PAGA and arbitration:

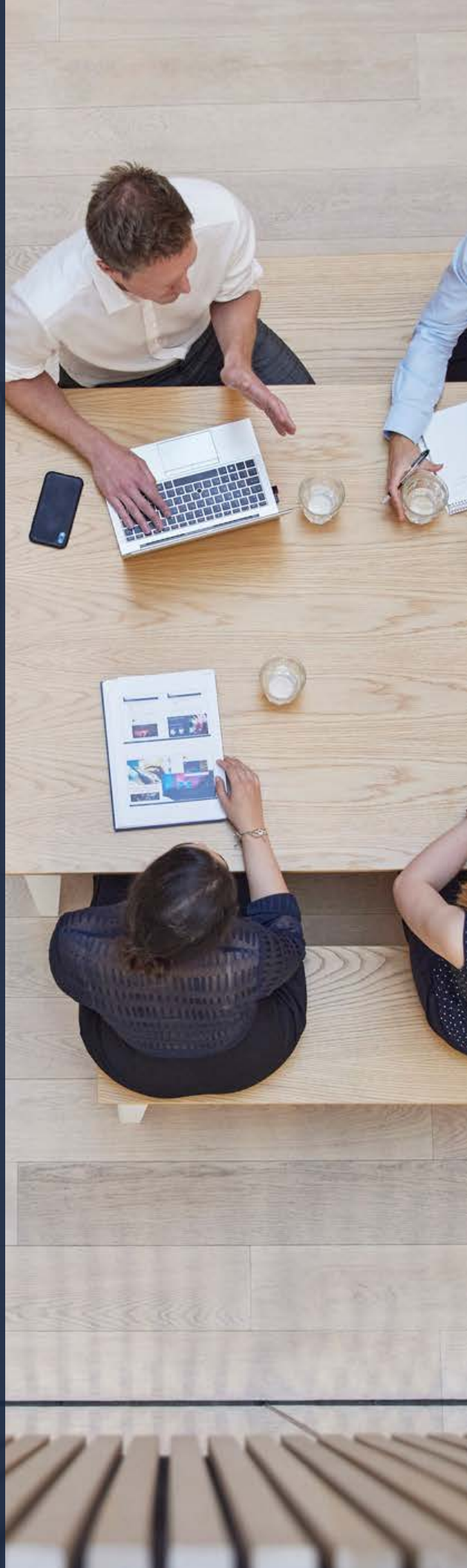
New opportunities to manage risks

DLA PIPER

Litigation under the California Private Attorneys General Act (PAGA) has become a stand-alone cottage industry. PAGA effectively deputizes "aggrieved employees" to act as private attorneys general and pursue civil penalties on behalf of themselves and other current and former employees for alleged Labor Code violations. Moreover, since the California Court of Appeal held that an employee who suffers just one Labor Code violation has standing to prosecute PAGA actions on behalf of employees who suffered any other Labor Code violation, it is now common for employees to file boilerplate complaints alleging a panoply of labor code violations, knowing that if they can prove they suffered a violation of even one provision, they have standing to sue on behalf of any employee who suffered any Labor Code violation.

Thousands of PAGA actions are filed each year, and employers have paid more than $8 billion over the last six years to settle them. Civil penalties for initial violations generally accrue at up to $100 per employee per pay period (and up to $200 for subsequent violations). The risk of astronomical pyramided PAGA penalties – which can quickly jump into the tens of millions of dollars even for a small employer – can force a rational employer to settle regardless of the merits.

So, what's an employer to do?



Recent decisions provide employers with new options

A key benefit of arbitration agreements is the ability to require arbitration of all disputes on an individual basis, rather than as a class, representative, or collective action. While California courts have long prevented employers from compelling PAGA claims to individual arbitration, recent decisions have reaffirmed the right of employers to require arbitration of these claims on an individual basis.

Last year in *Viking River Cruises v. Moriana*, the US Supreme Court held that the Federal Arbitration Act (FAA) requires the enforcement of an arbitration agreement that requires an employee to individually arbitrate PAGA claims. The Court also concluded that, based on its reading of California law, a PAGA civil action filed by an employee who agreed to individually arbitrate PAGA disputes must be dismissed. However, the question of whether courts should dismiss or merely stay PAGA civil actions filed by employees who agreed to individually arbitrate their PAGA claims is currently pending before the California Supreme Court.

In *US Chamber of Commerce v. Bonta*, the Ninth Circuit held that the FAA preempts California's effort to impose criminal and civil sanctions on employers who require mandatory arbitration agreements as a condition of employment.

Most recently, the *California Supreme Court concluded* that a PAGA action should be stayed when the named plaintiff has signed an arbitration agreement governed by the FAA that calls for arbitration of individual employment disputes. According to the court, the correct procedure is for the trial court to order the named plaintiff into arbitration, stay the civil action pending the outcome of the arbitration, adopt the findings of the arbitrator regarding whether the named plaintiff is aggrieved or not, and then decide the named plaintiff's standing to prosecute the PAGA civil action on behalf of others accordingly. If the arbitrator concludes the plaintiff suffered no Labor Code violations, then the trial court should dismiss the PAGA civil action on behalf of other employees.

Based on these decisions, employers in California should consider whether to update existing arbitration agreements or adopt an arbitration program. Arbitration agreements governed by the FAA can offer employers a number of advantages depending on the circumstances:

- Arbitrating an individual claim is generally cheaper than litigating a statewide PAGA action
- If the named plaintiff's claims are weak, it may be easier to settle on an individual basis
- While an employer is arbitrating the named plaintiff's individual claims, it can analyze the potential broader liability and assess whether a statewide settlement is advantageous

In short, arbitration agreements can give the employer breathing room to assess PAGA claims and decide how best to resolve them – seek to win in arbitration, settle on an individual basis, settle a statewide problem cheaply because the named plaintiff's claim is weak, or settle a statewide problem early, without incurring the expense of full-blown civil litigation (requiring costly up-front payouts for such things as discovery and experts).

Here, we address various strategies for employers considering whether to update or adopt an arbitration program, and what to watch for next.

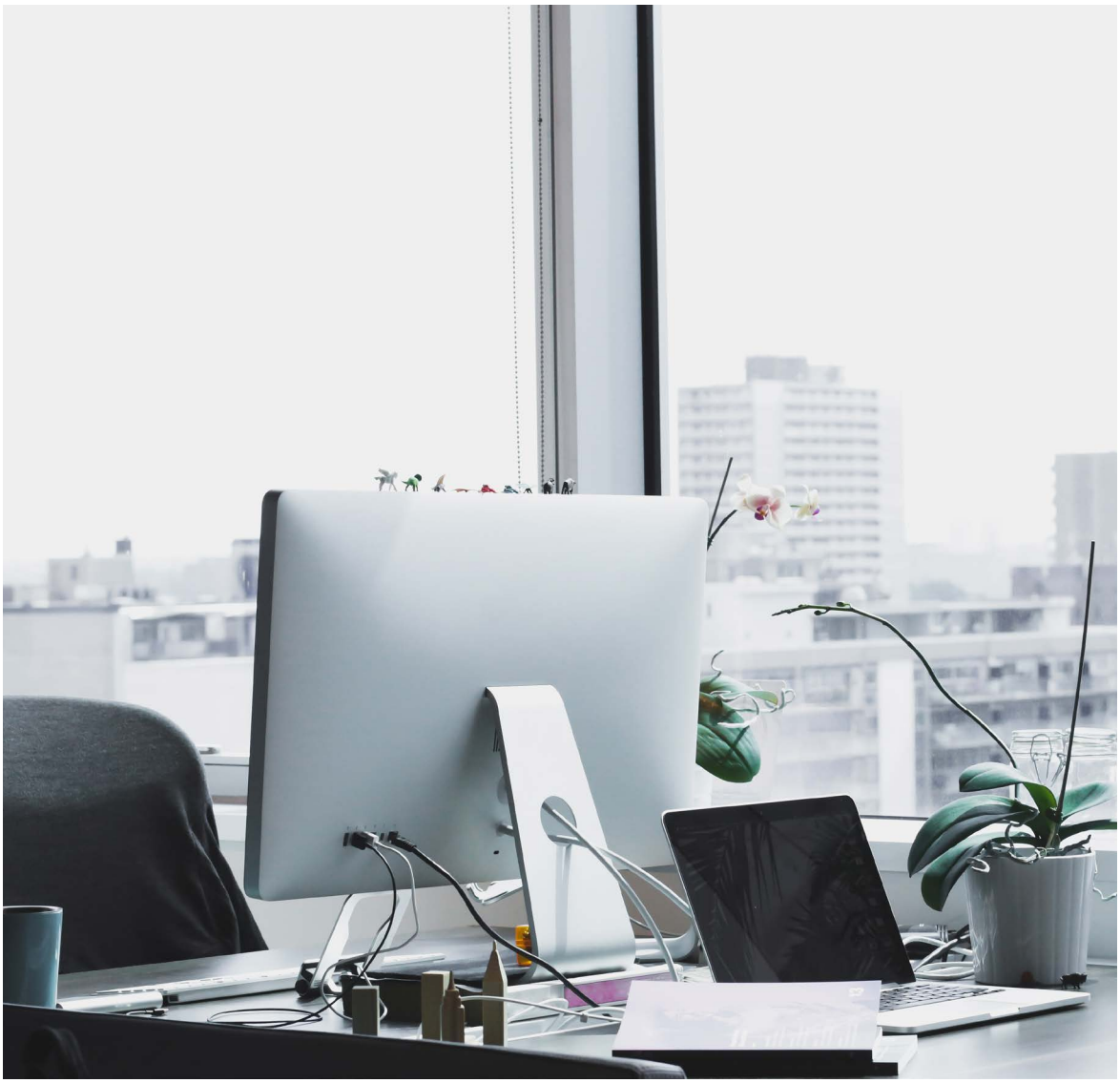
Strategies for drafting or revising arbitration agreements

- **Designate FAA as applicable law:** Employers should determine whether their workers are covered by the FAA, which embodies federal policy strongly favoring arbitration, and expressly invoke the FAA in their agreements.
- **Establish elements of contract formation:** To prove mutual assent, employers should address issues such as signature method, acknowledgements, and distribution. For example, wet signatures may be more difficult for employees to deny but require storage of physical documents. Since arbitration agreements are subject to common law defenses for enforceability (eg, fraud, duress, unconscionability), employers should also ensure that the substantive terms and methods of obtaining assent are inherently fair.
- **Decide between mandatory or voluntary arbitration:** Approaches vary based on the employer's objectives and risk tolerance. Some employers adopt mandatory arbitration programs, while others provide for voluntary arbitration for new hires or the entire workforce.
- **Consider an opt-out provision:** Arbitration programs that allow employees to opt out may make it more likely that a court will enforce the agreement, but they impose an administrative burden – employers must track opt-outs.
- **Exclude non-arbitrable claims:** To enhance enforceability, employers should exclude claims that are not arbitrable. Employers should also decide whether to include a general or express carve-out for disputes covered by the federal Ending Forced Arbitration of Sexual Assault and Sexual Harassment Act of 2021, which prohibits employers from enforcing pre-dispute arbitration provisions and class or collective action waivers with respect to sexual assault and sexual harassment claims at the claimant's option.
- **Select an arbitral forum and procedural rules:** Arbitration providers can have different fee schedules, protocols, processes, and protections. Employers are urged to research and consider which is the best fit and clearly specify the procedures related to arbitration.
- **Define the arbitrator's authority:** Employers may choose to have arbitrators, rather than courts, decide gateway issues, such as formation, enforceability, revocability, or validity of an arbitration agreement. Absent "clear and unmistakable" language in the arbitration agreement delegating these issues to an arbitrator, a court will decide arbitrability.
- **Review class, collective and representative action waivers:** Employers should consider explicitly including PAGA representative action waivers. For now, waivers can be an effective tool to limit PAGA representative actions.
- **Mitigate the risk of mass arbitrations:** In response to class, collective and representative action waivers, some plaintiffs' firms are resorting to a new strategy – filing tens, hundreds, and even thousands of similar arbitration claims against the same employer, which can be administratively burdensome and extremely costly for employers. Depending on the circumstances, various options exist to reduce this risk, such as providing for informal dispute resolution prior to arbitration; requiring claimants to personally sign their arbitration demands; providing for "batch" arbitration; requiring claimants to pay initial filing fees comparable to fees required to file a lawsuit; using fee-splitting provisions where possible (generally highly compensated employees); permitting offers of judgment; and reserving the right to settle claims on a class-wide basis.
- **Include a severability provision:** Employers should include a severability provision to allow courts to sever unconscionable or unenforceable terms rather than invalidating the whole agreement.
- **Additional strategies:** Employers may contemplate other options, including discovery protocols, written decisions, entry of judgment, language specifying the voluntary nature of the agreement, and timing of fees and payments.

What's ahead for California employers

The PAGA landscape continues to evolve. The California Supreme Court is set to weigh in on issues related to the authority of trial courts to ensure that claims under PAGA will be manageable at trial and whether a PAGA plaintiff has the right to intervene, object to, or move to vacate, a judgment in a related PAGA action raising the same claims.

In the meantime, *Viking River Cruises* and other decisions have opened a window of opportunity. Employers are encouraged to review their current arbitration agreements or consider whether they should implement an arbitration program to prepare for what may come next.



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For more information

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