

California Supreme Court Holds No Wage Recovery in PAGA Claims

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On September 12, 2019, the California Supreme Court in *ZB, N.A., et al. v. Superior Court*, No. S246711, firmly held that employees cannot collect unpaid wages under the Private Attorneys General Act (commonly known as “PAGA”). This surprising decision curtails one avenue PAGA plaintiffs and their attorneys used as a workaround when faced with enforceable arbitration agreements containing class action waivers.

As we have frequently written, PAGA allows an aggrieved employee to seek civil penalties for his employer’s violations of the Labor Code on behalf of himself, the State, and other aggrieved employees. Critically, PAGA permits aggrieved employees to recover civil penalties that previously could be collected only by the Labor and Workforce Development Agency.

In calculating these penalties, PAGA often “borrows” from penalties set forth in particular provisions of the Labor Code. This process is generally straight forward but is complicated in rare situations where the civil penalty provided in the underlying Labor Code provision is equal to an “amount sufficient to recover unpaid wages.” Specifically, Labor Code section 558 provides, in pertinent part:

(a) Any employer or other person 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. [Emphasis added].

California’s appellate courts quickly became divided in their attempts to interpret these provisions. Specifically, the courts were tasked with determining whether the “amount sufficient to recover underpaid wages” called for a civil penalty or individual damages. While seemingly punctilious, the distinction between unpaid wage damages and civil penalties measured by the amount of unpaid wages drives at least three key determinations: (1) whether the amount can be recovered in PAGA claims; (2) whether the claim, or a portion thereof, is subject to arbitration; and (3) the statute of limitations applicable to the claim. The key decisions analyzing this issue are discussed below in chronological order.

Thurman v. Bayshore Transit Management, Inc.

In *Thurman v. Bayshore Transit Management, Inc.* (2012) 203 Cal.App.4th 1112, the plaintiff brought a PAGA claim based upon missed meal and rest periods during his employment. The employee sought, and the trial court awarded, civil penalties, including unpaid wages.

On appeal, the employer argued that the award of unpaid wages under PAGA was improper because such wages were not part of the civil penalty provided for in Section 558. The California Court of Appeal for the Fourth Appellate District disagreed, holding that the civil penalty under Section 558 “consists of *both* the \$50 or \$100 penalty amount *and* any underpaid wages.” The court reasoned that this conclusion was compelled by the LWDA’s ability to seek underpaid wages on behalf of employees under Section 558, combined with the PAGA plaintiff suing “as a proxy or agent of the state’s labor law enforcement agencies.”

The *Thurman* court further held that the underpaid wages portion of the penalty was to “go[] entirely to the affected employee or employee, as an express exception to the general rule that civil penalties recovered in a PAGA action are distributed 75 percent to the [LWDA] and 25 percent to the aggrieved employees.”

In the opinion’s sole glimmer of hope for employers, the court discussed and agreed with the unpublished federal opinion in *Yadira v. Fernandez* (N.D. Cal. June 14, 2011) 2011 WL 2434043, which firmly held that an action to recover unpaid wages under Section 558 is subject to a one-year statute of limitations applicable to recovery of penalties, rather than the three year statute of limitations generally applicable to recovery of wages.

Iskanian v. CLS Transp. Los Angeles, LLC

In *Iskanian v. CLS Transp. Los Angeles, LLC* (2014) 59 Cal.4th 348, the California Supreme Court held that PAGA representative claims for civil penalties are not waivable, even in the context of an otherwise valid arbitration agreement. The Court reasoned that the Federal Arbitration Act governs “disputes involving the parties’ *own* rights and obligations, not the rights of a public enforcement agency” and thus that PAGA claims, which are disputes between the employer and the state, are not subject to arbitration thereunder.

The Court further explained that “the civil penalties recovered on behalf of the state under the PAGA are distinct from the statutory damages to which employees may be entitled in their individual capacities.” In making this distinction, the Court explained that civil penalties do not include recoveries that could have been obtained by individual employees suing in their individual capacities – i.e. victim-specific relief.

Esparza v. KS Industries, L.P.

In *Esparza v. KS Industries, L.P.* (2017) 13 Cal.App.5th 1228, the plaintiff alleged that his employer failed to: pay minimum and overtime wages, provide meal and rest breaks, pay wages in a timely manner, provide complete and accurate wage statement, and reimburse business expenses. Based on these alleged violations, the employee pursued a single cause of action for violation of PAGA seeking to recover, “penalties and wages” for the listed Labor Code sections, including Section 558.

The employer moved to compel arbitration of the portion of the claim seeking unpaid wages, arguing that the label “civil penalties” could not disguise the nature of the relief sought – individualized damages. The trial court denied the motion to compel “based on [plaintiff’s] contention that he only seeks PAGA civil penalties and no individual damages.”

The California Court of Appeal for the Fifth Appellate District, however, agreed with the employer, holding that a claim to recover wages under Section 558 was not exempt from arbitration because it was a “private claim for victim-specific relief.” Interestingly, the court reached this decision, in large part, based upon its finding that unpaid wages recovered under Section 558 are payable solely to the aggrieved employees. Relying heavily on the *Iskanian* discussion of the same distinction, the *Esparza* court held that, for purposes of determining exemption from arbitration, representative actions for civil penalties under PAGA are limited to “those where a portion of the recovery is allocated to the [LWDA].”

Based on Section 558’s express provision that wages recovered thereunder are payable to the employee, the court thus concluded that such wages are not a civil penalty recoverable in a non-arbitrable PAGA action, but are a “private dispute” over “statutory damages.”

Lawson v. ZB, N.A.

In *Lawson v. ZB, N.A.* (2017) 18 Cal.App.4th 705, the plaintiff alleged violations of various Labor Code provisions related to overtime, meal and rest periods, minimum wages, timely wage payments, wage statements, and expense reimbursement. Based upon these allegations, she filed a representative PAGA action seeking to recover penalties under Section 558, including underpaid wages owed to herself and other allegedly aggrieved employees. In response, her employer moved to compel arbitration of the underpaid wage claim. The trial court granted the employer’s motion, bifurcating the employee’s underpaid wage claim from her claim for per-pay-period penalties and compelling the former to arbitration *as a representative action*.

The employer filed a writ of mandate challenging the trial court’s expansion of the scope of arbitration to include representative claims. The California Court of Appeal for the Fourth Appellate District held that the trial court erred in bifurcating the underpaid wages portion of the employee’s PAGA claim and ordering arbitration of that portion of the claim. The court reaffirmed its prior holding in *Thurman* that Section 558 claims, including claims for underpaid wages, are claims for civil penalties under PAGA.

In so holding, the court noted that, contrary to the *Esparza* court’s holding, Section 558 does not provide for a private right of action. As such, the underpaid wages mentioned therein are a civil penalty recoverable only by a state enforcement agency or by a PAGA plaintiff standing in the shoes of that agency.

The *Lawson* court did not specifically address, and thus left intact, the secondary holding in *Thurman* that one hundred percent of the underpaid wage portion of Section 558’s penalties are payable to the aggrieved employees. Instead, the *Lawson* court merely notes that the total penalty recoverable under Section 558 may, depending upon the number of violations and employees’ pay rates, still be “largely” payable to the state.

Zakaryan v. The Men's Wearhouse

In *Zakaryan v. The Men's Wearhouse* (2019) 33 Cal.App.5th 659, the employee brought a PAGA action for alleged misclassification of managers as exempt, resulting in alleged overtime, meal and rest break, derivative wage statement, and final pay violations. Among other relief, the employee prayed for recovery of “unpaid and underpaid wages of all aggrieved employees.” Relying on *Esparza*, the employer moved to compel arbitration of the portion of the claim seeking reimbursement of underpaid wages. The trial court denied the employer’s motion, finding that the PAGA claim could not be split.

On the employer’s appeal, the California Court of Appeal for the Second Appellate District agreed, holding that where an employee brings a solitary PAGA claim, the court may not split that claim by sending the employee to arbitration to recover underpaid wages while retaining jurisdiction to award per-pay-period statutory penalties. In this regard, the *Zakaryan* court fell into agreement with the *Lawson* court.

The court specifically reasoned that Section 558 provides for a single civil penalty consisting of two components – one measured by the pay periods in which violations occurred and one measured by the underpayment to the aggrieved employee. That civil penalty is recoverable by an individual only when he is acting on behalf of the state and thus his “‘personal claim’ for underpaid wages ... is ‘not at stake’.”

The *Zakaryan* court, however, parted ways with *Lawson* when it reached its secondary holding – that the entirety of Section 558’s “single, indivisible civil penalty,” including the portion measured by the employee’s underpaid wages, is payable 75% to the LWDA and only 25% to the aggrieved employee.

Resolving the Split - *ZB, N.A., et al. v. Superior Court*

Noting the split among the appellate divisions, the California Supreme Court granted review of *Lawson* on March 21, 2018 presumably to determine whether an employer could compel arbitration of a PAGA claim seeking unpaid wages under Section 558. Instead, the Court rendered that question moot, holding that a PAGA plaintiff may not recover any allegedly unpaid wages in any forum. In support of this holding, the Court explained that the only PAGA remedy under Section 558 is the civil penalty of either \$50 or \$100 per pay period. Unpaid wages, it reasoned, are compensatory damages that can be ordered only by the Labor Commissioner.

This decision is a rare and unexpected win for employers, drastically limiting the amount plaintiffs can attempt to recover in the PAGA arena. This case also serves as an important reminder about the importance of having an enforceable arbitration agreement in place.

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