Turning Tides For Employee Arbitration Agreements

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Introduction

On October 11, 2016, Judge Brendan Linehan Shannon of the United States Bankruptcy Court for the District of Delaware ruled that an arbitration agreement was unenforceable under the National Labor Relations Act (the "NLRA")[1] because it contained a class-action waiver provision.[2] In so doing, the *Fresh & Easy* Court became the most recent to find that the Federal Arbitration Act ("FAA") did not require enforcement of such agreements. This is because they infringe on the substantive federal right, provided for by the NLRA, to engage in "concerted activities," including, but not limited to, collectively adjudicating employment claims.[3] The *Fresh & Easy* decision deepens a split in authority over whether the FAA mandates enforcement of agreements containing such waivers. Attorneys representing employees in cases within the Third Circuit should read *Fresh & Easy* as well-reasoned support for arguments attacking employers' attempts to short-circuit class action litigation through class action waivers in employment agreements.

Background of the FAA and Employment Contracts

In the early twentieth century courts routinely struck down arbitration agreements, which they viewed as an intrusion on the judiciary's purview. Merchants and other commercial actors, however, wished to contract for arbitral forums as agreed-upon venues for dispute resolution. Upon their lobbying, Congress enacted the FAA in 1925 "to reverse the longstanding judicial hostility to arbitration agreements" and place them "upon the same footing as other contracts."[4] To that end, the FAA provides that a "written provision in any maritime transaction or a contract evidencing a transaction involving commerce to settle by arbitration a controversy thereafter arising . . . shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract."[5]

While debate over the FAA was ongoing, organized labor opposed its enactment for fear that "the legislation might authorize federal judicial enforcement of arbitration clauses in employment contracts and collective-bargaining agreements."[6] In response to these concerns, then Secretary of Commerce Herbert Hoover stated that, "if objection appears to the inclusion of workers' contracts in the law's scheme, it might be well amended by stating 'but nothing herein contained shall apply to contracts of employment of seamen, railroad employees, or any other class of workers engaged in interstate or foreign commerce.'"[7] Hoover's language was included in the FAA and codified at 9 U.S.C. § 1. Ironically, however, this very provision would be used seventy-six years later to extend the FAA's reach to arbitration clauses in most employment agreements.

In *Circuit City*, the Supreme Court considered a provision in an employment application providing that employment claims would be settled "*exclusively* by final and binding *arbitration*[.]"[8] The employee, a sales counselor, subsequently filed an employment discrimination lawsuit. Justice Kennedy, writing for the majority, employed a textualist interpretation of the FAA and determined that, contrary to the legislative history showing that Hoover's exclusion was meant to apply to all workers, the language of Section 1 in fact confined the exception to only transportation workers. Specifically, Justice Kennedy observed that the term "engaged in foreign or interstate commerce" set forth in the Section 1 exclusion differed materially from the term "transaction involving commerce" in the Section 2 coverage provision. Because prior Supreme Court cases had construed the word "involving" to extend to the outer limits of authority under the Commerce Clause and the phrase "engaged in" to be "a limited assertion of federal jurisdiction," Justice Kennedy reasoned that the coverage provision applied generally, while Hoover's carve-out applied to a limited subset of workers. Kennedy then used the rule *eiusdem generis*—literally, "of the same kind," a canon of construction meaning that general wording is restricted by preceding terms—to cabin the exclusion to transportation workers, who are in the same class as "seamen" and "railroad employees."[9] Notwithstanding J. Stevens' dissent and subsequent scholarly criticism, which pointed to Congress' clear intent for the FAA not to govern employment contracts, *Circuit City* remains controlling law.

Prior Precedent

Independent of *Circuit City*, the judiciary, over several decades, created a "strong national policy" that has elevated arbitration provisions to a superposition above that intended by Congress; *i.e.*, the same footing as other contracts. This policy may only be "overridden by a contrary congressional command," evidenced either by the text or legislative history of a statute passed subsequent to the FAA, or "an inherent conflict between arbitration and [such] statute's underlying purposes."[10] Thus any non-transportation employee seeking to defeat a mandatory arbitration clause would either have to show grounds for revocation of the contract or a contrary congressional command set forth in a statute enacted after the FAA.

Demonstrating a "contrary congressional command" has proven to be no small task. In *Gilmer*, a financial services manager had completed a registration application that required arbitration pursuant to the rules of certain exchanges. The plaintiff was terminated, and subsequently brought a claim under the Age Discrimination in Employment Act of 1967 ("ADEA"). The plaintiff in *Gilmer* conceded that there was no intent in the ADEA, or its legislative history, to override the FAA. The Court found that, because the plaintiff was still able to effectively vindicate his rights in the arbitral forum, the arbitration agreement was enforceable.[11] The holding in *Gilmer* did not address whether a prohibition on collective and class action by employees would be enforceable, though the Court discussed the possibility in dicta.

By way of further example, in *American Express Co. et al. v. Italian Colors Restaurant*, a restaurateur brought an antitrust action against American Express claiming it used its monopoly power in the market for credit cards to force merchants to accept credit cards at rates approximately 30% higher than the fees for competing credit cards in violation of the Sherman Act.[12] The restaurateur challenged a prohibition on class arbitration, on the basis that it would not be able to effectively vindicate its rights absent proceeding as a class due to the prohibitively high cost of retaining an expert. The *Italian Colors* Court was unswayed. It found that the antitrust laws did not evince an intention to preclude a waiver of class-action procedures, and refused to invalidate the arbitration agreement even though it would cost the restaurateur hundreds of thousands of dollars to challenge a claim worth a tiny fraction of that amount. In her dissent, Justice Kagan observed that the arbitration clause imposed "a variety of procedural bars that would make pursuit of the antitrust claim a fool's errand" such that if the clause was enforceable, "Amex [had] insulated itself from antitrust liability—even if it [had] in fact violated the law."[13]

Against this backdrop, the National Labor Relations Board ("NLRB" or "Board") decided a series of cases holding that arbitration agreements that contain waivers of employees' rights to class or collective actions violate the NLRA. Section 7 of that statute guarantees employees "the right to self-organization, to form, join, or assist labor organizations, to bargain collectively through representatives of their own choosing, and to engage in other concerted activities for the purpose of collective bargaining or other mutual aid or protection[.]"[14] The Board first reached this determination in *D.R. Horton, Inc.*, in which it found a class action waiver in the arbitration clause of an employment agreement unlawful.[15] The Board found that there was no conflict between the NLRA and the FAA because the waiver in the arbitration clause interfered with substantive statutory rights guaranteed by the FAA, "and the intent of the FAA was to leave substantive rights undisturbed." The Board has repeated this holding in numerous other cases.[16]

Unfortunately for aggrieved employees, some courts have expressed views contrary to those espoused by the Board. In particular, the Fifth Circuit has rejected the Board's reasoning in appeals of both the *D.R. Horton* and *Murphy Oil* decisions. The Fifth Circuit found that "[t]he use of

class action procedures . . . is not a substantive right" and the right to engage in concerted activity guaranteed by Section 7 neither implicated the FAA's savings clause (*i.e.*, it was not "grounds as exist at law or in equity for the revocation of any contract") nor constituted a congressional command contrary to the FAA.[17] The Fifth Circuit reached the same finding two years later, noting that it did "do not celebrate the Board's failure to follow our *D.R. Horton* reasoning."[18]

Other courts have split over whether to follow the Board's reasoning or that of the Fifth Circuit. The Eighth and Second Circuits have declined to follow the Board, though neither opinion performed an analysis like that conducted by the Fifth Circuit.[19] The Ninth Circuit initially declined to consider the issue because it was not raised in briefing.[20] The *Richards* and *Owen* Courts did note a number of district courts that had sided with the Fifth Circuit.[21] However, *Richards* and *Owen* also noted that other district courts have, to varying degrees, adopted the Board's reasoning.[22] The Fifth Circuit's reasoning has also been rejected by *Totten v. Kellogg Brown & Root, LLC*.[23] Recent decisions by the Seventh and Ninth Circuits have unequivocally endorsed the Board's reasoning.

The *Epic Systems* and *Ernst & Young* Decisions

The plaintiff in *Lewis v. Epic Systems Corporation* brought an action under the Fair Labor Standards Act of 1938 ("FLSA") in federal court, asserting that an arbitration agreement violated the NLRA because it interfered with employees' right to engage in concerted activities.[24] The Seventh Circuit found that the plain and unambiguous language of Section 7's text, as well as the history and purpose of the NLRA, supported its guarantee of the substantive right to pursue collective, representative, and class legal remedies. The Seventh Circuit noted that the Board's interpretation of Section 7 is, at a minimum, "a sensible way to understand the statutory language" that must be afforded deference under *Chevron U.S.A., Inc. v. Natural Resources Defense Council, Inc.*[25] It further noted that this interpretation does not implicate the FAA because Section 7 rendered the arbitration agreement illegal, implicating the FAA's savings clause.

Three months after *Epic Systems*, the Ninth Circuit also endorsed the Board's understanding of the NLRA.[26] In *Morris v. Ernst & Young*, the Ninth Circuit wrote that the "intent of Congress is clear from the [text of the NLRA] and is consistent with the Board's interpretation." The court continued to find that the class action waiver at issue also voided the mandatory arbitration provision contained in the agreements sent to the employees. Like the court in *Epic Systems*, the Ninth Circuit determined that the FAA "does not dictate a contrary result" because the savings clause provides that an arbitration provision is not enforceable where "grounds as exist at law or in equity for the revocation of any contract."

Chan v. Fresh & Easy

Against this backdrop, the United States Bankruptcy Court for the District of Delaware decided *Fresh & Easy*, an adversary proceeding in the bankruptcy case pertaining to the eponymous west-coast chain of grocery stores. The putative class, comprised of former employees of the debtor grocery chain, filed claims for unpaid wages and benefits under the Worker Adjustment and Retraining Notification Act ("WARN Act"), claiming that the debtor had failed to provide them written notice in advance of mass layoffs, as required by the WARN Act. The debtor moved to compel arbitration, relying on an agreement, entered into by the grocer and the plaintiff in the adversary proceeding, pursuant to which the plaintiff purported to waive her right to prosecute a class action and submit to arbitration as the exclusive forum for any dispute arising in connection with her employment. Furthermore, "[i]n the event a provision in the agreement was held to be void, the Arbitration Agreement provided that the remainder of the contract would remain in full force and effect."

Plaintiff, following *Epic Systems* and the Board's various decisions, argued that the court should defer to the Board's finding that the NLRA's guarantee of employee participation in "concerted activities" includes the right to pursue class and collective actions. Plaintiff further argued that the FAA did not require that the arbitration agreement be enforced because the agreement contravened the NRLA, and the savings clause was therefore implicated.

In a twenty-eight page memorandum opinion, the *Fresh & Easy* Court held that the agreement contravened the NLRA, and that the class waiver could not be severed from the rest of the contract because it was central to the parties' agreement. Consequently, the Court declined to compel arbitration and held that the adversary proceeding should go forward in a class capacity. While the Court wrote that "[c]onsideration of the Board's interpretation of Section 7 is not required here under *Chevron*, since the Court has concluded that the NLRA unambiguously protects the right of employees to bring a collective action," it nevertheless found that "even if [the meaning of 'concerted activities'] is ambiguous and the Court resorts to the second step of the *Chevron* analysis, the Court's conclusion would remain unchanged" because the "Board, on at least two occasions, has interpreted Section 7 to provide a substantive right to class or collective remedies" (citing *D.R. Horton* and *Murphy Oil*).

The *Fresh & Easy* Court joined the Board, as well as the Seventh and Ninth Circuits, in finding that rights guaranteed by Section 6 of the NLRA—*viz*, "the right to organize, the right to bargain collectively, and the right to engage in other concerted activities"—are substantive and cannot be waived in an employment agreement. Like the *Epic Systems* and *Ernst & Young* courts, the *Fresh & Easy* Court further determined that the FAA was not implicated because the savings clause prohibited enforcement of the arbitration agreement on account of its illegality under the NLRA. Finally, the *Fresh & Easy* Court also found that the fact that the employee was allowed to opt-out of the arbitration agreement did not "revive the Class Waiver[.]" Because NLRA section 8(a)(1) prohibits employers from "interfer[ing] with, restrain[ng], or coerc[ing] employees in the exercise of the rights guaranteed under Section 7," and the Board had previously determined that class waivers interfere with rights guaranteed by the NLRA, the *Fresh & Easy* Court deferred to the Board under *Chevron* "step two" and determined that the opt-out did not save the agreement.

What it Means for Employees

Employees in the Third Circuit, comprising Delaware, Pennsylvania, and New Jersey, should read *Fresh & Easy* as in-circuit authority supporting their right to collective action and not refrain from seeking relief on behalf of collectives and classes of employees. Moreover, employees in circuits other than the Second, Fifth, and Eighth Circuits may well consider filing such actions, knowing that *Fresh & Easy* provides further support for the NLRB's interpretation of the NLRA. Given the rapidity with which *Epic Systems*, *Ernst & Young*, and *Fresh & Easy* were decided, it appears that the tide is turning concerning class waivers. Many legal commentators have expressed a belief that the Supreme Court will, in light of the circuit split, consider this issue in the upcoming term. The reasoning set forth in this trio of decisions extensively and forcefully argues that the Board's interpretation of the NLRA is correct. Moreover, while the Supreme Court has previously rejected arguments, supported by the statute's legislative history, that the FAA was never meant to extend to employment contracts in the first place, legal commentators have suggested it is possible that the Supreme Court may revisit its finding in light of recent changes to the Court's composition.

That said, employees in the Fifth Circuit, and (to a lesser extent) the Second and Eighth Circuits, must continue to proceed with caution, as presently-governing precedent does not recognize that class actions are part of a substantive right to engage concerted activity.

Conclusion

Fresh & Easy is a third beacon for other courts to follow the congressional mandate embodied in the NLRA to protect workers' rights from employers who force upon them adhesory arbitration agreements that effectively

preclude employees from defending their rights. Ultimately, however, *Fresh & Easy*—even if embraced by the Supreme Court—will only guarantee the right to proceed with class *arbitration*. If employees' right to their day *in court* is to ever be restored, it will require that the Supreme Court revisit its opinion in *Circuit City*.

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[1] 29 U.S.C. § 151 *et seq.*

[2] *Chan v. Fresh & Easy, LLC, et al.*, No. 15-51897-BLS, 2016 Bankr. LEXIS 3690 (Bankr. Del., Oct. 11, 2016).

[3] *Id.* at *10-13.

[4] *Gilmer v. Interstate/Johnson Lane Corp.*, 500 U.S. 20, 24 (1991).

[5] 9 U. S. C. § 2.

[6] *Circuit City Stores v. Adams*, 532 U.S. 105, 127 (2001) (J. Stevens, dissenting).

[7] *Id.*

[8] *Id.* at 110 (emphasis in original).

[9] *Id.* at 115-16.

[10] *Shearson/American Express v. McMahon*, 482 U.S. 220, 227 (1987).

[11] *See Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth*, 473 U.S. 614, 637 n. 19 (1985) (noting that the court would condemn as against public policy an arbitration agreement that would act as a waiver of a party's right to pursue statutory remedies).

[12] *American Express Co. et al. v. Italian Colors Restaurant, et al.*, 133 S. Ct. 2304 (2013)

[13] *Italian Colors*, 133 S. Ct. at 2313.

[14] 29 U.S.C. § 157.

[15] *D.R. Horton, Inc.*, Case 12–CA–025764 (NLRB Jan. 3, 2012),

[16] *Murphy Oil USA, Inc.*, 10-CA-038804 (NLRB Oct. 28, 2014); *Chesapeake Energy Corporation*, Case 14–CA–100530 (NLRB April 30, 2015); and, *Hobby Lobby Stores Inc.*, Case 20-CA-139745 (NLRB May 18, 2016).

[17] *D.R. Horton, Inc. v. NLRB*, 737 F.3d 344, 357-60 (5th Cir. 2013)

[18] *Murphy Oil USA, Inc. v. NLRB*, 808 F.3d 1013, 1018 (5th Cir. 2015).

[19] *Owen v. Bristol Care, Inc.*, 702 F.3d 1050, 1053–54 (8th Cir. 2013); *Sutherland v. Ernst & Young LLP*, 726 F.3d 290, 297–98 fn. 8 (2d Cir. 2013); *see also Raniere v. Citigroup Inc.,* 533 Fed. App'x. 11 (2d Cir. 2013) (class arbitration not required by NLRA in light of *Sutherland* and *Italian Colors*).

[20] *Richards v. Ernst & Young, LLP*, 744 F.3d 1072, 1075 & fn. 3 (9th Cir. 2013).

[21] *See Jasso v. Money Mart Express, Inc.*, 879 F. Supp. 2d 1038 (N.D. Cal. 2012); *Carey v. 24 Hour Fitness USA, Inc.*, 2012 U.S. Dist. LEXIS 143879 (S.D. Tex. Oct. 4, 2012); *Tenet Healthsystem Phila., Inc. v. Rooney*, 2012 U.S. Dist. LEXIS 116280 (E.D. Pa. Aug. 17, 2012); *Reyes v. Liberman Broadcasting, Inc.*, 208 Cal. App. 4th 1537 (C.D. Cal. 2012); *Morvant v. P.F. Chang's China Bistro, Inc.*, 870 F. Supp. 2d 831 (N.D. Cal. 2012); *Delock v. Securitas Sec. Servs. USA, Inc., 883 F. Supp. 2d 784, 789 (E.D. Ark. 2012)*; *LaVoice v. UBS Fin. Servs., Inc.*, 2012 U.S. Dist. LEXIS 5277 (S.D.N.Y. Jan. 13, 2012).

[22] *See Brown v. Citicorp Credit Servs.*, 2013 U.S. Dist. LEXIS 24913 (D. Idaho Feb. 21, 2013); *Herrington v. Waterstone Mortg. Corp.*, 993 F. Supp. 2d 940 (W.D. Wis. 2014).

[23] *Totten v. Kellogg Brown & Root, LLC*, 2016 U.S. Dist. LEXIS 10424 (C.D. Cal. Jan. 22, 2016).

[24] *Lewis v. Epic Systems Corporation*, No. 15-2997, 2016 U.S. App. LEXIS 9638 (7th Cir. May 26, 2016)

[25] *Chevron U.S.A., Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837 (1984).

[26] *Morris v. Ernst & Young, LLP*, No. 13-16599, 2016 U.S. App. LEXIS 15638 (9th Cir. Aug. 22, 2016).