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PAGA: The good, the bad, and the uncertain

A PATH AROUND ARBITRATION AGREEMENTS AND CLASS-ACTION WAIVERS IN EMPLOYMENT LAW? FACTORS TO CONSIDER IN VALUING AND SETTLING PAGA ACTIONS

Despite being on the books for 14 years, the Labor Code Private Attorneys General Act ("PAGA"), Labor Code section 2698, et seq., remains surrounded by much uncertainty. A host of issues have yet to be resolved, including such fundamental questions as whether a PAGA plaintiff has a right to a jury trial. Slowly but surely, however, courts have begun answering these questions, and a more developed – but ever-evolving – PAGA landscape has begun to take shape. This article will describe what PAGA is and how it works, why PAGA claims have garnered so much attention in recent years; and it will highlight some of the key differences between traditional wage and hour class actions and PAGA claims. This article will then discuss many of the factors an employee advocate should consider when evaluating, negotiating, and settling PAGA claims.

What is PAGA?

The California Legislature enacted PAGA in 2004 to address the state's lack of resources to address labor law violations. (*Arias v. Superior Court* (*Angelo Dairy*) (2009) 46 Cal.4th 969, 986.) As its name suggests, PAGA enables employees to act as private attorneys general to supplement enforcement actions by public agencies. Specifically, PAGA authorizes "aggrieved employees" to bring civil lawsuits on behalf of themselves, other aggrieved employees, and the State of California, to collect civil penalties that otherwise would have been assessed and collected by the Labor and Workforce Development Agency ("LWDA").

Before bringing a PAGA lawsuit, an aggrieved employee must provide written notice to the employer and to the LWDA, and for most alleged violations must provide the LWDA with a 65-day period to determine whether to investigate the alleged violations. If the LWDA does not respond within 65 days, or if it responds that it does not intend to investigate, the aggrieved employee may bring a civil suit to collect civil penalties. (Lab. Code, § 2699.3.)

For those Labor Code violations that do not already provide a specific civil penalty, PAGA establishes a default civil penalty of $100 for each aggrieved employee per pay period for the "initial" violation, and $200 for each aggrieved employee per pay period for each "subsequent" violation. (Lab. Code, § 2699, subd. (f).) Any civil penalties collected in a PAGA action must be divided 75 percent to the LWDA and 25 percent to the "aggrieved employees." (Lab. Code, § 2699, subd. (i).) An employee who prevails in a PAGA action is entitled to recover his or her reasonable attorneys' fees and costs. (Lab. Code, § 2699, subd. (g).)

Why is so much attention now being paid to PAGA?

PAGA has become more prominent in recent years, particularly as employers have become increasingly aggressive in their implementation and enforcement of arbitration agreements with class action waivers.

Earlier this year, the United States Supreme Court held in *Epic Systems Corp. v. Lewis* (2018) 138 S.Ct. 1612, that employer-employee mandatory arbitration agreements with class action waivers are enforceable. In so holding, the Court rejected employees' argument that mandatory class-action waivers violate Section 7 of the National Labor Relations Act, which guarantees the right of employees to pursue "concerted activity" against their employer. *Epic Systems* is the latest in a line of closely divided United States Supreme Court decisions that have elevated the Federal Arbitration Act ("FAA") over other statutes and policy considerations. (See *AT&T Mobility LLC v. Concepcion* (2011) 563 U.S. 333 [enforcing arbitration agreement with class-action waiver in consumer contract and invalidating California's "*Discover Bank* rule," which had held such waivers to be unenforceable, because such rule "stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress"]; *American Express v. Italian Colors* (2013) 570 U.S. 228 [enforcing arbitration agreement with class action waiver even where the costs of individual arbitration exceeded the plaintiff's potential individual recovery].)

In 2014, however, the California Supreme Court held that this rule does not apply to PAGA actions. In *Iskanian v. CLS Transp. Los Angeles* (2014) 59 Cal.4th 348, the Court held that class-action waivers in employment agreements were enforceable under the FAA pursuant to U.S. Supreme Court precedent. But *Iskanian* also held that a pre-dispute arbitration agreement and class action waiver could *not* waive an employee's right to bring a *representative* action under PAGA. This is because an employee bringing a PAGA action does so "as the proxy or agent of the state's labor law enforcement agencies," rather than as a private employee. (*Iskanian*, 59 Cal.4th at 380.) "A PAGA representative action is therefore a type of qui tam action." (*Id.* at 382.) Accordingly, an employee's right to bring a public lawsuit on behalf of the state's law-enforcement agencies "cannot be contravened by private agreement." (*Id.* at 383.)

Relying on *Iskanian*, multiple California appellate decisions have held that pre-dispute arbitration agreements may not compel an employee's PAGA claim to arbitration. (See *Betancourt v. Prudential Overall Supply* (2017) 9 Cal.App.5th 439, 445 ["The trial court

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correctly denied Prudential's motion to compel arbitration because a defendant cannot rely on a pre-dispute waiver by a private employee to compel arbitration in a PAGA case, which is brought on behalf of the state"]; *Tanguilig v. Bloomingdale's, Inc.* (2016) 5 Cal.App.5th 665, 678 ["Because a PAGA plaintiff… acts as a proxy for the state only with the state's acquiescence [citation] and seeks civil penalties largely payable to the state via a judgment that will be binding on the state, the PAGA claim cannot be ordered to arbitration without the *state's* consent."] (emphasis in original); *Julian v. Glenair, Inc.* (2017) 17 Cal.App.5th 853, 871 [agreeing with *Betancourt* and *Tanguilig* that "a pre-dispute agreement to arbitrate is ineffective to compel arbitration of a PAGA claim…"].)

In *Sakkab v. Luxottica Retail North America* (9th Cir. 2015) 803 F.3d 425, the Ninth Circuit adopted *Iskanian*'s reasoning. Importantly, the Ninth Circuit found that, unlike the "*Discover Bank* rule," the "*Iskanian* rule" does not conflict with the FAA's purpose and therefore is not preempted by the FAA.

Based on the above, it is easy to understand why PAGA has garnered so much attention lately. With class action waivers becoming more prevalent and readily enforceable in California courts, a PAGA claim is often the only viable representative claim an employee can bring against his or her employer.

Some key differences between PAGA claims and wage and hour class actions

From the employee advocate's perspective, PAGA has several disadvantages as compared with traditional wage and hour class actions, but also several distinct advantages.

Administrative requirements

PAGA has unique administrative requirements. A PAGA plaintiff must provide written notice to the LWDA and the employer of the employer's alleged Labor Code violations before commencing a private lawsuit. The notice must be submitted electronically to the LWDA, and by certified mail to the employer, and must be accompanied by a $75 fee. (Lab. Code, §§ 2699.3(a)(1)(A)-(B), (c)(1)(A)-(B).)

Employer's ability to "cure" certain violations

For certain Labor Code violations, the employer has the opportunity to "cure" the alleged violation within 33 days of the postmark date of the PAGA notice and avoid PAGA civil penalties. (Lab. Code, § 2699.3(c)(2)(A).)

Majority of civil penalties inure to the State

Seventy-five percent of civil penalties recovered in a PAGA action go to the state, with only 25 percent of the recovered civil penalties going to aggrieved employees. (Lab. Code, § 2699(i).)

One-year statute of limitations

Perhaps the biggest disadvantage of PAGA claims is that, because damages recoverable under PAGA are "penalties," PAGA claims must be commenced within the one-year statute of limitations applicable to penalties under Code of Civil Procedure section 340, rather than the three- or four-year statute of limitations applicable to most Labor Code claims. However, the statute of limitations is tolled during the mandatory notice period. (Lab. Code, § 2699, subd. (d).)

No need to satisfy class-action requirements, but same scope of available discovery

On the other hand, perhaps the most significant advantage of a PAGA claim is that a PAGA plaintiff does not need to satisfy the class action requirements of Code of Civil Procedure section 382. (*Arias*, *supra*, 46 Cal.4th at 981-82.) At the same time, the scope of available discovery in a PAGA action is virtually identical to that of a class action, including the lead plaintiff's entitlement to discover contact information for other allegedly aggrieved employees. (See *Williams v. Superior Court* (*Marshalls of CA, LLC*) (2017) 3 Cal.5th 531, 547-48 [holding that a plaintiff's right to discover contact information of other "aggrieved employees" in a PAGA action is the same as a putative class plaintiff's right to discover contact information of putative class members].) In a sense, then, PAGA presents the best of both worlds: the named plaintiff enjoys the full panoply of class action discovery but does not need to satisfy the class certification requirements of Code of Civil Procedure section 382.

PAGA claims cannot be aggregated for removal to federal court

Because a PAGA claim is neither an individual Labor Code claim nor a "class-action" claim, the aggregate value of the civil penalties sought by all "aggrieved employees" in a PAGA action cannot be aggregated for purposes of removal to federal court under either ordinary diversity jurisdiction or the Class Action Fairness Act. (See *Urbino v. Orkin Svcs. of Calif., Inc.* (9th Cir. 2013) 726 F.3d 1118, 1121-23 [holding that the claims of all "aggrieved employees" cannot be aggregated to establish the $75,000 threshold for diversity jurisdiction because aggrieved employees do not have a "common and undivided interest" in those penalties]; *Baumann v. Chase Inv. Svcs. Corp.* (9th Cir. 2014) 747 F.3d 1117, 1124 [holding that "PAGA is not sufficiently similar to Rule 23 to establish the original jurisdiction of a federal court under CAFA"]; *Yocupicio v. PAE Grp., LLC* (9th Cir. 2015) 795 F.3d 1057, 1062 [holding that the value of a PAGA claim cannot be aggregated and added to the value of class claims to establish the $5,000,000 amount-in-controversy requirement for CAFA jurisdiction].)

Kim v. Reins: a cautionary tale?

What if an employee resolves his or her underlying wage and hour claims individually? Is the employee still considered an "aggrieved employee" for purposes of PAGA? In *Kim v. Reins Int'l Calif., Inc.* (2017) 18 Cal.App.5th 1052, *review granted* Mar. 28, 2018, the plaintiff-employee brought a wage-and-hour class action with a derivative PAGA claim, and the employer successfully moved to compel individual arbitration of the employee's wage-and-hour claims, dismiss the class claims, and stay the PAGA claim. While arbitration was pending, the plaintiff settled his individual wage-and-hour claims and agreed to dismiss them *with*

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prejudice. The employer then moved for summary judgment in the PAGA action, arguing that the employee was no longer "aggrieved" and therefore did not have standing to bring a PAGA claim. The trial court granted the motion, and the Court of Appeal affirmed: "We hold that Kim's dismissal of his individual Labor Code claims with prejudice foreclosed his standing under PAGA." (*Id.* at 1055.)

Notably, the California Supreme Court has granted review in *Kim*. Many employee advocates are hopeful that *Kim* will be reversed. In the meantime, what's a plaintiff to do if he or she has already pled classwide wage-and-hour claims, the defendant produces an enforceable arbitration agreement, and the plaintiff desires to pursue a PAGA claim? To obviate the possibility of a trial court following *Kim* (which is still citable as persuasive authority – see C.R.C. 8.1115(e)(1)), the more prudent course of action is to seek dismissal of the class and individual wage-and-hour claims *without prejudice* pursuant to California Rules of Court, rule 3.770 – citing the arbitration agreement as the rationale for doing so – and pursue only the PAGA claim.

Factors to consider when negotiating a PAGA settlement

Courts have only recently begun to grapple with key aspects of PAGA, including which PAGA civil penalties apply to various Labor Code violations, whether multiple PAGA penalties can be recovered for a single pay period, and the definition of "initial" and "subsequent" violations. As a result, a PAGA claim presents many unique questions to consider when evaluating the viability and the value of the claim, particularly in the context of settlement negotiations. Below is a summary of several of the most salient factors to consider when evaluating a potential PAGA settlement.

While PAGA penalties cannot be denied outright, they can be substantially reduced

The court in *Amaral v. Cintas Corp. No. 2* (2008) 163 Cal.App.4th 1157, 1213 held that PAGA civil penalties are "mandatory, not discretionary" and therefore cannot be denied outright where the plaintiff has demonstrated that the employer otherwise is liable. However, Labor Code section 2699, subdivision (e)(2) gives the court discretion to reduce PAGA civil penalties if it finds that awarding the full amount of penalties would be "unjust, arbitrary and oppressive, or confiscatory."

While in *Amaral*, the Court of Appeal affirmed the trial court's decision to award the full PAGA penalties, other courts have reduced PAGA civil penalties, often dramatically. For example, in *Thurman v. Bayshore Transit Mgmt., Inc.* (2012) 203 Cal.App.4th 1112, 1136, the Court of Appeal affirmed the trial court's reduction of PAGA civil penalties by 30 percent, finding that awarding the full penalties would have been "unjust" because "the evidence showed…defendants took their obligations…seriously and attempted to comply with the law," and that the defendants' financial condition "rendered them unable to pay penalties from ongoing revenues." Similarly, in *Fleming v. Covidien*, No. ED CV 10-01487 RGK (OPx), 2011 WL 7563047 at *4 (C.D. Cal. Aug. 12, 2011), the court reduced PAGA civil penalties for wage statement violations from $2,800,000 to $500,000, because "the aggrieved employees suffered no injury" as a result of the violations, the defendants "were not aware" their wage statements violated the law, and the defendants "took prompt steps to correct all violations once notified."

Accordingly, while courts cannot deny PAGA civil penalties outright, they can and do reduce the awarded penalties based on such considerations as the egregiousness of the violations, the employer's efforts at compliance, and the employer's ability to pay. Likewise, courts have approved PAGA settlements for only a fraction of the potential PAGA civil penalties, particularly where counsel have presented compelling reasons why recovery of penalties was unlikely. (See, e.g., *Viceral v. Mistras Grp., Inc.* (N.D. Cal. Oct. 11, 2016, 2016 WL 5907869 at *9 [preliminarily approving class action settlement that included a PAGA set-aside of just 0.15 percent of the PAGA claim's full potential value, where "Plaintiffs face[d] a substantial risk of recovering nothing on either the class or PAGA claims"]; *Cotter v. Lyft, Inc.* (N.D. Cal. 2016) 193 F.Supp.3d 1030, 1037 [preliminarily approving class action settlement allocating a PAGA set-aside worth a fraction of the PAGA claim's potential value, where the defendant's obligations were "genuinely unclear" and there was no evidence the defendant acted deliberately or negligently failed to learn about its obligations].)

Only "initial" penalties recoverable?

PAGA's plain language indicates that an employer will be assessed a lower, "initial" penalty for each initial pay period in which a violation occurs, and a higher, "subsequent" penalty for each subsequent pay period in which a violation occurs. (Lab. Code, § 2699, subd. (f)(2).) In *Amaral*, however, the court held, "Until the employer has been notified that it is violating a Labor Code provision (whether or not the commissioner or court chooses to impose penalties), the employer cannot be presumed to be aware that its continuing underpayment of employees is a 'violation' subject to penalties [and will be assessed only the 'initial' violation rate]." (*Amaral*, *supra*, 163 Cal.App.4th at 1209.) This language could be read as indicating that until the Labor Commissioner or a court informs an employer that it has violated the Labor Code, the employer can only be assessed the "initial" violation rate. On the other hand, it could be argued that when an employee submits a PAGA notice to the LWDA and the employer, the employer has "been notified that it is violating a Labor Code provision" and could be assessed the "subsequent" penalty.

May PAGA penalties be "stacked"?

PAGA's statutory language is unclear as to whether PAGA penalties may be "stacked" – that is, whether multiple civil penalties can be recovered in the same pay period for different Labor Code violations. On the one hand, Labor Code

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section 2699, subdivision (f) establishes "*a* civil penalty for *a* violation" (emphasis added), implying a separate civil penalty for each violation. On the other hand, employers cite Labor Code section 2699, subdivision (g)(1), which states that "an aggrieved employee may recover *the* civil penalty described in subdivision (f)…on behalf of himself or herself and other current or former employees against whom *one or more of the alleged violations* was committed" (emphasis added). While no California appellate court has addressed this issue, multiple federal district courts have found that "stacking" of PAGA civil penalties may be permitted. (See *Schiller v. David's Bridal, Inc.* (E.D. Cal. July 14, 2010, 2010 WL 2793650 at *6 [in order denying motion for remand, court observed "Plaintiff cites no authority establishing that PAGA penalties could not be awarded for every cause of action under which they are alleged"]; *Smith v. Brinker Int'l, Inc.* (N.D. Cal. May 5, 2010, 2010 WL 1838726 at **2-6 [stacking PAGA penalties when calculating amount in controversy].) Of course, these decisions were issued before the Ninth Circuit's opinions in *Baumann* and *Yocupicio*, which, as we have seen, preclude the aggregation of PAGA penalties for purposes of removal. But the relevant take-away for our purposes is the fact that these district courts assumed that PAGA allowed "stacking" of PAGA civil penalties.

Labor Code section 226.3 – a double-edged sword?

Although Labor Code section 226 does not itself provide for a civil penalty, and therefore the default penalty under Labor Code section 2699, subdivision (f)(2) would seem to apply, Labor Code section 226.3 *does* provide a civil penalty for violations of Labor Code section 226. The Labor Code section 226.3 civil penalty is $250 for "initial" violations and $1,000 for "subsequent" violations. Until recently, there was an open question as to whether the "default" $100/$200 civil penalty or the $250/$1,000 section 226.3 penalty applied to violations of Labor Code section 226. But the California Court of Appeal recently held in *Raines v. Coastal Pacific Food Distributors, Inc.* (2018) 23 Cal.App.5th 667 that the applicable PAGA civil penalty for Labor Code section 226(a) violations is the $250/$1,000 civil penalty in Labor Code section 226.3. This is a double-edged sword: on the one hand, potential penalties are higher ($250 for "initial" violations and $1,000 for "subsequent" violations), but a court may also have discretion to deny PAGA penalties outright. (See Lab. Code, § 226.3 [providing that the Labor Commissioner "may decide not to penalize an employer for a first violation when that violation was due to a clerical error or inadvertent mistake."].)

Labor Code section 226 violations

For Labor Code section 226 violations, a plaintiff need not demonstrate that the violation was "knowing and intentional" or that employees suffered "injury" – and the same reasoning should apply to violations of Labor Code sections 201-202.

The court held in *Lopez v. Friant & Assoc.* (2017) 15 Cal.App.5th 773, 778, that in a PAGA action alleging violations of Labor Code section 226, subdivision (a), a plaintiff does not need to demonstrate that the violations were "knowing and intentional" or that employees suffered "injury" as a result of the violations, which one would need to establish in order to recover the wage statement penalties provided for under section 226, subdivision (e). The *Lopez* court reasoned that the requirements set forth in subdivision (e) applied only to "a private cause of action for damages and statutory penalties," not to a cause of action for *civil* penalties under the PAGA. Moreover, the *Lopez* court observed that Labor Code section 2699.5 of the PAGA lists a violation of 226, subdivision (a) as a stand-alone violation for which a PAGA claim can be brought and does not mention section 226, subdivision (e). (*Lopez*, 15 Cal.App.5th at 785; *accord Raines*, *supra*, 23 Cal.App.5th 667.)

Based on the reasoning in *Lopez*, a violation of Labor Code sections 201 or 202 for failure to pay all final wages also need not be shown to be "willful" in order to recover PAGA civil penalties, even though one would need to demonstrate willfulness to recover individual "waiting time" penalties under Labor Code section 203. Like Labor Code section 226, subdivision (e), the requirements of section 203 apply only to the statutory "waiting time" penalty provided for in section 203, and they would not apply to a cause of action for PAGA civil penalties. And, as with the wage statement violations under section 226, subdivision (a) at issue in *Lopez*, Labor Code section 2699.5 lists Labor Code sections 201 and 202 as stand-alone violations for which PAGA penalties are available.

Recovery of unpaid wages

Can a PAGA plaintiff recover an "amount sufficient to recover the underpaid wages" under Labor Code section 558 where there is a binding arbitration agreement?

Labor Code section 558 provides that an employer may be assessed a civil penalty of $50/$100 for "initial"/"subsequent" violations of various labor laws, "in addition to an amount sufficient to recover underpaid wages." (Lab. Code, § 558, subd. (a)(1)-(2).) Section 558 further provides that the amount recovered as "underpaid wages" is distributed entirely to the "affected employee," with no portion going to the State. (Lab. Code § 558(a)(3).) There is a split of California appellate authority over whether a plaintiff who has executed a binding arbitration agreement may pursue a claim under Labor Code section 558 for "an amount sufficient to recover underpaid wages" as part of a PAGA claim. In *Esparza v. KS Industries, L.P.* (2017) 13 Cal.App.5th 1228, the Court of Appeal for the Fifth District held that the "underpaid wages" recoverable under Labor Code section 558 were subject to arbitration under *Iskanian* because such damages amounted to "victim-specific relief," rather than "civil penalties," since they are paid entirely to the employee rather than paid primarily to the LWDA.

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On the other hand, the Court of Appeal for the Fourth District in *Lawson v. ZB, N.A.* (2017) 18 Cal.App.5th 705, *review granted* Mar. 21, 2018, held that, because the relief sought under section 558 could not be pursued by an employee in his or her individual capacity but only as a private attorney general stepping into the shoes of the State, such relief constitutes "civil penalties" under the PAGA and could not be compelled to arbitration per *Iskanian*. Since the California Supreme Court granted review in *Lawson*, *Esparza* is currently the only precedential authority on this issue, although *Lawson* may be cited as "persuasive" authority. (Cal. Rules of Court, rule 8.1115(e)(1).)

Meal and rest period violations

Can a PAGA plaintiff recover PAGA penalties for meal and rest period violations where the employer has already paid the section 226.7 premium?

If an employer fails to provide legally required meal or rest periods, but has paid the premium wage remedy under Labor Code section 226.7, will the employer still be liable for PAGA civil penalties? Defense counsel argue the answer must be "no," since it would result in unfair double recovery. This author believes the answer is "yes," based on the California Supreme Court's statement in *Kirby v. Immoos Fire Protection, Inc.* (2012) 53 Cal.4th 1244, 1256 that "section 226.7 does not give employers a lawful choice between providing *either* meal and rest breaks *or* an additional hour of pay" (emphasis in original). Thus, the extra hour of pay does not excuse the violation; the employer has still committed a violation even if the remedy for the violation has been paid. This question has not yet been decided by any California appellate court, and there are conflicting district court decisions on the issue. (Compare *Ruelas v. Costco Wholesale Corp.* (N.D. Cal. Mar. 25, 2015, 2015 WL 1359326 [siding with defense position] *with Wert v. U.S. Bancorp* (S.D. Cal. Mar. 22, 2016, 2016 WL 1110302 at *4 [rejecting *Ruelas* and siding with plaintiff position].)

Right to a jury trial?

No California appellate court has decided whether a PAGA plaintiff is entitled to a jury trial. However, some trial courts have held that jury trial is not available since a PAGA claim is an equitable claim. (See, e.g., *Espinoza v. Bodycote Thermal Processing, Inc.* (Super. Ct. Los Angeles County, 2017, No. BC501617) [finding no right to jury trial on PAGA claim, since PAGA claim is an equitable, rather than legal, claim].)

Other considerations in PAGA settlements

In addition to the considerations noted above regarding the value of a PAGA claim, practitioners should also consider the following issues related to PAGA settlements.

No notice required to aggrieved employees prior to settlement approval hearing

PAGA does not require that notice be sent to aggrieved employees prior to a settlement approval hearing. It merely requires that a court approve any PAGA settlement (Lab. Code, § 2699, subd. (l)(2)), and that notice of the settlement be provided to the LWDA at the same time it is presented to the court (Lab. Code, § 2699, subd. (l)(2)).

Attorneys' fees and costs

As stated, PAGA expressly provides for recovery of reasonable attorneys' fees and costs (Lab. Code, § 2699, subd. (g).) Although there is no case law with respect to how attorneys' fees should be calculated in PAGA settlements, in this author's experience courts have adopted the common fund approach typical in class action settlements, wherein one-third of the gross PAGA settlement amount will generally be approved as reasonable, subject to a lodestar cross-check.

Named plaintiff incentive payment

There is no appellate case law addressing whether a named plaintiff in a PAGA action can receive an incentive payment. In this author's experience, courts generally have approved incentive payments, for the same reasons courts approve incentive payments in class actions – to reward the named plaintiff for bringing an action that vindicates the rights of other aggrieved employees and the State of California.

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