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Chicken or Egg: Applying the Age-Old Question to Class Waivers in Employee Arbitration Agreements

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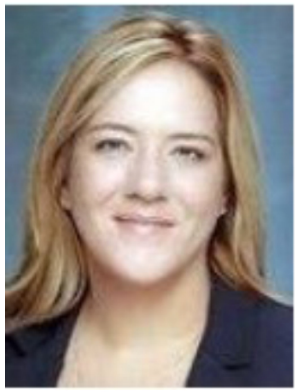

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Companies with employees across the country are faced with the problem of whether and how to effectuate employee arbitration agreements that are uniform within the company and yet enforceable nationwide. Class action waivers contained in employment arbitration agreements have faced a plethora of challenges from the plaintiffs' bar and varying treatment by the courts across the United States. The most recent cause of the lack of clarity arises out of the interplay between the National Labor Relations Act (NLRA) and the Federal Arbitration Act (FAA). At present, there is a split in the United States Courts of Appeals that results from how the courts have examined the perceived conflict between these federal statutes. In some jurisdictions, the courts begin with an examination of the FAA to determine whether a class waiver in an employee arbitration agreement is enforceable, and then turn to the NLRA to confirm their result. In other jurisdictions, the courts have taken the opposite approach, looking first to the NLRA and then to the FAA, and reaching an opposite result. These different approaches raise the question: Which comes first, the FAA or the NLRA?

The United States Supreme Court is poised to decide an issue troubling companies across the country and in a myriad of industries: "Whether an agreement that requires an employer and an employee to resolve employment-related disputes through individual arbitration, and waive class and collective proceedings, is enforceable under the Federal Arbitration Act, notwithstanding the provisions of the National Labor Relations Act." Petition for Writ of Certiorari, Epic Systems Corp. v. Lewis, 137 S. Ct. 809 (No. 16-285). The Supreme Court has consolidated three cases, stemming from the Seventh Circuit, Ninth Circuit, and Fifth Circuit, and will hear them together on the issue. These circuits are three of the five courts comprising the split.

On one side of the argument, the Second, Fifth, and Eighth Circuit Courts of Appeals have held that employee arbitration agreements that include class waivers are generally enforceable. These circuits arrive at their holding by looking first to the FAA's presumption that arbitration agreements are enforceable. They then examine whether a "contrary congressional command" overrides the presumption. CompuCredit Corp. v. Greenwood, 132 S. Ct. 665, 669 (2012). These courts have held that the NLRA does not contain a congressional command that overrides the FAA. As such, the FAA and the NLRA should be read to work together and courts may enforce the arbitration agreement and its waiver. The Fifth Circuit took the argument one step further and also analyzed the agreements under the FAA's savings clause – an analysis used by courts opposing class waivers – to determine whether the agreement is otherwise unenforceable due to conditions that would render any contract unenforceable. The savings clause of the FAA provides that "a written provision in any . . . contract . . . to settle by arbitration a controversy . . . arising [from] such contract . . . shall be valid, irrevocable, and enforceable, save upon grounds as exist at law or in equity for the revocation of any contract." The Fifth Circuit held that, "[r]equiring a class mechanism is an actual impediment to arbitration and violates the FAA," and, therefore, the savings clause will not invalidate the waiver. D.R. Horton, Inc. v. NLRB, 737 F.3d 344, 360 (5th Cir. 2013).

In D.R. Horton, Inc., the Fifth Circuit rejected the NLRB's decision in D.R. Horton, Inc., 357 N.L.R.B. 184 (2012), in which the Board barred the use of class action waivers in employment arbitration agreements, relying on Section 7 of the NLRA. Section 7 of the NLRA provides, in pertinent part, that "employees shall have the

right to engage in . . . concerted activities for the purpose of collective bargaining or other mutual aid or protection." The Board found that class action waivers in arbitration agreements infringe on the ability to use "mutual aid or protection" through class or collective actions to improve employees' terms or conditions of employment. Thus, in D.R. Horton, Inc., the Board held that class action waivers directly restrict employees' rights afforded by the NLRA and that unlawful violation invoked the savings clause provided under the FAA permitting the NLRA's protections to override the provisions of the FAA. The Fifth Circuit rejected the Board's analysis, instead finding that the FAA requires the enforcement of arbitration agreements according to their terms unless such terms are overridden by the FAA's savings clause or another federal statute's "congressional command." The Fifth Circuit noted that there is a strong federal policy favoring arbitration, that the right to pursue class and collective actions is a procedural versus substantive right, and that there was no conflict between the FAA and NLRA's purposes. The Fifth Circuit determined that the Board's reliance on the FAA's savings clause was misplaced because "requiring the availability of class-wide arbitration interferes with fundamental attributes of arbitration and thus creates a scheme inconsistent with the FAA."

While the Fifth Circuit rejected the Board's findings that the arbitration agreement at issue violated employees' rights to engage in protected activity, it agreed with the Board that the arbitration agreement contained language that could be construed to violate Section 8(a)(1) of the NLRA. Specifically, the Fifth Circuit explained that "[t]he arbitration agreement would violate the NLRA if it prohibited employees from filing unfair labor practice claims with the Board" because "a company . . . violates section 8(a)(1) if 'employees would reasonably construe the language to prohibit section 7 activity.'" The Fifth Circuit upheld the Board's decision to require the employer to clarify with its employees that the arbitration agreement did not prohibit the pursuit of unfair labor practice claims with the NLRB.[1]

[1] Following its decision in *D.R. Horton, Inc.*, the Fifth Circuit had occasion once again to address whether an arbitration agreement infringed on protected rights under the NLRA. In *Murphy Oil v. NLRB*, 808 F.3d 1013 (5th Cir. 2015), the Fifth Circuit reviewed two versions of the employer's arbitration agreements. The first version required employees to resolve all disputes arising out of their employment on an individual basis in arbitration proceedings and contained an explicit waiver of their rights to bring class and collective action claims. The second version contained, in addition to the above provisions, an exception to arbitration proceedings for unfair

On the other side of the argument, the Seventh and Ninth Circuit Courts of Appeals have examined the issue by first looking to the NLRA. They have held that class waiver provisions in employee arbitration agreements violate Sections 7 and 8 of the NLRA by interfering with or restraining employees' rights to "engage in [] concerted activity for the purpose of . . . . mutual aid or protection." 29 U.S.C. §§ 157, 158. These courts have held that the NLRA affords employees substantive protection to engage in concerted activity under Section 7 and agreements that run contrary to this substantive right are illegal. Finding such agreements illegal, these courts have held the agreements themselves to be unenforceable under the FAA's savings clause, which states that an arbitration agreement will be enforceable "save upon such grounds as exist at law or in equity for the revocation of any contract." 9 U.S.C. § 2. Since illegality is a defense to contract formation, they have decided that class waivers in arbitration agreements render the agreements illegal and therefore unenforceable under the FAA.

In *Lewis v. Epic Systems Corp.*, 823 F.3d 1147 (7th Cir. 2016), the Seventh Circuit (the first appellate court to adopt the NLRB's position) disagreed with the decisions on class action waivers from the Second, Fifth and Eighth Circuits. Specifically, in *Lewis*, the Seventh Circuit held that a class action waiver violated Section 8 of the NLRA, and, therefore, was unenforceable. The employee plaintiff in *Lewis* entered into the arbitration agreement with the employer defendant as a condition of employment. Despite the agreement, the plaintiff filed a putative collective/class action in federal court and the employer then moved to compel individual arbitration, relying on the arbitration agreement and the class action waiver contained therein. The district court held that the arbitration agreement was invalid because it violated the NLRA. The Seventh Circuit affirmed, explaining that the class action waiver violated Section 8 of the NLRA by precluding employees from engaging in concerted activities protected under Section 7 of the

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labor practice (ULP) claims. The Fifth Circuit found that the ULP exception provided for in the second version adequately addressed its concerns identified in *D.R. Horton, Inc.* and disagreed with the Board's finding that the agreement was unlawful. The court agreed with the Board, however, that the first version without the ULP exception would likely have a chilling effect on employees' rights and upheld the Board's order that the employer "take corrective action as to any employees that remain subject to that version of the contract."

NLRA. The Seventh Circuit held that there was no conflict between the FAA and the NLRA, but that the savings clause of the FAA rendered the arbitration agreement unenforceable on its written terms. In reaching this decision, the *Lewis* court stressed the fact that because the arbitration agreement at issue (1) was a condition of employment and (2) did not contain an opt-out clause allowing for exclusion of the employee from the employer's alternative dispute policy, it ran afoul of the NLRA. The court further emphasized that it had no need to address nor resolve the question of whether an arbitration agreement that does contain an opt-out clause violates the NLRA.

The question left unaddressed by the *Lewis* court has been answered twice by the Ninth Circuit. *See Morris v. Ernst & Young*, 834 F.3d 975, 982 fn. 4 (9th Cir. 2016); *Johnmohammadi v. Bloomingdale's, Inc*., 755 F.3d 1072, 1077 (9th Cir. 2014). In *Morris*, the Ninth Circuit relied upon and followed the Seventh Circuit's decision in *Lewis,*[2] but held that where an arbitration agreement contains an opt-out provision, a class action waiver in the agreement will not violate the NLRA. Similarly, in *Johnmohammadi*, the Ninth Circuit upheld an arbitration agreement with an opt-out provision despite the argument that the class action waiver contained therein violated the NLRA. The Ninth Circuit found that, "[i]n the absence of any coercion influencing the decision, we fail to see how asking employees to choose between those two options can be viewed as interfering with or restraining their right to do anything."

Now, it is up to the United States Supreme Court to determine whether ***mandatory*** arbitration agreements containing class and/or collective action waivers are enforceable under the FAA, despite any protections afforded by the NLRA. Briefing on this issue before the United States Supreme Court is scheduled to conclude in late July 2017. Based on the Supreme Court's prior arbitration decisions on the enforceability of class action waivers, many employers are hoping to obtain relief from challenges presented by the current circuit split. For

[2] In *Morris*, the Ninth Circuit reversed and remanded the district court's decision to dismiss the case and compel arbitration. The Ninth Circuit held that the right to pursue class and collective actions constitutes "concerted activities" falling within the scope of Section 7 of the NLRA. Thus, the arbitration agreement's class action waiver violated Section 8 of the NLRA. In its decision, the Ninth Circuit noted the Seventh Circuit's decision in *Lewis v. Epic Systems Corp.,* as well as the NLRB's 2012 *D.R. Horton* decision.

example, in *AT&T Mobility LLC v. Concepcion*, 563 U.S. 333 (2011), the Supreme Court invalidated a California state law that declared class arbitration waivers unenforceable and reversed a California decision invalidating an arbitration agreement with a class action waiver contained in a consumer arbitration agreement. Specifically, in *Concepcion*, the Supreme Court held that the FAA's savings clause did not allow a state law to invalidate a consumer contract containing a class action waiver. Likewise, in *American Express v. Italian Colors*, 133 S. Ct. 2304 (2013), the Supreme Court upheld class action waivers in a commercial setting (involving a maritime shipping dispute) in a 5-3 majority decision. The Supreme Court held that mandatory class arbitrations provisions will be upheld absent an express congressional statement that class proceedings were so necessary to the federal claim as to permit preemption of the FAA. Many court observers believe, based on the composition of the court hearing the consolidated petition in *Epic Systems Corp. v. Lewis,* that a ruling upholding waivers is likely. The addition of Justice Gorsuch, based on past decisions, likely leans in favor of the FAA and enforcement of agreements between parties who have expressly agreed to arbitrate and against arbitration by classes of individuals who were not a party to the agreement.[3]

Whatever the outcome, employers nationwide who have or plan to have arbitration agreements with their employees will be impacted. In the interim, a close reading of the recent appellate decisions provides employers with guidance to overcome the current attacks on class action waivers in arbitration agreements, including the use of opt-out provisions in such agreements. Companies with employees spanning the conflicting circuits' jurisdictions may want to address these employee agreements with an eye toward Seventh and Ninth Circuits' criticisms.[4] Here are some best practices to keep in mind:

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[3] *See e.g., Ragab v. Howard*, 841 F.3d 1134 (10th Cir. 2016) (Gorsuch dissenting and arguing that six agreements by the parties to arbitrate provides sufficient evidence that the parties intended to arbitrate); *Genberg v. Porter*, 566 F. App'x 719, 722 (10th Cir. 2014) (arbitration can be invoked "only by a signatory of the agreement, and only against another signatory"); *Howard v. Ferrellgas Partners LP*, 748 F.3d 975, 977 (10th Cir. 2014) (the FAA's "heavy hand in favor of arbitration" requires that the parties to the contract agree to arbitrate).

[4] Employers in California must continue to be mindful of the challenges presented by representative actions under California's Private Attorney General Act (PAGA). Under PAGA, an aggrieved employee may sue on behalf of himself and similarly aggrieved employees to enforce and collect monetary penalties provided for violations of the California Labor Code. In

- Provide the arbitration agreement to employees in writing with an acknowledgement of receipt by the employee.
- Give employees sufficient time to consider the agreement before its effective date.
- Consider including an opt-out provision.
- Consider language that excludes claims under the NLRA's Section 7, state law, or other statutes that prohibit such waivers.
- Specifically and clearly identify the class waiver in the arbitration agreement, as well as whether the court or arbitrator will decide if arbitration may proceed on a class basis.
- To avoid the possibility of a class arbitration (and its many pitfalls), consider language that provides for litigation if the waiver clause is found to be unenforceable.
- Consider language whereby the employee agrees that individual arbitration of all employment-related claims will be the initial manner of resolving the conflicts before engaging in litigation on an individual, class, collective, or representative basis.

In addition, employers should consider whether to include specific details in the arbitration agreement setting out:

- Method for selection of arbitrator or panel of arbitrators

Iskanian v. CLS Transportation Los Angeles, LLC, 327 P.3d 129 (Cal. 2014), the California Supreme Court held that an employee's right to bring a PAGA action in court is unwaivable. The court further found that PAGA claims fall outside of the FAA's coverage because it is not an employee-employer dispute, but rather a dispute between the employer and the state. The FAA governs the enforceability of arbitration agreements involving private disputes and cannot bind public enforcement actions. Decisions from California state appellate court following the *Iskanian* decision reinforce that, in California state court, employers generally cannot force PAGA claims into arbitration. This end run around class action waivers in arbitration agreements is not one without consequence. The civil penalties provided for under PAGA are non-inconsequential – *i.e.*, $100 for initial violations for each aggrieved employee per pay period, and $200 for each subsequent violation. The ability of an individual employee to sue on behalf of all aggrieved employees is the functional equivalent of pursuing claims on a class action basis; however, PAGA actions are not subject to the requirements of class certification. Unsurprisingly, the California courts have seen an influx of actions brought as "PAGA only" actions to avoid arbitration challenges.

- The minimum qualifications required of arbitrator – *i.e.*, lawyers or former judges
- The governing substantive law
- The governing arbitration resolution group – *i.e.*, AAA, JAMS, etc.
- The payment of initiation fees and cost of arbitration
- Limits on length of the arbitration process
- Deadline for initiating arbitration
- Deadline on submission of additional claims / amendment of claims
- Limits on discovery in length of time and form
- Requirement that arbitrator is required to rule on dispositive motions
- Requirement that arbitrator issue a reasoned written award

Just as philosophers through the ages have debated which came first – chicken or egg – so may we all continue to debate the order for class waiver analysis – FAA or NLRA. And, until the United States Supreme Court renders an opinion, employers should work closely with their counsel to craft employee arbitration agreements that balance their needs with the rights of their employees across the country.