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Supplemental Materials for Submission to the House Committee on the Judiciary

April 1, 2018

Chairwoman Grad, Vice-Chair Conquest and members of the Committee, I respectfully submit the following supplemental materials requested during my testimony on Thursday, March 29, 2018. I have organized the material as follows (with embedded links that are clickable so you can access the primary sources directly):

1. RELEVANT CASES: *AT&T v. Concepcion, American Express v. Italian Colors, National Labor Relations Board v. Murphy Oil et al.;*
2. FEDERAL ARBITRATION ACT ("FAA"): brief discussion of the FAA;
3. PREEMPTION: brief analysis of preemption doctrine as applied to FAA preemption of state common law/legislation seeking to limit the effects of forced arbitration;
4. STUDIES: listing of studies on the effects of forced arbitration on consumers, employees and small businesses;
5. QUI TAM & PAGA: brief discussion of statutory models that "deputizing" victims to bring claims alleging statutory violations and seeking civil penalties on behalf of the state.
6. WHY *QUI TAM* AVOIDS FAA PREEMPTION: analysis of relevant legal precedent establishing that the public nature and penalty structure of *qui tam* claims avoids preemption.

RELEVANT CASES:

AT&T v. Concepcion (2011): Plaintiff-consumers filed a class action alleging defendant had falsely advertised its product in violation of state consumer protection laws. The mobile service provider moved to compel individual arbitration of the claims pursuant to the arbitration clause in the standard-form contract. Plaintiffs successfully defeated this motion at the district court by asserting that individual arbitration would violate established state public policy favoring class actions as a means of resolving consumer claims; the 9th Circuit affirmed.

A 5-4 Supreme Court reversed, finding that where a state law rule or policy "stand[s] as an

obstacle to the accomplishment of the FAA's objectives," such a rule is preempted. Here, California's policy favoring class proceedings prevented resolution of this dispute in an arbitral forum, where class proceedings were barred as a matter of contract. Justice Scalia's decision was openly dismissive of the policy argument, made by the dissenting Justices, that class proceedings are necessary to prosecute small-dollar claims that might otherwise slip through the legal system." Brushing the dissent away, Justice Scalia flatly stated that "States cannot require a procedure that is inconsistent with the FAA, even if it is desirable for unrelated reasons."

American Express v. Italian Colors (2013): Plaintiff-small business owners filed a federal antitrust suit against American Express for violations of the Sherman Act. Specifically, plaintiffs argued that the credit card company used its monopoly power to force them to accept its cards at rates 30% higher than the fees charged for competing credit cards. The U.S. Court of Appeals for the Second Circuit heard this case three separate times, and each time, refused to enforce the arbitration clause and class action ban, citing the prohibitive costs that would be incurred by these small business owners if they were compelled to pursue individual actions. In particular, the court explained that compelling arbitration would force each plaintiff to shoulder non-recoupable expert and other costs that vastly exceeded any amount the individual plaintiff could hope to win – and, as such, would prevent them from vindicating their rights under federal statutory law.

In another divided decision, the Supreme Court rejected this argument, asserting that "the antitrust laws do not guarantee an affordable procedural path to the vindication of every claim." (Nonsensically) Justice Scalia explained "the fact that it is not worth the expense involved in *proving* a statutory remedy does not constitute the elimination of the *right to pursue* that remedy." In dissent, Justice Kagan (angrily) observed that, when faced with plaintiffs' argument that forced arbitration clauses left them without remedy for antitrust claims guaranteed by federal law, the majority's response was simply "too darned bad."

National Labor Relations Board v. Murphy Oil, *Epic Systems v. Lewis*, *Ernst & Young LLP v. Morris*: The Supreme Court will soon decide, in these consolidated cases, whether imposing a class action ban in a forced arbitration clause violates workers' rights under the NLRA to engage in "other concerted activities for the purpose of collective bargaining or other mutual aid or protection[.]" This right is enforced by Section 8 of the statute, which states that it is an unfair labor practice to "interfere with, restrain, or coerce employees in the exercise of the rights guaranteed in" the Act. Observers predict the Court will side with employers, essentially spelling the end of class-action employment litigation.

FEDERAL ARBITRATION ACT ("FAA"):

The FAA was enacted in 1925 to ensure the validity and promote the enforcement of arbitration agreements. Specifically, Section 2 of the FAA provides:

> [a] written provision in any maritime transaction or a contract evidencing a transaction involving commerce to settle by arbitration a controversy thereafter arising out of such contract or transaction, or the refusal to perform the whole or any part thereof, or an agreement in writing to submit to arbitration an existing controversy arising out of such a contract, transaction, or refusal, shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract.

Prior to the mid-1990's, the FAA was interpreted to apply to contracting parties with roughly equal bargaining power and engaged in arms-length negotiations – in other words, parties who fully consented to arbitrating their disputes. But in the past two decades, the Supreme Court has applied the FAA to employment contracts and standard-form consumer contracts where bargaining power and consent are sorely lacking. This new interpretation of the FAA has emboldened companies to insert forced arbitration clauses in all sorts of contracts, click-wrap, envelope stuffers and other fictive "contracts" in an effort to prevent consumers, employees and small businesses from bringing suit in public courts or aggregating their claims to render them more economically viable.

PREEMPTION:

Preemption is rooted in the Supremacy Clause of the Constitution, which states that the laws of the United States "shall be the supreme Law of the Land; and the Judges in every State shall be bound thereby, any Thing in the Constitution or Laws of any State to the Contrary notwithstanding." This basically means that whenever federal and state law are in conflict, federal law will supersede the inconsistent state law.

While preemption can take many forms, the one most relevant to the FAA jurisprudence is "obstacle" preemption: wherever implementation of state law "stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress," it is preempted by federal law. This is relevant because historically, states have played an active role in the regulation of contracts generally and arbitration agreements specifically, and have often placed various restrictions on the enforcement of arbitration clauses and proceedings. This typically occurs when state courts or legislatures perceive that forced arbitration would be unfair, contrary to public policy, or harmful to the interests of vulnerable individuals.

State efforts to regulate or restrict the enforcement of arbitration clauses can raise preemption issues under current law. The Supreme Court has applied obstacle preemption principles whenever it suspects that a state has "singled out" arbitration clauses for different or

harsher treatment.[1] The Court has repeatedly held that Section 2 of the FAA requires that arbitration agreements be placed "on equal footing with all other contracts," precluding states from imposing requirements for the enforceability of arbitration clauses that they do not impose on other contractual agreements.[2]

STUDIES ON THE EFFECTS OF FORCED ARBITRATION:

On consumers: CONSUMER FINANCIAL PROTECTION BUREAU, ARBITRATION STUDY: REPORT TO CONGRESS, PURSUANT TO DODD-FRANK WALL STREET REFORM AND CONSUMER PROTECTION ACT § 1028(A) 9 (2015), http://files.consumerfinance.gov/f/201503_cfpb_arbitration-study-report-to-congress-2015.pdf: finding that tens of millions of consumers use consumer financial products that are subject to forced arbitration clauses.

On workers: KATHERINE V.W. STONE AND ALEXANDER J.S. COLVIN, ECON. POLICY INST., THE ARBITRATION EPIDEMIC: MANDATORY ARBITRATION DEPRIVES WORKERS AND CONSUMERS OF THEIR RIGHTS 15 (2015), http://www.epi.org/files/2015/arbitration-epidemic.pdf: finding that nearly 25% of non-union employees are subject to forced arbitration.

On small businesses: ALEXANDER J.S. COLVIN, ECON. POLICY INST., THE GROWING USE OF MANDATORY ARBITRATION (2017), https://www.epi.org/publication/the-growing-use-of-mandatory-arbitration/: finding that large businesses are more likely to impose forced arbitration and class action bans on their employees than smaller businesses; by doing so, these corporations have effectively insulated themselves from liability for violating employee rights. Smaller companies, are less likely to have legal advice in creating employment contracts or other HR materials, are at a competitive disadvantage compared to these companies that can skirt the law with impunity.

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[1] *See, e.g.*, Marmet Health Care Ctr., Inc. v. Brown, 565 U.S. 530, 533 (2012) ("West Virginia's prohibition against predispute agreements to arbitrate personal-injury or wrongful-death claims against nursing homes is a categorical rule prohibiting arbitration of a particular type of claim, and that rule is contrary to the terms and coverage of the FAA."); AT&T Mobility LLC v. Concepcion, 563 U.S. 333, 341 (2011) ("When state law prohibits outright the arbitration of a particular type of claim, the analysis is straightforward: The conflicting rule is displaced by the FAA.").

[2] *See, e.g.*, Doctor's Assocs., Inc. v. Casarotto, 517 U.S. 681, 687 (1996) (Montana's law preempted, as it placed arbitration agreements in "a class apart" from other contracts and "singularly limit[ed] their validity."); Southland Corp. v. Keating, 465 U.S. 1, 16 (1984) ("Congress intended to foreclose state legislative attempts to undercut the enforceability of arbitration agreements."); Preston v. Ferrer, 552 U.S. 346, 349-350 (2008) (the state law preempted because it "impose[d] prerequisites to enforcement of an arbitration agreement that are not applicable to contracts generally."); Kindred Nursing Ctrs. Ltd. P'ship v. Clark, 137 S. Ct. 1421 (2017) (Kentucky law which "singles out arbitration agreements for disfavored treatment" preempted); Perry v. Thomas, 482 U.S. 483, 484 (1987) (finding preempted California rule allowing claims for unpaid wages to proceed in court h provides that actions for the collection of wages may be maintained "without regard to the existence of any private agreement to arbitrate").

QUI TAM & CALIFORNIA'S PRIVATE ATTORNEY GENERAL ACT ("PAGA"):

Qui tam actions, which authorize private individuals to bring enforcement actions on behalf of the state, have been used for centuries to enforce a variety of legal protections. Today, *qui tam* is most commonly used to enlist whistleblowers in rooting out fraud against the government under federal and state False Claims Acts (FCA). The Act and its state-law analogs authorize both the government and private actors to file civil claims seeking treble damages and civil penalties for fraud.[3] Private actors who file claims under the Act are referred to as "relators" because they bring the case "on relation of" the government. *Qui tam* relators must file their complaints under seal with the court before the complaint is publicly served upon the defendant.[4] The government then has a statutory period to decide, based on the allegations and information in the relator's complaint, whether or not the state will pursue the claim.[5] If the government declines to join the suit, the relator may proceed on behalf of him/herself and the government; if the government chooses to take the case, the relator has a right to remain a named party to the suit.[6] Regardless of who pursues the case, the relator is entitled to some share of the proceeds of the action or settlement of the claim.[7]

In 2004, California adapted the *qui tam* model in enacting the Private Attorney Generals Act (PAGA).[8] PAGA was enacted to help enforce the state's Labor Code, which had gone underenforced as a result of severe understaffing of the state's labor agency.[9] By deputizing aggrieved employees to bring lawsuits on behalf of the state's labor agency, PAGA sought to deter employers from engaging in "unlawful and anti-competitive business practices."[10]

Under the statute, individual workers can file suit against their employer for most violations of the Labor Code and collect civil penalties on behalf of the State.[11] Before filing a suit, an employee must file notice with both the state labor agency and her employer; the agency is then given an opportunity to investigate the claims and to determine whether to intervene in the litigation. If the agency fails to investigate, the employee's civil action may commence. After a successful suit or settlement, 25% of recovered penalties go to the employee(s), and the remainder flows to the labor agency.

California has collected over $25 million in PAGA penalties across nearly 1300 cases since the statute was enacted in 2004 -- on average, about $5.6 million in penalties each year.[12] Perhaps more importantly, according to attorneys who practice in this field, PAGA has had a dramatic

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[3] *See, e.g.*, 31 U.S.C.A. § 3729(a)(1).
[4] *See id.* § 3730(b)(2).
[5] *See id.* § 3730(b)(2), (3).
[6] *Id.* § 3730(b)(4)(B), (c)(3), (c)(1).
[7] *Id.* § 3730(d)(4).
[8] CAL. LAB. CODE § 2698-2699.
[9] *See* Assembly Judiciary Committee, Committee Analysis of S.B. 796, 3-4, 6/26/03 (asserting employers have generally been able to "violate the laws with impunity.").
[10] S.B. 796, 2003-2004, Sen. Reg. Sess. (CA 2003).
[11] *Id*.
[12] *See* Department of Industrial Relations Budget Change Proposal, Fiscal Year 2016/2017.

impact on compliance with workplace protections.[13] And California's economy has only grown stronger and more robust since PAGA was enacted.[14]

WHY *QUI TAM* AVOIDS FAA PREEMPTION

Importantly, the *qui tam* approach avoids the preemption problems that have hindered other state legislative efforts to regulate forced arbitration. This is because the state is not a party to the underlying contract imposing arbitration and class action bans, and is therefore immune from their reach. Accordingly, citizen-victims who are deputized to bring claims in the name of the state for civil penalties are also not bound by the arbitration clause – nor are they suing pursuant to the contract.

This view is based on settled Supreme Court Law: in its 2002 decision in *EEOC v. Waffle House*, the Supreme Court concluded that an arbitration clause in the contract between Waffle House and one of its employees did not require the Equal Employment Opportunity Commission to arbitrate its enforcement action against Waffle House, even though the EEOC sought victim-specific relief for that employee.[15] The Court noted that, despite an employer's or merchant's intention to shield itself from judicial actions seeking redress for wrongs committed against an employee or consumer covered by an arbitration clause, the contractual relationship between the parties did not cover the dispute. "Because the FAA is at bottom a policy guaranteeing the enforcement of private contractual relationships, we look first to whether the parties agreed to arbitrate a dispute, not to general policy goals, to determine [whether a party is bound to arbitrate a dispute]."[16] As the EEOC was not a party to the contract, it had not agreed to the arbitration clause and could bring suit in court.[17] The lower federal courts have uniformly followed *Waffle House* in a series of FCA cases finding that "the government is a real party in interest to an FCA action regardless of its decision to intervene [or not] in the case," and refusing to "expand [arbitration clauses] to cover non-parties to the agreement."[18]

The same analysis applies to PAGA claims, which courts have characterized as public enforcement actions that itigated by aggrieved workers and their private counsel, but supervised by

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[13] Laura Reathaford & Eric Kingsley, *He Said, She Said: Employment Litigators Debate California's Private Attorneys General Act*, 30 No. 23 Westlaw J. Emp. 2, June 7, 2016, at 1.

[14] For example, over the past five years, California's job growth has been stronger than the national average. *See* *Economy: California's Future,* PUBLIC POLICY INSTITUTE OF CALIFORNIA (2018). Moreover, California's gross domestic product grew by 4.2% in 2015 -- more than twice the national rate. *See* Michael Hiltzik, *If California Is a "Bad State for Business," Why Is It Leading the Nation In Job and GDP Growth?* LOS ANGELES TIMES, July 26, 2016.

[15] 534 U.S. 279 (2002) (reasoning that the FAA does not mention enforcement by public agencies but instead ensures the enforceability of private agreements to arbitrate).

[16] *Id*.

[17] *Id.* at 294 ("[i]t goes without saying that a contract cannot bind a nonparty"), *citing* section 706(f) (1) of Title VII of the Civil Rights Act of 1964 and sections 16(c) and 17 of the Fair Labor Standards Act.

[18] *See, e.g.*, United States v. My Left Foot Children's Therapy, LLC, 2016 WL 3381220, at *4 (D. Nev. June 13, 2016), *aff'd on other grounds sub nom;* United States ex rel. Welch v. My Left Foot Children's Therapy, LLC, 871 F.3d 791 (9th Cir. 2017); *see also Mikes v. Strauss*, 889 F. Supp. 746, 754 (S.D.N.Y. 1995).

and brought in the name of the state.[19] Accordingly, courts have determined that PAGA actions are not covered by private arbitration agreements between employers and employees.[20] As the 9th Circuit observed in the leading decision, *Sakkab v. Luxottica Retail*, a citizen's claim under a *qui tam* statute for enforcement of workplace rights is simply a mechanism for enforcing "the state's interest in penalizing and deterring employers who violate California's labor laws." Such a claim does not relate to the "contract or transaction" that includes the arbitration requirement and therefore does not "interfere with the FAA's policy goals."[21] Further, California courts have held that PAGA actions fall under the "historic police powers" delegated to the states. Such actions require clear Congressional intent to preempt via federal law – and courts have found no intent to block states from collecting penalties for labor violations.[22]

Notably, the U.S. Supreme Court has repeatedly—and as recently as 2017—rejected certiorari petitions by employers alleging that PAGA is preempted by the FAA.[23] Taken together, the long history of *qui tam* actions and these recent PAGA decisions reveal that this unique public enforcement approach rests on strong legal footing.

[19] *See, e.g.,* Arias v. Superior Court, 46 Cal.4th 969, 985 (2004) ("An employee-plaintiff suing ... under the [PAGA] does so as the proxy or agent of the state's labor law enforcement agencies ... In a lawsuit brought under the act, the employee-plaintiff represents the same legal right and interest as state labor law enforcement agencies – namely, recovery of civil penalties that otherwise would have been assessed and collected by the Labor Workforce Development Agency.")

[20] Iskanian v. CLS Transp. Los Angeles LLC, 173 Cal.Rptr.3d 289, 313 (Cal. 2014) (the "FAA's goal of promoting arbitration as a means of private dispute resolution does not preclude our Legislature from deputizing employees to prosecute Labor Code violations on the state's behalf"); O'Connor v. Uber Tech., Inc., 311 F.R.D. 547, 555-7 (N.D. Ca. 2015).

[21] 803 F.3d 425, 430-31, 439 (9th Cir. 2015).

[22] Californians For Safe & Competitive Dump Truck Transp. v. Mendonca, 152 F.3d 1184, 1186 (9th Cir. 1998).

[23] *See, e.g., Bloomingdale's, Inc. v. Vitolo*, 137 S. Ct. 2267 (petition for certiorari denied on June 19, 2017).