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