitation on the State's law enforcement functions would require clear authorization that the FAA does not provide." Brief at 12. The Court has repeatedly held that arbitration is a matter of consent of the parties. In this litigation, California did not consent to waive its statutory right to civil penalties under PAGA. To enforce the waiver against California's claim would turn a plaintiff's agreement to arbitrate their individual claims into a waiver of a nonparty's statutory remedies.

The respondent further rejects the notion that the PAGA anti-waiver rule permits litigants to circumvent the Court's *Concepcion* decision by relabeling class actions as a representative lawsuit. She suggests that this argument is mistaken and reaches too far, because, if correct, then defendants could immunize themselves from all variations of representative actions, including *qui tam* actions, ERISA claims brought on behalf of benefit plans, shareholder derivative claims brought on behalf of corporations, and claims by trustees or beneficiaries on behalf of trusts. All are representative actions in the same way as PAGA suits. "An enforcement ban on all 'private attorney general' actions could sweep even more broadly." Brief at 13.

Finally, the respondent counterargues that Viking's policy arguments are meritless. She refutes the argument that plaintiffs may evade *Concepcion* and *Epic* merely by changing the label "class action" in their pleadings and substituting it with a "PAGA action." PAGA actions are unlike class actions. In PAGA actions, a plaintiff is limited to seeking civil penalties on behalf of the state for a one-year limitation period. Compensatory damages are not available under PAGA. Furthermore, violations of the California Labor Code are rampant, with weak and ineffective agency enforcement.

Considering this reality, the respondent suggests that statistics cited by Viking and its amici do nothing to support their assertion that PAGA claims are incompatible with arbitration. "Their fundamental objection is that there are too many PAGA claims, and this Court rather than the California Legislature should curtail the availability to benefit a subset of California businesses that compete unfairly by cutting labor costs in violation of the Labor Code." Brief at 47. The adoption of Viking's position, respondent argues, would have far-reaching negative consequences. If the Court upholds Viking's position, then opportunistic companies would not hesitate to apply their arbitration language beyond PAGA to apply to other state law representative actions, such as *qui tam* actions. The respondent concludes by urging the Court not to grant potential defendants an unfettered power to choose which claims may be brought against them.

Significance

Over the past twenty years, the Supreme Court has repeatedly returned to the problem of arbitration agreements that have attempted to restrict class action or collective redress procedures in lieu of bilateral arbitration. One would have thought that by now the Court would

have sorted out every possible combination and permutation of arbitration language intended to foreclose collective procedures in arbitration agreements, but the enduring persistence and recurrence of new variations of these cases proves otherwise.

The frequent recurrence of the class action waiver problem illustrates the dynamic relationship between the Court's pronouncements on the subject and attorney responses to the changing legal landscape of arbitration clauses. On the one hand, potential defendants—chiefly corporate entities—have responded to the Court's evolving jurisprudence by perfecting the art of arbitration clause drafting. With each successive Court opinion, and to immunize themselves from having to engage in any form of collective arbitration or litigation, corporate counsel have expanded and elaborately defined the list of arbitration exclusions (other than bilateral arbitration). On the other hand, plaintiffs' attorneys have proven equally adept at devising means to pursue collective relief notwithstanding carefully crafted arbitration language specifically designed to describe and prohibit every possible collective procedure.

Viewed in this historical context, the Viking appeal is yet the latest chapter in the arbitration class action waiver saga. It returns the Court to a consideration of federal preemption under the FAA of state anti-waiver laws. It asks the Court to consider the latest twist in this narrative, namely a California state statute that purportedly creates a representational procedure on behalf of the state. In deciding this appeal, the Court will consider the reach of its *Concepcion* and *Epic* decisions, counterbalanced by the California Supreme Court's determination that PAGA actions lie outside the *Concepcion* and *Epic* pronouncements.

Apart from the textual discussion of FAA preemption doctrine as it applies to arbitration clauses, the Court may also consider and weigh the policy arguments advanced by the parties. Viking and its numerous business amici have supplied the court with compelling statistics about the flood of PAGA cases after the California Supreme Court determined that PAGA actions were beyond the reach of federal preemption. The plaintiffs plead on behalf of California employees whom they contend are exploited by California employers, a situation compounded by ineffectual state agency enforcement of the California labor laws. They point out that if the Court adopts Viking's position and disallows exclusion of PAGA suits in arbitration agreements, employers will not only continue to list PAGA as an exclusion but will continue to expand their list of prohibited actions in arbitration agreement.

The Court may be very interested, in this light, of the impact of its possible ruling on the fate of *qui tam* actions and other types of collective redress that have not yet come before the Court. What perhaps may be the most certain outcome of the Viking appeal is that we may not yet have seen the last of the arbitration cases. A good bet is that *qui tam* actions will be the next test case for litigants and the courts in the ever flourishing arbitration vineyard.

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