Case No. S246711





**IN THE SUPREME COURT**
**OF THE STATE OF CALIFORNIA**

ZB, N.A. and ZIONS BANCORPORATION,

Petitioners,

v.

SUPERIOR COURT OF THE STATE OF CALIFORNIA
FOR THE COUNTY OF SAN DIEGO,

Respondent;

KALETHIA LAWSON,

Real Party In Interest.

After a Decision by the Court of Appeal
Fourth Appellate District, Division One
Case Nos. D071279 & D071376 (Consolidated)

# PETITIONERS' OPENING BRIEF

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**TO THE HONORABLE CHIEF JUSTICE AND THE ASSOCIATE JUSTICES OF THE CALIFORNIA SUPREME COURT:**

Petitioners ZB, N.A. and Zions Bancorporation ("Petitioners") respectfully submit their Opening Brief.

## I. ISSUE PRESENTED

Does a representative action under the Private Attorneys General Act of 2004 (Labor Code §§ 2698, *et seq.*) seeking recovery of individualized lost wages as civil penalties under Labor Code section 558 fall within the preemptive scope of the Federal Arbitration Act (9 U.S.C. §§ 1, *et seq.*)?

## II. INTRODUCTION

This appeal involves the Supremacy Clause of the United States Constitution and the Federal Arbitration Act (the "FAA"), which requires the "enforcement of arbitration agreements according to their terms. . . ." (*AT&T Mobility LLC v. Concepcion* (2011) 563 U.S. 333, 334.) In *Concepcion*, the United States Supreme Court – continuing its rigorous enforcement of arbitration agreements — struck down a California rule invalidating class action waivers in consumer arbitration agreements, holding that "States cannot require a procedure that is inconsistent with the FAA, even if it is desirable for unrelated reasons." (*Concepcion*, 563 U.S. at 351.)

Three years later, in *Iskanian v. CLS Transportation Los Angeles LLC* (2014) 59 Cal.4th 348, *cert. denied* (2015) 574 U.S. __, 135 S.Ct. 1155, this Court applied *Concepcion* to overrule its holding in *Gentry v. Superior Court* (2007) 42 Cal.4th 443, that certain class action waivers in employment arbitration agreements are unenforceable under California law. (*Iskanian*, 59 Cal.4th at 364.) Citing *Concepcion*, this Court recognized that "because class proceedings interfere with fundamental attributes of arbitration, a class waiver is *not* invalid even if an individual proceeding would be an ineffective means to prosecute certain claims." (*Id.*)

Despite finding that *Concepcion* required enforcement of class action waivers in employment arbitration agreements, this Court held in *Iskanian* that an arbitration agreement, even if governed by the FAA, cannot waive an employee's right to bring a representative action under the Private Attorneys General Act of 2004, Labor Code, §§ 2698 *et seq.* ("PAGA"). (*Iskanian*, 59 Cal.4th 348, 387-88). Recognizing the tension between this holding and the United States Supreme Court's holding in *Concepcion* that states cannot require procedures that interfere with arbitration agreements, this Court imposed an important limitation on the type of relief an employee can pursue in a PAGA action if the employee seeks to avoid the obligation to arbitrate on an individual basis:

> Our opinion today would not permit a state to circumvent the FAA by, for example, deputizing employee A to bring a suit for the individual damages claims of employees B, C, and D. This pursuit of victim-specific relief by a party to an arbitration agreement on behalf of other parties to an arbitration agreement would be tantamount to a private class action, whatever the designation given by the Legislature. Under *Concepcion*, such an action could not be maintained in the face of a class waiver.

(*Iskanian*, 59 Cal.4th at 387-88 [*referencing Concepcion*, 563 U.S. 333].)[1]

This Court thus made clear in *Iskanian* that under *Concepcion*, a PAGA action seeking victim-specific unpaid wages payable directly (and exclusively) to affected employees "could not be maintained in the face of a class waiver." (*Iskanian*, 59 Cal.4th at 388.) This limitation was necessary to avoid undermining the Court's rationale against FAA preemption, *viz.*, that a PAGA action is fundamentally an action between the State and the

[1] The Court's above-quoted limitation is referred to herein as the "*Iskanian* exception."

employer designed to recover civil penalties primarily on behalf of the State, making the State – which is not a party to any arbitration agreement – the real party in interest in the action. (*Id.* at 386-87.)

Attempting to circumvent her obligation to arbitrate her unpaid wages claim on an individual basis, Lawson alleged a single cause of action for violation of the PAGA, on behalf of herself and other aggrieved employees. (AA I:015.) Lawson did not, however, limit her Complaint to seeking only the normal civil penalties that go primarily to the State of California. Instead, she also seeks individual, employee-specific relief in the form of unpaid wages under Labor Code section 558, both on her own behalf and on behalf of all other non-exempt employees in California. (AA I:009, 014 at ¶¶ 13, 49.)

The Court of Appeal, Fourth Appellate District, Division One, held in this matter that the *Iskanian* exception does not apply to Lawson's pursuit of individual wages payable directly to employees under PAGA, instead finding that all PAGA claims are exempt from pre-dispute arbitration agreements. (*Lawson v. ZB, N.A.* (2017) 18 Cal.App.5th 705, 722-726.) The Court of Appeal not only misread and disregarded the *Iskanian* exception, but also failed to follow the United States Supreme Court's holdings in *Concepcion* and numerous other cases that "courts must 'rigorously enforce' arbitration agreements according to their terms . . . ." (*American Express Co. v. Italian Colors Restaurant* (2013) 570 U.S. 228, 233 [quoting *Stolt-Nielsen S. A. v. AnimalFeeds Int'l Corp.* (2010) 559 U.S. 662, 683].)

Under the Supremacy Clause of the United States Constitution, the Federal Arbitration Act must prevail when an individual employee seeks to recover unpaid wages on behalf of herself and other employees, regardless whether those wages are characterized as civil penalties, statutory penalties, damages, or some other form of relief. Accordingly, Petitioners urge this Court to hold, as a matter of law and sound public policy, that a representative

action under the PAGA falls within the preemptive scope of the FAA when it seeks recovery of individualized lost wages under Labor Code section 558. To hold otherwise would violate the Supremacy Clause of the United States Constitution and would impose "a procedure that is inconsistent with the FAA, even if it is desirable for unrelated reasons," contrary to well-settled United States Supreme Court precedent. (*Concepcion* 563 U.S. at 351.)

## III. FACTUAL AND PROCEDURAL BACKGROUND

### A. Lawson voluntarily agreed to arbitrate her disputes with Petitioners on an individual, bilateral basis.

Respondent began working for California Bank & Trust ("CB&T") on June 3, 2013. (AA I:037.) CB&T is now a division of petitioner ZB, N.A. (AA I:040.) Prior to commencing employment with CB&T, Respondent received an e-mail with a hyperlink to CB&T's "Statement of Compliance with Employee Handbook and Code of Ethics" (the "Statement of Compliance"). (AA II:229, 233-234.) The Statement of Compliance included hyperlinks to several documents, including the full Employee Handbook and the "Mandatory Binding Arbitration Policy and Agreement" (the "Arbitration Agreement"), which is Section 4.4 of the Employee Handbook. (AA II:230, 233-234.)

On May 31, 2013, Lawson acknowledged receipt of the Statement of Compliance. (AA II:229-230, 234, 237, 240-241, 244, 261, 263-268.) By acknowledging receipt of the Statement of Compliance, Lawson confirmed that she had "read and [would] comply with the policies and standards contained in the Handbook," and also confirmed that she had "read particularly . . . Section 4.4 of the Handbook, which contains the Mandatory Binding Arbitration Agreement." (AA II:230-231, 233-234, 240-241, 244.)

On Lawson's first day of work (June 3, 2013), Lawson again agreed to be bound by the Arbitration Agreement. (AA I:037-038, 050-061; AA II:230-231, 234-235, 245-257.) On February 14, 2014, Lawson also

acknowledged receipt of, and her agreement to be bound by, an updated version of the Arbitration Agreement. (AA I:038-039, 062-072; AA II:231-232, 233-236, 259-261.) The first paragraph of the Arbitration Agreement specifies that all employment-related claims are subject to arbitration:

> Any legal controversy or claim arising out of your employment with the Company or with Zions or Zions Entities, which is not otherwise governed by an arbitration provision, and that cannot be satisfactorily resolved through negotiation or mediation, shall be resolved, upon election by you or the Company, Zions or Zions Entities, by binding arbitration pursuant to this arbitration provision and the code of procedures of the American Arbitration Association (AAA).

(AA I:050, 063.)

The Arbitration Agreement contains a provision precluding an employee or former employee from seeking "to represent the legal interests of or obtain relief for a larger group":

> [C]laims by different claimants against the Company, Zions and Zions Entities or by the Company against different employees, former employees, or applicants, **may not be combined in a single arbitration**. Unless specific state law states otherwise, **no arbitration can be brought as a class action (in which a claimant seeks to represent the legal interests of or obtain relief for a larger group)**, and the parties recognize that the arbitrator has no authority to hear an arbitration either against or on behalf of a class.

(AA I:051, 064 [emphasis added].)

Further expressing the parties' intent to arbitrate any disputes only on an individual basis, the Arbitration Agreement states that the arbitrator "shall not consolidate claims of different employees or have power to hear arbitration as a class action." (AA I:053, 066.) A "class action" is defined in the Arbitration Agreement as an action "in which a claimant seeks to

represent the legal interests of or obtain relief for a larger group." (AA I:051, 064.)

As shown above, the Arbitration Agreement was presented to Lawson on three occasions. Specifically, it was presented to Lawson (i) during the pre-hire process in May 2013, (ii) when she commenced employment on June 3, 2013, and (iii) again as part of an update to the Employee Handbook in February 2014. (AA I:038-039, 062-072; AA II: 230-236, 244, 245-261.) Significantly, the acknowledgment forms Lawson was asked to accept on each of these occasions specifically referred to the mandatory arbitration policy in bold, uppercase text that is readily apparent to the employee.

> I have read particularly the *Handbook Overview* and *General Management Practices* sections of the Handbook which contain the **EMPLOYMENT AT-WILL POLICY**, *Section 4.4* of the Handbook, which contains the **MANDATORY BINDING ARBITRATION POLICY AND AGREEMENT**, and *Section 5.5* of the Handbook, . . . . I understand that by accepting or continuing employment with the Company I agree to use binding arbitration to resolve certain legal claims or controversies with the Company, Zions or Zions Entities, including federal Title VII and state civil rights claims, pursuant to the mandatory binding arbitration policy. . . .

(AA I:055, 068; AA II:240-241 [emphasis in original].)

Lawson acknowledged receipt of the Arbitration Agreement on all three occasions. (AA I:038-039, 062-072; AA II:230-236, 244, 245-261.) In acknowledging receipt of the employee handbook and Arbitration Agreement, Lawson agreed that "by accepting or continuing employment with the Company," she would use "binding arbitration to resolve" her claims against Petitioners. (AA I:055, 068; AA II:240-241.)

### B. Lawson filed a PAGA action seeking individual wages on behalf of herself and other employees.

On February 19, 2016, Lawson filed her Complaint in San Diego County Superior Court. In her Complaint, Lawson alleged a single cause of action for violation of PAGA, on behalf of herself and other aggrieved employees. (AA I:006-019.)

As part of her PAGA claim, Lawson seeks not only the normal PAGA civil penalties that go primarily to the State of California, but also individual, employee-specific relief in the form of "unpaid wages and premium wages" under Labor Code section 558, which provides that unpaid wages "recovered pursuant to this section shall be paid to affected employees." (Labor Code § 558(a)(3) [emphasis added]; AA I:014 at ¶ 49.) Lawson seeks such "unpaid wages and premium wages" not just on her own behalf, but also on behalf of all other hourly-paid or non-exempt employees throughout California. (AA I:009, 014 at ¶¶ 13, 49.)

### C. The Superior Court denied Petitioners' motion to compel Lawson to submit her claim for unpaid wages under Labor Code section 558 to *individual* arbitration, and instead compelled Petitioners to arbitrate on a quasi-class, representative basis in contravention of the Arbitration Agreement.

On August 3, 2016, Petitioners moved the Superior Court for an Order "compelling plaintiff Kalethia Lawson to submit her claim for victim-specific relief under Labor Code § 558 to individual binding arbitration and to stay the action." (AA I:021.) On September 28, 2016, the Court issued its tentative ruling granting Petitioners' motion, although the Court included in its tentative ruling advisory language suggesting that the arbitrator could hear the matter on a representative basis. (Ex. AA II:378.)

At the hearing on September 30, 2016, Petitioners addressed the potential of the arbitration being ordered to proceed on a representative basis,

noting that both state law and the arbitration agreement preclude arbitration of claims between the parties on a class or representative basis:

> The motion we brought was a very narrow motion asking the Court to compel the plaintiff's individual claim under Labor Code Section 558(a)(3) to individual arbitration. And the tentative ruling in the first sentence says that the Court grants that motion to compel individual arbitration, but this language at the end [of the tentative ruling], I think, creates confusion regarding that. Under both state law, the *Iskanian* decision, and the arbitration [agreement] itself, they both prohibit the arbitration of claims on a class or representative basis.

(Reporter's Transcript, at p.16:3-12.)

Petitioners further argued that the parties had made no agreement to arbitrate on any basis other than on an individual basis.

> Here the defendants have no agreement to arbitrate other than on an individual basis. And, in fact, the portion of the *Iskanian* decision the Court relies upon in its tentative ruling as well as the Arbitration Agreement both say the exact opposite, that if it's victim specific relief, these class action waiver provisions are enforceable under the Federal Arbitration Act and the matter should be sent to individual arbitration, and so that's why I think that language in the Court's – at the end of the Court's ruling is superfluous.

(Reporter's Transcript, at p.17:9-19.)

At the conclusion of the hearing, the Superior Court took the matter under submission. (Reporter's Transcript, at p.20:19-21.) By Minute Order dated September 30, 2016, the Superior Court purported to grant Petitioners' motion to compel arbitration, but the Order did not compel arbitration on an individual basis as requested by Petitioners in their motion. (AA II:379-382.) Instead, the Superior Court denied the relief requested by Petitioners, and

compelled the claim for victim-specific, unpaid wages and premium wages under Labor Code § 558 to arbitration "as a representative action." (AA II:381.) The Superior Court served notice of the Order on October 3, 2016. (AA II:382.)

### D. The Court of Appeal issued a peremptory writ directing the Superior Court to deny in its entirety Petitioners' motion to compel arbitration, holding that a pre-dispute arbitration agreement cannot waive an employee's right to bring any type of PAGA claim in court.

On October 27, 2016, Petitioners filed their notice of appeal (the "Appeal"). (AA II:383-390.) On November 29, 2016, Petitioners also filed a petition for a writ of mandate (the "Writ Petition"), requesting that the Court of Appeal direct the Superior Court to vacate its Order compelling arbitration on a representative basis, and enter a new and different Order granting Petitioners' motion to compel Lawson to arbitrate her PAGA claim for unpaid wages under Section 558 on an individual basis, as required by the parties' arbitration agreement. (Ex. B to Petition for Review.) The Court of Appeal subsequently consolidated the Appeal and writ proceeding. (*Lawson*, 18 Cal.App.5th at 713.)

On December 19, 2017, the Court of Appeal filed its Opinion, dismissing the Appeal on the grounds the Superior Court's Order is non-appealable, but purporting to "grant" the Writ Petition, and issuing a peremptory writ of mandate requiring the Superior Court to vacate its Order that a portion of Lawson's claims be arbitrated, and enter a new order denying Petitioners' motion to compel arbitration in its entirety. (*Id.* at 725-26.) On December 21, 2017, the Court of Appeal modified its Opinion (and the judgment), altering its award of costs. (*Id.* at 705.)

Petitioners then filed a Petition for Review to the California Supreme Court on January 26, 2018, which the Court granted on March 21, 2018.

## IV. LEGAL ARGUMENT

### A. Courts must rigorously enforce arbitration agreements governed by the Federal Arbitration Act.

The FAA strongly favors the arbitration of disputes. (*See, e.g., Perry v. Thomas* (1987) 482 U.S. 483, 489 [interpreting the Federal Arbitration Act as "a congressional declaration of a liberal federal policy favoring arbitration agreements, notwithstanding any state substantive or procedural policies to the contrary"].) The United States Supreme Court has repeatedly emphasized in recent decisions the need for both federal and state courts to enforce arbitration agreements rigorously according to their terms. (*See, e.g., Italian Colors Restaurant*, 570 U.S. at 233 [explaining that "courts must 'rigorously enforce' arbitration agreements according to their terms, including terms that 'specify *with whom* [the parties] chose to arbitrate their disputes.'"], *quoting Stolt-Nielsen*, 559 U.S. 662, 683; *KPMG LLP v. Cocchi* (2011) 565 U.S. 18, 19 ["Agreements to arbitrate that fall within the scope and coverage of the [FAA], must be enforced in state and federal courts. State courts, then, 'have a prominent role to play as enforcers of agreements to arbitrate.'"]; *quoting Vaden v. Discover Bank* (2009) 556 U. S. 49, 59.)

Therefore, under the Supremacy Clause of the United States Constitution, "[w]hen the FAA applies, it preempts any contrary state law and is binding on state as well as federal courts." (*Mastick v. TD Ameritrade, Inc.* (2012) 209 Cal.App.4th 1258, 1263; *see Perry*, 482 U.S. at 493 [holding that FAA preempts Labor Code § 229, which permits employees to pursue civil actions to recover unpaid wages despite arbitration agreement]; *Screen Extras Guild v. Superior Court* (1990) 51 Cal.3d 1017, 1023 [explaining that when a state law conflicts with federal law, the "state action is preempted, without balancing state and federal interests, by direct operation of the supremacy clause of the United States Constitution"]; and *Nitro-Lift Techs., L.L.C. v. Howard* (2012) 568 U.S. 17, 21 [holding that "the Oklahoma

Supreme Court must abide by the FAA, which is 'the supreme Law of the Land,' U.S. Const., Art.VI, cl. 2, and by the opinions of this Court interpreting that law."])

As the United States Supreme Court explained in striking down a decision of the California Court of Appeal, Second Appellate District, invalidating a class-arbitration waiver:

> The Federal Arbitration Act is a law of the United States, and *Concepcion* is an authoritative interpretation of that Act. Consequently, the judges of every State must follow it. U. S. Const., Art. VI, cl. 2 ("[T]he Judges in every State shall be bound" by "the Laws of the United States").

(*DIRECTV, Inc. v. Imburgia* (2015) 577 U.S. ___, 136 S.Ct. 463, 468.)

As *Concepcion* makes clear, the FAA preempts state law rules that impose obstacles to the enforcement of arbitration agreements, whether those rules are legislative or court-made. (*Concepcion*, 563 U.S. 333 [striking down court-made rule that invalidated class-arbitration waivers in consumer arbitration agreements].) Hence, the FAA, not California law, governs whether Lawson (who is subject to a class-waiver provision in her arbitration agreement) may pursue her ***individual*** unpaid wages claim outside of arbitration by asserting the claim under PAGA.

### B. The California Supreme Court in *Iskanian* held that California's rule invalidating class action waivers in employment arbitration agreements violates the FAA.

In 2005, this Court held in *Discover Bank* that a class-waiver provision in an arbitration agreement in certain consumer contracts is unconscionable under California law because "the waiver becomes in practice the exemption of the party 'from responsibility for [its] own fraud, or willful injury to the person or property of another.'" (*Discover Bank v. Superior Court* (2005) 36 Cal.4th 148, 163 [*citing* CIVIL CODE § 1668] [*overruled by Concepcion*, 563 U.S. 333].) This Court later extended the

reasoning of *Discover Bank* to class waivers in the employment relationship, holding that California's interest in classwide resolution of employees' wage-and-hour claims required invalidating class-action waivers contained in arbitration agreements governed by the FAA. (*Gentry*, 42 Cal.4th at 450, 463-64.)

In *Concepcion*, the United States Supreme Court "consider[ed] whether the FAA prohibits States from conditioning the enforceability of certain arbitration agreements on the availability of classwide arbitration procedures." (*Concepcion*, 563 U.S. at 336.) Determining that the *Discover Bank* rule stood "as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress," the United States Supreme Court held that "California's *Discover Bank* rule is pre-empted by the FAA." (*Id.* at 352 [internal quotations and citation omitted].)

Thereafter, in 2011, this Court evaluated the "viability of *Gentry* in light of *Concepcion*." (*Iskanian*, 59 Cal.4th at 362.) After thoroughly evaluating the issue, this Court held that *Concepcion* also overruled *Gentry*:

> But *Concepcion* held that the FAA does prevent states from mandating or promoting procedures incompatible with arbitration. The *Gentry* rule runs afoul of this latter principle. We thus conclude in light of *Concepcion* that the FAA preempts the *Gentry* rule.

(*Iskanian*, 59 Cal.4th at 366.)

**1. The *Iskanian* decision creates a limited exception to its rule invalidating class action waivers for PAGA claims for which the State of California is the real party in interest.**

After determining that *Concepcion* required enforcement of class action waivers in the employment relationship, this Court held that a predispute arbitration agreement cannot waive an employee's right to bring a representative action under the PAGA. (*Iskanian*, 59 Cal.4th 348, 387-88).

The Court's decision was, however, limited to PAGA claims for which the State is the real party in interest. (*Id.* at 386-388.)

This Court explained that "[t]hrough his PAGA claim, Iskanian [was] seeking to recover civil penalties, *75 percent of which will go to the state's coffers*." (*Id.* at 387 [emphasis added].) The fact that the State was the primary recipient of the civil penalties was significant to this Court in *Iskanian*, which emphasized that its holding applies *only* "where any resulting judgment is binding on the state and any *monetary penalties largely go to state coffers*." (*Id.* at 388 [emphasis added].) The Court specifically noted that the *Iskanian* action "involve[d] an employee bound by an arbitration agreement bringing suit on behalf of the government to obtain remedies *other than victim-specific relief, i.e., civil penalties paid largely into the state treasury*." (*Id.* at 386 [emphasis added].)

The *Iskanian* decision limited its holding to PAGA actions in which the civil penalties were sought primarily on behalf of the State of California (75% payable to the State) – *i.e.*, cases in which the State of California is the real party in interest – not PAGA actions seeking individual, victim-specific relief. To avoid any doubt that claims seeking victim-specific relief (*i.e.*, unpaid wages payable directly to employees) under the PAGA were still subject to class-arbitration waivers under the FAA, the *Iskanian* court held:

> Our opinion today would not permit a state to circumvent the FAA by, for example, deputizing employee A to bring a suit for the individual damages claims of employees B, C, and D. **This pursuit of victim-specific relief by a party to an arbitration agreement on behalf of other parties to an arbitration agreement would be tantamount to a private class action, whatever the designation given by the Legislature.** Under *Concepcion*, such an action could not be maintained in the face of a class waiver.

(*Iskanian*, 59 Cal.4th at 387-88 [emphasis added].)

By adopting this limitation, this Court made clear that under the United States Supreme Court's *Concepcion* decision, an action seeking victim-specific, unpaid wages, even if asserted under the PAGA, "could not be maintained in the face of a class waiver." (*Iskanian*, 59 Cal.4th at 388.) A recent case from the First Appellate District recognizes this important limitation of the *Iskanian* exception, explaining:

> *Iskanian's* prohibition on representative action waivers applies only to a representative action under PAGA seeking recovery of civil penalties ("an action that can only be brought by the state or its representatives") where the state is the real party in interest. (*Iskanian*, *supra*, 59 Cal.4th at p. 388.)

(*Tanguilig v. Bloomingdale's, Inc.* (2017) 5 Cal.App.5th 665, 676 n.4 [emphasis added], *cert. denied* (2017) 583 U.S. ___, 138 S.Ct. 356; *see also Hernandez v. DMSI Staffing, LLC* (N.D. Cal. 2015) 79 F.Supp.3d 1054, 1064 [explaining that when evaluating whether the FAA preempts California law prohibiting class waivers of PAGA claims "[t]he proper focus is on the real party in interest"].) As explained below, Lawson, not the State, is the real party in interest for her claim seeking unpaid wages payable 100% to her under Section 558, subdivision (a)(3).

**2. Lawson, not the State of California, is the real party in interest for the claim seeking victim-specific, unpaid pages under Labor Code section 558(a).**

In determining whether individual arbitration of the unpaid wages claim under Labor Code section 558 is subject to arbitration, the *Iskanian* decision requires an analysis of who is the "real party in interest." (*Iskanian*, *supra*, 59 Cal.4th at 388.) In this action, Lawson seeks two types of recovery under Labor Code section 558: (1) civil penalties of $50 for the initial violation and $100 per pay period for each subsequent violation, payable 75% to the State of California; and (2) unpaid wages recoverable individually

by Lawson and other non-exempt employees – amounts that would go 100% to the affected employees, not to the State. The State of California is the real party in interest for the $50/$100 civil penalties that "largely go to state coffers." (*Iskanian*, *supra*, 59 Cal.4th at 388.) The State is not, however, "the real party in interest" for the separate claim for unpaid wages Lawson seeks to recover under Section 558.

Here, without question, the State would not share in any of the unpaid wages Lawson seeks to recover in this action. (LABOR CODE § 558(a)(3).) Rather, Section 558 allows for the recovery of "an amount sufficient to recover underpaid wages," which amount "shall be paid to the affected employee." (LABOR CODE § 558(a)(3).)

Lawson's counsel necessarily conceded during the hearing on the motion to compel arbitration that individual employees, not the State of California, receive all unpaid wages under Section 558 – *i.e.*, there is no 75/25 split of the usual PAGA civil penalties, which go primarily to the State of California.

| | |
|---|---|
| THE COURT: | Who gets the penalty? |
| MS. GHOSH: | I'm sorry? |
| THE COURT: | **Who gets the penalty?** |
| MS. GHOSH: | **The employee gets the penalty.** |
| THE COURT: | Okay, this is a PAGA representative claim and the employee gets the penalty, right? |
| MR. SINCLAIR: | Yes. |
| THE COURT: | That's what you are saying? |
| MS. GHOSH: | Yes. |

(Reporter's Transcript, at pp. 11:27-12:8 [emphasis added].)[2]

Lawson – and not the State of California – necessarily is the real party in interest for the claim seeking *unpaid wages* under Labor Code section 558, because Lawson has asserted a claim for victim-specific, unpaid wages recoverable solely and exclusively by her, albeit styled in her Complaint as a PAGA claim. Lawson's claim for unpaid wages under Labor Code section 558 therefore falls squarely within the *Iskanian* exception. (*Esparza v. KS Indus., L.P.* (2017) 13 Cal.App.5th 1228, 1246 ["The rule of nonarbitrability adopted in *Iskanian* is limited to representative claims for civil penalties in which the state has a direct financial interest."].)

### C. The Court of Appeal's decision misapprehends the *Iskanian* exception, contravenes *Concepcion* and other Supreme Court precedent, and improperly rejects the Fifth Appellate District's holding in *Esparza* that the *Iskanian* exception applies to claims for unpaid wages.

In the motion to compel arbitration, Petitioners sought to compel to arbitration only Lawson's ***individual*** claim for unpaid wages under Labor Code section 558. (AA I:021.) Petitioners limited their motion to Lawson's claim seeking unpaid wages, recognizing that the *Iskanian* decision precluded them from moving to compel arbitration of claims seeking traditional PAGA penalties payable primarily to the State of California ($50/$100 per pay period under Labor Code section 558). Therefore, with respect to PAGA claims seeking civil penalties payable primarily to the State of California, there is no individual claim to be compelled to arbitration, since the State is the real party in interest. For these civil penalties, the action

[2] Attorney Joanna Ghosh appeared on behalf of Lawson at the hearing on the motion to compel arbitration. Attorney Brian Sinclair appeared on behalf of Petitioners.

truly is "a representative action on behalf of the state." (*Iskanian*, *supra*, 59 Cal.4th at 386–87.)

Although the Court of Appeal recognized that Labor Code section 558 permits employees asserting PAGA claims to recover individualized, victim-specific unpaid wages, the Court of Appeal elevated form over substance by holding that the unpaid wages are merely part of the civil penalty under the PAGA and, therefore, the State remained the real party in interest unbound by the arbitration agreement. Specifically, the Court of Appeal held that unpaid wages available under section 558 constitute an additional part of the civil penalties set forth in the statute, and that monetary penalties under PAGA (of which the State receives 75%, while the employee receives 25%) cannot be separated from unpaid wages claims, even though the affected employees retain all unpaid wages recovered in the action. (*Lawson*, 18 Cal.App.5th at 716-18, 722-24.)

Relying on its decision in a pre-*Iskanian* case, the Court of Appeal held that "in bringing a PAGA action an employee is not acting on his or her own behalf, but on behalf of the state and the state is not bound by the employee's prior agreement, including any waiver of his or right to bring a representative action." (*Id.* at 725.) Thus, the Court of Appeal held, because the employee effectively acts on behalf of the State, which is not a party to any arbitration agreement, the Superior Court erred in ordering Lawson to arbitrate any part of her PAGA claim, including the portion seeking victim-specific, unpaid wages under Labor Code section 558. (*Id.*)

#### 1. The Court of Appeal's decision misapprehends *Iskanian* and contravenes *Concepcion*.

The Fourth Appellate District's decision misapprehends the limitation the *Iskanian* court imposed on class-action waivers involving PAGA claims. Specifically, the Court of Appeal's Opinion ignores the express limitation that *Iskanian* articulated by permitting Lawson – "Employee A" in

*Iskanian*'s parlance – to seek the recovery of underpaid wages on behalf of other employees – "Employees B, C, and D" as described in *Iskanian* – in the face of an undisputed class action waiver. This ruling contravenes the United States Supreme Court's holding in *Concepcion* and the *Iskanian* exception, based on the fiction that Lawson stands in the shoes of the State, even though none of the unpaid wages recovered under Section 558 would be paid to the State.

The fiction is evident. Lawson purports to stand in the shoes of the State to assert claims under PAGA, when in actuality she is asserting claims to recover unpaid wages entirely on behalf of herself. In other words, Lawson is standing in her own shoes to pursue her own individual unpaid wage claims (and those of other employees) under Labor Code section 558. The Court of Appeal's decision "is based on semantics and not substance" because "the financial reality [is] that 100 percent of the 'amount sufficient to recover underpaid wages' is paid to the affected employee." (*Esparza*, 13 Cal.App.5th, at 1245; *quoting* LABOR CODE § 558(a)(3).)

The Fourth Appellate District's decision in this case would – in direct contravention of the United States Supreme Court's decision in *Concepcion* – permit employees to pursue representative, quasi-class claims for unpaid wages under PAGA in the trial courts despite FAA-governed arbitration agreements that permissibly preclude class claims. This is the very circumstance this Court sought to avoid when it articulated the *Iskanian* exception.

Rather than rigorously enforcing the FAA, the Fourth Appellate District ignores the *Iskanian* exception and binding U.S. Supreme Court precedent. Instead, the *Lawson* decision adopts a "judicially created" state rule that prevents parties to an arbitration agreement – Lawson and CB&T – from being able to enforce their agreement to resolve through arbitration on an individual basis any unpaid wages claims arising between them. To

conclude that this judge-made rule does not frustrate the purposes of the FAA, the Fourth Appellate District ignores not only the basic precepts enunciated in *Concepcion* but also the careful balance drawn by this Court in *Iskanian* and the Fifth Appellate District in *Esparza*.

The Fifth Appellate District opinion in *Esparza* is instructive regarding the careful balance the *Iskanian* court drew between FAA preemption for PAGA claims seeking traditional civil penalties paid primarily to the State of California, on the one hand, and PAGA "claims for unpaid wages and other types of victim-specific relief" payable directly to employees, on the other hand. (*Esparza*, 13 Cal.App.5th at 1234, 1246.) The *Esparza* court explained that claims seeking unpaid wages, even under PAGA, are "private disputes" that must be arbitrated pursuant to the terms of the parties' arbitration agreement. (*Id.* at 1234, 1246.) The excerpt below from the *Esparza* decision makes clear that the *Lawson* decision rests upon a misconception of this Court's decision in *Iskanian*:

> In *Iskanian*, our Supreme Court explained why a representative action under the PAGA that sought only civil penalties was not subject to arbitration and why this rule of nonarbitrability was not preempted by the Federal Arbitration Act. (*Iskanian*, *supra*, 59 Cal.4th at pp. 378-389.) That explanation is summarized here.
>
> Our Supreme Court reviewed the text of the Federal Arbitration Act and concluded the act's focus was on private disputes, not disputes between an employer and a state agency – parties with no contractual relationship. (*Iskanian*, *supra*, 59 Cal.4th at p. 384.) As to United States Supreme Court cases applying the Federal Arbitration Act, our high court stated that, with one exception, those cases consisted "entirely of disputes involving the parties' own rights and obligations, not the rights of a public enforcement agency." (*Iskanian*, *supra*, at p. 385.) Our high court then stated:

> "[A] PAGA claim lies outside the [Federal Arbitration Act's] coverage because it is not a dispute between an employer and an employee arising out of their contractual relationship. It 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.* at pp. 386-387.)

The court emphasized the distinction between a dispute between the state and an employer, which was not covered by the Federal Arbitration Act, and a private dispute between the employer and one or more employees by stating: "Our opinion today would not permit a state to circumvent the [Federal Arbitration Act] by, for example, deputizing employee A to bring a suit for the individual damages claims of employees B, C, and D." (*Iskanian*, *supra*, 59 Cal.4th at p. 387.) Thus, an employee's status as the proxy or agent of the state while pursuing a PAGA representative action is not merely semantic, but reflects the substantive role of the employee in enforcing California labor law on behalf of state agencies and producing (1) a judgment binding on the state and (2) monetary penalties that largely would go to state coffers. (*Iskanian*, *supra*, at p. 388.)

* * *

Employee's contention that his claim for unpaid wages constitutes a civil penalty is based on Labor Code section 558, subdivision (a), which provides in full:

> "(a) Any employer or other person acting on behalf of an employer who violates, or causes to be violated, a section of this

> chapter or any provision regulating hours and days of work in any order of the Industrial Welfare Commission shall be subject to a *civil penalty* as follows:
>
> "(1) For any initial violation, fifty dollars ($50) for each underpaid employee for each pay period for which the employee was underpaid in addition to an amount sufficient to recover underpaid wages.
>
> "(2) For each subsequent violation, one hundred dollars ($100) for each underpaid employee for each pay period for which the employee was underpaid *in addition to an amount sufficient to recover underpaid wages.*
>
> "(3) *Wages recovered pursuant to this section shall be paid to the affected employee.*" (Italics added.)

Employee argues this text clearly states that an award "an amount sufficient to recover underpaid wages" is a civil penalty. Employee further argues that this "civil penalty" under Labor Code section 558 constitutes a "civil penalty" within the meaning of Labor Code section 2699, subdivision (a) and a "civil penalty" for purposes of the rule adopted in *Iskanian*. We disagree. Employee's argument is based on semantics and not substance. One substantive aspect of the claim is the financial reality that 100 percent of the "amount sufficient to recover underpaid wages" is paid to the affected employee. (Lab. Code, § 558, subd. (a)(2).) In *Iskanian*, our Supreme Court clearly expressed the need to avoid semantics and analyze substance in determining the scope of representative claims that could be pursued outside arbitration without violating the Federal Arbitration Act. (*See Iskanian, supra*, 59 Cal.4th at p. 388.) In short, parsing the language in the

California statutes does not determine the scope of the federal statute, which ultimately is the legislation that controls whether a particular claim by Employee is subject to arbitration.

Employee's attempt to recover unpaid wages under Labor Code section 558 is, for purposes of the Federal Arbitration Act, a private dispute arising out of his employment contract with KS Industries. In statutory terms, the wage claim is covered by "[a] written provision in . . . a contract . . . to settle by arbitration a controversy thereafter arising out of such contract." (9 U.S.C. § 2.) The dispute over wages is a private dispute because, among other things, it could be pursued by Employee in his own right. We recognize that private disputes can overlap with the claims that could be pursued by state labor law enforcement agencies. When there is overlap, the claims retain their private nature and continue to be covered by the Federal Arbitration Act. To hold otherwise would allow a rule of state law to erode or restrict the scope of the Federal Arbitration Act – a result that cannot withstand scrutiny under federal preemption doctrine. Therefore, we conclude preventing arbitration of a claim for unpaid wages would interfere with the Federal Arbitration Act's goal of promoting arbitration as a forum for private dispute resolution. (*See Iskanian*, *supra*, 59 Cal.4th at p. 389.)

Similarly, Employee's attempt to recover wages on behalf of *other aggrieved employees* involve victim-specific relief and private disputes. The rule of nonarbitrability adopted in *Iskanian* is limited to claims "that can *only* be brought by the state or its representatives, where any resulting judgment is binding on the state and any monetary penalties largely go to state coffers." (*Iskanian*, *supra*, 59 Cal.4th at p. 388, italics added.) These limitations are not met by the claims for unpaid wages owed to other aggrieved

> employees because (1) those employees could pursue recovery of the unpaid wages in their own right and (2) the unpaid wages recovered would not go to state coffers.
>
> In sum, Employee's claims for unpaid wages are subject to arbitration pursuant to the terms of the parties' arbitration agreement and the Federal Arbitration Act. The rule of nonarbitrability adopted in *Iskanian* is limited to representative claims for civil penalties in which the state has a direct financial interest.

(*Esparza*, 13 Cal.App.5th at 1243–46.)

The Court of Appeal in the instant case rejected the *Esparza* court's reasoning, holding that (1) while Section 558 does permit individual recovery of unpaid wages by a plaintiff-employee, the plaintiff-employee must first satisfy PAGA procedural requirements and acts "in the place of and for the Labor and Workforce Development Agency ('LWDA')," such that the claim is not purely private; and (2) *Iskanian* permits the recovery of all "civil penalties" under Section 558, including unpaid wages, "even when an employee is subject to a class waiver agreement." (*Lawson*, 18 Cal.App.5th at 716-18, 722-24.)

The Court of Appeal's decision in *Lawson* allows employees to avoid their obligation to arbitrate individual wage claims by characterizing the unpaid wages under Labor Code section 558(a)(3) as "civil penalties," even though any amount recovered would constitute "wages" paid directly "to the affected employee[s]." (LABOR CODE § 558(a)(3).) The *Esparza* court properly rejected this exact argument, explaining that the "argument is based on semantics and not substance" because "the financial reality [is] that 100 percent of the 'amount sufficient to recover underpaid wages' is paid to the affected employee." (*Esparza*, 13 Cal.App.5th, at 1245; *quoting* LABOR CODE § 558(a)(3).)

In plain statutory terms, the wage claim by Lawson under Labor Code section 558(a), even if asserted as a PAGA claim, is covered by "'[a] written provision in . . . a contract . . . to settle by arbitration a controversy thereafter arising out of such contract.' (9 U.S.C. § 2.)" (*Esparza*, 13 Cal.App.5th at 1246.) Therefore, it is subject to individual arbitration, even if the Fourth Appellate District might believe that it is "desirable for unrelated reasons" for such claim to be heard in the Superior Court. (*Concepcion*, 563 U.S. at 351.) Accordingly, the *Lawson* decision must be overruled as inconsistent with the *Iskanian* exception and *Concepcion*, and the Superior Court should be directed to enter a new Order compelling Lawson's unpaid wages claim to arbitration on an *individual* basis.

**2. The Ninth Circuit Court of Appeals and the U.S. District Court for the Northern District of California have rejected the *Lawson* decision as violating the Federal Arbitration Act.**

As of the filing of this Opening Brief, the only two federal cases to analyze the split between *Lawson* and *Esparza* have both rejected the Fourth Appellate District's holding in *Lawson*. (*See Mandviwala v. Five Star Quality Care, Inc.* (9th Cir., Feb. 2, 2018) 2018 WL 671138, at *2, 2018 U.S. App. LEXIS 2770 , at *3-5; *Cabrera v. CVS Rx Servs.* (N.D. Cal. March 16, 2018) 2018 U.S. Dist. LEXIS 43681, *14-15.)[3] The Ninth Circuit Court of Appeals followed the *Esparza* decision, which it found both to be "more

[3] California courts have recognized the appropriateness of citing cases reported on computer services, like LEXIS and Westlaw. *See, e.g., Ortega Rock Quarry v. Golden Eagle Ins. Corp.* (2006) 141 Cal.App.4th 969, 986 n.1, *citing Discover Bank v. Superior Court* (2005) 134 Cal.App.4th 886, 892 n.2 ("Although California Rules of Court, rule 977, prohibits citation of unpublished opinions of California's appellate courts, it does not prohibit citation of unpublished federal opinions.").

consistent with *Iskanian*" and to "reduce[s] the likelihood that *Iskanian* will create FAA preemption issues":

> Recovery of unpaid wages is a private dispute, particularly because it could be pursued individually by the employee. *Id.* at 1246. *Iskanian* is limited to claims "that can only be brought by the state or its representatives, where any resulting judgment is binding on the state and any monetary penalties largely go to state coffers." *Id.* (quoting *Iskanian*, 59 Cal.4th at 388).
>
> [¶¶]
>
> We find *Esparza* to be more consistent with the ruling of *Iskanian*. *Esparza* specifically distinguished between individual claims for compensatory damages (such as unpaid wages) and PAGA claims for civil penalties, which is more consistent with *Iskanian* and reduces the likelihood that *Iskanian* will create FAA preemption issues. *See Esparza*, 13 Cal. App. 5th at 1246 ("Employees claims for unpaid wages are subject to arbitration pursuant to the terms of the parties' arbitration agreement and the [FAA]. The rule of nonarbitrability adopted in *Iskanian* is limited to representative claims for civil penalties in which the state has a direct financial interest.").
>
> Thus, based on *Esparza*, we reverse the district court's order and remand to the district court to order arbitration of the victim-specific relief sought by Mandviwala.

(*Mandviwala*, 2018 WL 671138, at *2, 2018 U.S. App. LEXIS 2770 , at *4-5.)

The District Court for the Northern District of California similarly rejected the *Lawson* holding in favor of *Esparza*. (*Cabrera*, 2018 U.S. Dist. LEXIS 43681, *14-15.) After analyzing both the *Esparza* and *Lawson*

decisions, the District Court in *Cabrera* (Judge William Alsup) agreed with *Esparza* that a claim for unpaid wages is indeed a private dispute because it could be pursued by a plaintiff in her own right, and not on behalf of the State. The District Court held that "Plaintiffs' PAGA claim for unpaid wages [under Labor Code § 558] accordingly falls squarely within the scope of the parties' agreement to arbitrate and *arbitration of this victim-specific relief is therefore proper.*" (*Id.* at *15 [emphasis added].)

The *Lawson* case stands alone in finding that an employee may circumvent his or her arbitration agreement by pursuing unpaid wages under the PAGA. The Fourth Appellate District's reasoning elevates form over substance, which is contrary to California law. (CIVIL CODE § 3528 ["The law respects form less than substance."]; *Esparza*, 13 Cal.App.5th, at 1245.) Courts should be especially careful to avoid elevating form over substance when interpreting the FAA, which embodies "a liberal federal policy favoring arbitration agreements, notwithstanding any state substantive or procedural policies to the contrary[.]" (*Moses H. Cone Mem'l Hosp. v. Mercury Constr. Corp.* (1983) 460 U.S. 1, 24.)

### 3. The *Lawson* court's conclusion that arbitration may be appropriate if Petitioners proved the primary recovery would go to employees' conflicts with Supreme Court precedent prohibiting judge-made rules that impose evidentiary hurdles to arbitration.

The Court of Appeal's holding further sows confusion by opining that the *Iskanian* exception may apply if an employer can prove that the predominant recovery in a PAGA action will be paid to employees instead of to the State. Specifically, the Court of Appeal observed that "there is nothing in the record which suggests the predominate amounts recovered under section 558 will be in the form of underpaid wages payable to employees." (*Lawson*, 18 Cal.App.5th at 724.) The Court of Appeal reasoned that "depending upon how many violations occurred during a pay

period and the effected employees' rate of pay, it is quite possible that, at least as to the rest break and meal break allegations, the underpaid wage portion of any recovery will fall within the 25 percent range implicitly approved by the court in *Iskanian*." (*Id.*) Therefore, the Court of Appeal explained, its "conclusion with respect to preemption [under the FAA] is without prejudice to ZB's right to show, on a fuller factual record, that preemption should apply here." (*Id.* at 726 n.5.)

As explained above, Petitioners moved to compel arbitration of Lawson's claims for underpaid wages to be recovered 100% by Lawson, with none going to the State. (AA I:021.) Whether those "underpaid wages" would ultimately form the predominant amount of the total recovery in the action – something that cannot be known at this preliminary stage of the action before a judgment is entered – is irrelevant. (*Broughton v. Cigna Healthplans* (1999) 21 Cal.4th 1066, 1088 ["United States Supreme Court case law makes clear that when a suit contains both arbitrable and inarbitrable claims, the arbitrable claims should be severed from those that are inarbitrable and sent to arbitration."] [*citing Dean Witter Reynolds Inc. v. Byrd* (1985) 470 U.S. 213, 221]; 9 U.S.C. § 3 [requiring court to stay arbitrable dispute "until such arbitration has been had in accordance with the terms of the agreement"].)

More importantly, the Court of Appeal's decision that FAA preemption will apply if Petitioners develop a record of the amount of unpaid wages paid to employees versus civil penalties paid to the State violates the United States Supreme Court's holding in *Italian Colors*, which rejected a requirement that a party seeking to enforce an arbitration first meet certain evidentiary burdens regarding the merits or value of the claims:

> The regime established by the Court of Appeals' decision would require – before a plaintiff can be held to contractually agreed bilateral arbitration – that a federal court determine (and the parties

> litigate) the legal requirements for success on the merits claim-by-claim and theory-by-theory, the evidence necessary to meet those requirements, the cost of developing that evidence, and the damages that would be recovered in the event of success. Such a preliminary litigating hurdle would undoubtedly destroy the prospect of speedy resolution that arbitration in general and bilateral arbitration in particular was meant to secure. The FAA does not sanction such a judicially created superstructure.

(*Italian Colors*, 570 U.S. at 238-39.)

In addition to conflicting with the holding in *Italian Colors*, the Court of Appeal's decision in this matter also creates an anomalous situation in which the FAA preempts some PAGA claims seeking "underpaid wages" under Labor Code section 558, while not preempting other PAGA claims, with the distinction being dependent upon a Superior Court's finding as to whether the underpaid wages recovery or the civil penalties recovery will predominate. In fact, the Court of Appeal specifically stated that FAA preemption could "depend[] upon how many violations occurred during a pay period and the effected employees' rate of pay." (*Lawson*, 18 Cal.App.5th at 724.) In other words, the Court of Appeal has adopted a sliding-scale standard for FAA preemption. This standard would require an employer to develop evidence at the outset of an action that the predominant relief would be underpaid wages instead of civil penalties, necessitating extensive discovery and expert analysis before a motion to compel arbitration could even be filed. This portion of the holding directly contravenes *Italian Colors*, which prohibits pre-arbitration litigation involving the merits and value of the arbitrable claims to determine whether arbitration is appropriate.

In addition, the evidentiary burden the Court of Appeal has adopted presents an unworkable standard for several reasons. First, when a motion to compel arbitration is brought at the outset of an action, trial courts will not

have made any rulings regarding what, if any, civil penalties should be awarded. (*See*, *Law Offices of Dixon R. Howell v. Valley* (2005) 129 Cal.App.4th 1076, 1101 [explaining that motion to compel arbitration "should be brought at the earliest opportunity"].) Second, for employers to obtain an order compelling arbitration, the Court of Appeal's reasoning would effectively require employers to concede that the liability for underpaid wages exceeds the liability for civil penalties.

This approach would preclude an employer from moving to compel arbitration of the underpaid wages portion of the action without first admitting substantial liability. Moreover, under this standard, an employer who denies liability altogether could not move to compel arbitration, because the employer would be unable to establish that any underpaid wages recovery would predominate over any civil penalties recovery. For that matter, if the employer contends that it has no liability for either civil penalties or unpaid wages – *i.e.*, the State is entitled to $0 and the employee is entitled to $0 – such a claim could not be considered under *Lawson's* sliding-scale, damages-dependent approach to FAA preemption.

Indeed, this sliding-scale approach would likely result in a two-tiered application of the FAA, in which higher-paid workers are required to arbitrate their disputes, while lower-paid workers are not. For example, if a non-exempt computer programmer makes $43.00 per hour,[4] he or she would need to have an average of 2½ meal period violations per pay period for the underpaid wages portion of the Section 558 claim to predominate over the $100 per-pay-period civil penalty. On the other hand, a lower-wage earner making $11 per hour would need to have more than nine violations per pay

[4] The minimum hourly wage for the computer software exemption under Labor Code section 515.5 is $43.58 per hour in 2018. (*See*, *https://www.dir.ca.gov/oprl/ComputerSoftware.pdf*.)

period for the underpaid wages portion of the Section 558 claim to predominate.

As the Court of Appeal acknowledges, its sliding-scale approach to application of the FAA necessarily "depend[s] upon how many violations occurred during a pay period and the effected employees' rate of pay." (*Lawson*, 18 Cal.App.5th at 724.) This simply should not be the law. Just as in the *Italian Colors* decision, the procedure established by the Court of Appeal's decision here would require – before an employer could compel arbitration – that the "court determine (and the parties litigate) the legal requirements for success on the merits claim-by-claim and theory-by-theory, the evidence necessary to meet those requirements, the cost of developing that evidence, and the damages that would be recovered in the event of success." (*Italian Colors*, 570 U.S. at 238-39.) "The FAA does not sanction such a judicially created superstructure." (*Id.*)

Moreover, the Court of Appeal's Opinion provides no clear dividing line for when trial courts should find that FAA preemption is inapplicable. Is it when 51% of the recovery is payable to the State, or perhaps when 60% is payable to the State, or alternatively, when 75% is payable to the State? There is simply no discernible, consistent standard.

Furthermore, the final amount of liability cannot be known until the trial court renders a judgment in the action at any rate, as a result of Labor Code section 2699(d)(2). That statute allows the trial courts to "award a lesser amount [of PAGA penalties] if, based on the facts and circumstances of the particular case, to do otherwise would result in an award that is unjust, arbitrary and oppressive, or confiscatory." (LABOR CODE § 2699(d)(2).) Must the employer move to compel arbitration of the underpaid wages portion of the claim *after* entry of judgment, with the judgment then being subject to *res judicata* in the arbitral forum, effectively eviscerating the arbitration, in contravention of the FAA? (*See, e.g., Federal Ins. Co. v.*

*Superior Court* (1998) 60 Cal.App.4th 1370, 1374 [explaining that "[t]he purpose of the statutory stay is to protect the jurisdiction of the arbitrator by preserving the status quo until arbitration is resolved"]; *Franco v. Arakelian Enterprises, Inc.* (2015) 234 Cal.App.4th 947, 966 ["The stay's purpose is to preserve the status quo until the arbitration is resolved, preventing any continuing trial court proceedings from disrupting and rendering ineffective the arbitrator's jurisdiction to decide the issues that are subject to arbitration."].)

Here, the Court of Appeal has imposed an insurmountable and impermissible precondition on an employer seeking to compel arbitration, by first requiring proof that "the predominate amounts recovered under section 558 will be in the form of underpaid wages payable to employees" instead of payable to the State as traditional PAGA civil penalties. This procedural superstructure cannot withstand preemption under the FAA.

**4. The *Lawson* decision conflicts with the United States Supreme Court's post-*Iskanian* decision in *Kindred Nursing*, holding that a judge-made rule preventing an agent or proxy from entering into an arbitration agreement contravenes the Federal Arbitration Act.**

After the 2014 *Iskanian* decision, the United States Supreme Court had occasion to review another court-imposed limitation to the enforcement of arbitration agreements, this time from the Kentucky Supreme Court. (*Kindred Nursing Centers Ltd. P'ship v. Clark* (2017) 581 U.S. __,137 S.Ct. 1421.) In *Kindred Nursing*, the Kentucky Supreme Court held that "a general grant of power (even if seemingly comprehensive) does not permit a legal representative to enter into an arbitration agreement for someone else." (*Kindred*, 137 S.Ct. at 1425). Rather, to form a valid arbitration agreement, the power of attorney must contain language specifically authorizing the representative to waive the principal's constitutional rights to access to the courts and to trial by jury. (*Id.*) In *Kindred Nursing*, the United States

Supreme Court rejected this court-imposed rule, finding that such a rule "single[d] out arbitration agreements for disfavored treatment" and, therefore, violated the FAA. (*Kindred*, 137 S.Ct. at 1425.) Under the *Kindred Nursing* holding, the proper inquiry is whether the grant of authority is "sufficiently broad to cover executing an arbitration agreement." (*Kindred*, 137 S.Ct. at 1429.)

The *Kindred Nursing* decision calls into question not only the *Lawson* decision, but the *Iskanian* decision itself. Specifically, the *Lawson* and *Iskanian* decisions are premised on "a PAGA litigant's status as 'the proxy or agent' of the state." (*Iskanian*, 59 Cal.4th at 388.) This Court referred to a PAGA plaintiff as "a statutorily designated proxy" and as "the proxy or agent of the state labor law enforcement agencies." (*Iskanian*, 59 Cal.4th at 388, 394.) In other words, the PAGA statute has granted employees broad powers to act on behalf of the State of California to seek civil penalties for violations of the Labor Code, just like the agent in *Kindred Nursing* was given broad power to act on behalf of the patient.

Despite the broad power granted by the State of California to plaintiff-employees to pursue claims on the State's behalf and control the litigation, both the *Iskanian* and *Esparza* decisions nonetheless prohibit these plaintiff-employees who have been appointed as agents of the State from entering into predispute arbitration agreements to resolve PAGA claims. This judge-made rule "singles out arbitration agreements for disfavored treatment" and, therefore, violates the FAA. (*Kindred*, 137 S.Ct. at 1425.) There is no principled distinction between the facts in *Kindred Nursing* and the facts in *Lawson*, both of which refuse to allow a designated agent to enter into an arbitration agreement, despite having been granted broad authority to do so.

*Kindred Nursing* and *Lawson* – and for that matter *Iskanian* – cannot coexist for a number of reasons. First, *Lawson* holds that the State of California may disregard an arbitration agreement entered into by its

designated agent (the plaintiff-employee), while *Kindred Nursing* rejects the concept that a judge-made rule can limit an agent's right to enter into an arbitration agreement. Second, the *Lawson* court justified its ruling based on the public policy and public interest underlying the PAGA statute, while the *Kindred Nursing* court, in finding the arbitration agreement enforceable, expressly rejected the State of Kentucky's asserted public policy. (*Cf. Lawson*, 18 Cal.App.5th at 715-17 with *Kindred Nursing*, 137 S.Ct. at 1425-29; *see also Concepcion*, 563 U.S. at 351 ["States cannot require a procedure that is inconsistent with the FAA, even if it is desirable for unrelated reasons."].)

Therefore, the basis for not only the *Lawson* court's refusal to compel Lawson to arbitrate her individual claims, but also the *Iskanian* court's refusal to compel individual arbitration of PAGA claims, has been undermined by the United States Supreme Court's decision in *Kindred Nursing*. (*See Miller v. Gammie* (9th Cir. 2003) 335 F.3d 889, 893 [holding that "where the reasoning or theory of our prior circuit authority is clearly irreconcilable with the reasoning or theory of intervening higher authority," the earlier decision is "effectively overruled"]; *see also Iskanian*, 59 Cal.4th at 364 [holding that *Concepcion* impliedly overruled the *Gentry* decision].) For this additional reason, the *Lawson* court's decision must be overruled, and this Court should reexamine the entire premise underlying its *Iskanian* decision in light of the *Kindred Nursing* ruling.

### D. Allowing Lawson to pursue her individual, victim-specific wage claims on a representative basis in court nullifies the parties' arbitration agreement.

One simple question exposes the flaws in Lawson's arguments and the Fourth Appellate District's decision: Why did Lawson seek to recover her and other employees' unpaid wages under PAGA – which has a one-year statute of limitations – instead of under the applicable Labor Code

provisions, which generally have a three-year statute of limitations? The answer is clear: Lawson had an enforceable arbitration agreement that required her to arbitrate her wage claims on an individual basis, and Lawson was attempting to circumvent her agreement by asserting the exact same claim under the PAGA.

Ordering CB&T to defend Lawson's unpaid wages claim on a representative basis in court, instead of an individual basis in arbitration, fundamentally alters the arbitration procedure to which the parties agreed: arbitration only on an individual basis. (*See Iskanian*, 59 Cal.4th, at 364 [explaining that, under *Concepcion*, "because class proceedings interfere with fundamental attributes of arbitration, a class waiver is *not* invalid even if an individual proceeding would be an ineffective means to prosecute certain claims"]; *Concepcion*, 563 U.S. at 348 [explaining that requiring parties to follow class procedures "sacrifices the principal advantage of arbitration – its informality – and makes the process slower, more costly, and more likely to generate procedural morass"].)

Here, Petitioners entered into a bilateral Arbitration Agreement with Lawson to achieve "the informality of arbitral proceedings," thereby "reducing the cost and increasing the speed of dispute resolution." (*See Concepcion*, 563 U.S. at 345.) Acknowledging that class and representative claims are less efficient to adjudicate, the Arbitration Agreement with Lawson provides that the "no arbitration can be brought as a class action (in which a claimant seeks to represent the legal interests of or obtain relief for a larger group), and the parties recognize that the arbitrator has no authority to hear an arbitration either against or on behalf of a class." (AA I:051, 064.) The Arbitration Agreement allows for disputes arising out of the employment relationship to be resolved only in an individual capacity. It is indisputable that Lawson's claims in this action arise out of her employment relationship with CB&T.

Therefore, allowing Lawson to pursue her individual, victim-specific wage claims on a representative basis in court undermines (in fact, eviscerates) the Arbitration Agreement between the parties, in contravention of the FAA. Even if California courts believe it is desirable to allow plaintiff-employees to pursue individual wage claims under PAGA in contravention of their arbitration agreements, the FAA does not permit such a result. (*Concepcion*, 563 U.S. at 351 ["States cannot require a procedure that is inconsistent with the FAA, even if it is desirable for unrelated reasons."])

### E. Upholding the decision below would enable states to adopt rules precluding the enforcement of all arbitration agreements.

Petitioners recognize that Labor Code section 558 refers to unpaid wages as part of a "civil penalty." Referring to unpaid wages as a civil penalty, however, does not transform the nature of the relief sought, which is compensatory damages in the form of unpaid wages. If state legislatures could so easily transform employees' wage claims into "civil penalties" claims on behalf of the State, legislatures could adopt rules that would circumvent all arbitration agreements.

If this Court were to adopt the reasoning of *Lawson*, it would become remarkably easy for the State of California to negate the FAA in its entirety in employment cases. For example, with respect to wage-and-hour claims, the California legislature could add a few simple provisions to Labor Code section 2699 to undermine all class-arbitration waivers in the employment setting, in contravention of *Concepcion* and *Kindred Nursing*:

> (f) For all provisions of this code except those for which a civil penalty is specially provided, there is established a civil penalty for a violation of these provisions, as follows:
>
> (1) If, at the time of the alleged violation, the person does not employ one or more employees, the civil penalty is five hundred

> dollars ($500)**, in addition to an amount sufficient to recover any underpaid wages**.
>
> (2) If, at the time of the alleged violation, the person employs one or more employees, the civil penalty is one hundred dollars ($100) for each aggrieved employee per pay period for the initial violation and two hundred dollars ($200) for each aggrieved employee per pay period for each subsequent violation)**, in addition to an amount sufficient to recover any underpaid wages**.
>
> [¶¶]
>
> (i) Except as provided in subdivision (j), civil penalties recovered by aggrieved employees shall be distributed as follows: 75 percent to the Labor and Workforce Development Agency . . . and 25 percent to the aggrieved employees. **Wages recovered pursuant to this section shall be paid to the affected employee**

By adding these few simple bolded and underlined provisions to the PAGA, the California legislature could deputize any aggrieved employee to seek so-called "civil penalties" in the form of "underpaid wages." The legislature could add similar provisions to other statutes (*e.g.*, the California Fair Employment and Housing Act), deputizing employees to seek so-called civil penalties on behalf of the State, but making the lost wages portion payable directly to affected employees. This is exactly what the *Iskanian* court warned could not be done when it adopted the *Iskanian* exception to avoid violating *Concepcion* and the FAA: "Our opinion today would not permit a state to circumvent the FAA by, for example, deputizing employee A to bring a suit for the individual damages claims of employees B, C, and D." (*Iskanian*, 59 Cal.4th at 387-88.)

By misinterpreting the *Iskanian* exception, the *Lawson* court allows the State of California to circumvent the FAA by deputizing Lawson to seek

victim-specific, unpaid wages under Labor Code section 558. As the *Iskanian* court recognized, this is not permitted under *Concepcion*. (*Id.*) Rather, "[w]hen state law prohibits outright the arbitration of a particular type of claim, the analysis is straightforward: The conflicting rule is displaced by the FAA." (*Concepcion*, 563 U.S. at 341). Here, the *Lawson* decision prohibits outright the arbitration of wage claims brought by individual employees to recover victim-specific, unpaid wages. Therefore, that decision must be overruled as inconsistent with the FAA.

The general *Iskanian* holding that PAGA claims are not subject to predispute arbitration agreements was guided by the United States Supreme Court's decision in *EEOC v. Waffle House, Inc.* (2002) 534 U.S. 279, which held that an arbitration agreement between an employee and employer did not prevent the EEOC from filing a civil claim seeking relief on behalf of an employee. (*Iskanian*, 59 Cal.4th at 386.) The *Iskanian* court reasoned that because a PAGA plaintiff is acting on behalf of the State of California, the *Waffle House* decision permits the employee to avoid arbitration. Given its jurisprudence, however, one cannot reasonably believe that the United States Supreme Court would have ruled that the EEOC could designate an individual employee as its proxy to bring a discrimination case on the employee's own behalf, seeking victim-specific remedies for the employee in court, in complete disregard of an arbitration agreement. That is, however, exactly what the Court of Appeal's decision does, by holding that Lawson may act as the State's proxy to seek victim-specific unpaid wages on her own behalf.

In fact, the underlying facts in the *Waffle House* decision bear little resemblance to Lawson's attempt to recover unpaid wages on her own behalf.

> Unlike in *Waffle House*, where it was the EEOC actually bringing the suit, in this [PAGA] case

> Plaintiffs are the named parties, even if they stand in the shoes of a California agency. Moreover, it is Plaintiffs who would control the litigation.

(*Fardig v. Hobby Lobby Stores Inc.* (C.D. Cal. Aug. 11, 2014) 2014 U.S. Dist. LEXIS 139359, *10.)

Here, the Court of Appeal adopted a judge-made rule that allows employees to circumvent their FAA-governed arbitration agreements by seeking unpaid wages under the PAGA as so-called proxies of the State. This rule contravenes *Concepcion* and the FAA and cannot be permitted to stand.

## V. CONCLUSION

The United States Supreme Court's directive that federal and state courts rigorously enforce arbitration agreements reflects its commitment to the Federal Arbitration Act, which ensures that parties' arbitration agreements are enforced according to their terms. (*Italian Colors Restaurant*, 570 U.S. at 233 [explaining that "courts must 'rigorously enforce' arbitration agreements according to their terms, including terms that 'specify *with whom* [the parties] chose to arbitrate their disputes.'"], *quoting Stolt-Nielsen*, 559 U.S. 662, 683.) The *Lawson* decision negates that commitment and provides an obvious path to undermine all arbitration agreements between employers and employees. That path, taken to its logical conclusion, would end in complete repudiation by the United States Supreme Court under the FAA, an obviously unacceptable result.

Lawson had two options when she filed this lawsuit: (1) comply with her arbitration agreement by pursuing her victim-specific, unpaid wages claim on an individual basis in arbitration; or (2) forego her individual claim and seek only traditional civil penalties under the PAGA, "75 percent of which will go to the state's coffers." (59 Cal.4th at 387.) Lawson instead seeks to pursue both options, despite the prohibition of that approach under

*Iskanian*, *Concepcion*, and other consistent United States Supreme Court cases.

Therefore, Petitioners request that this Court (1) reverse the Court of Appeal's decision in *Lawson*; and (2) direct the Court of Appeal to issue a writ directing the Superior Court to vacate its September 30, 2016 Order compelling arbitration on a representative basis, and to enter a new and different Order granting Petitioners' motion to compel Lawson to arbitrate her PAGA claim for unpaid wages under Labor Code section 558(a)(3) on an individual basis, as required by the parties' arbitration agreement.

Respectfully submitted,

Dated: April 20, 2018

RUTAN & TUCKER, LLP

By: Brian C. Sinclair

Brian C. Sinclair
Counsel for Petitioners ZB, N.A.
and ZIONS BANCORPORATION

## CERTIFICATION OF WORD COUNT UNDER RULE 8.520(c)

The undersigned certifies that according to the word processing program used to prepare this brief, it consists of 11,265 words, exclusive of the matters that may be omitted under Rule 8.520(c) of the California Rules of Court.

Dated: April 20, 2018

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Counsel for Petitioners ZB, N.A.
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## PROOF OF SERVICE

*KALETHIA LAWSON v. CALIFORNIA BANK & TRUST, et al.*
San Diego Superior Court Case No. 37-2016-00005578-CU-OE-CTL
Court of Appeal Fourth Appellate District, Div. One, Case No. D071376
Supreme Court of California Case No. S246711

**STATE OF CALIFORNIA, COUNTY OF ORANGE**

I am employed by the law office of Rutan & Tucker, LLP in the County of Orange, State of California. I am over the age of 18 and not a party to the within action. My business address is 611 Anton Boulevard, Suite 1400, Costa Mesa, California 92626-1931.

On April 20, 2018, I served on the interested parties in said action the within:

**PETITIONERS' OPENING BRIEF**

as stated below:

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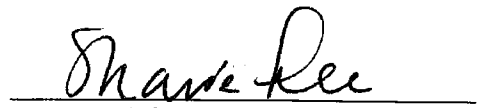
[✓] **(STATE)** I declare under penalty of perjury under the laws of the State of California that the foregoing is true and correct.

Executed on April 20, 2018, at Costa Mesa, California.

I declare under penalty of perjury under the laws of the State of California that the foregoing is true and correct.

Marie Lee
(Type or print name)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