Labor and Employment

Seventh and Ninth Circuits Find That Class Action Waivers in Arbitration Agreements Violate National Labor Relations Act, Creating Circuit Split

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On August 22, 2016, the Ninth Circuit followed the Seventh Circuit's lead to hold that an arbitration agreement with employees that included a waiver of the right to bring claims through a collective, representative, or class action violated employees' right to engage in collective activity under the National Labor Relations Act (NLRA) and was therefore unenforceable. The courts of appeal for the Second Circuit, Fifth Circuit, and Eighth Circuit previously reached opposite holdings, making this issue ripe for Supreme Court review.

In *Morris v. Ernst & Young, LLP,* the employer (E&Y) required employees to sign an arbitration agreement as a condition of continued employment which mandated that employment claims brought against E&Y be pursued exclusively through arbitration in "separate proceedings." *See* No. 13-16599, 2016 WL 4433080 (9th Cir. Aug. 22, 2016). An employee, Stephen Morris, signed the arbitration agreement but nonetheless brought a class and collective action alleging that E&Y misclassified him and a class of similarly situated employees as exempt and failed to pay them overtime wages in violation of the Fair Labor Standards Act (FLSA) and California labor laws. E&Y moved to compel arbitration, and the district court granted the motion.

On appeal, the Ninth Circuit reversed, holding that the arbitration agreement violated Section 7 of the NLRA, which provides that employees "have 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." The Ninth Circuit deferred to the National Labor Relations Board (NLRB) precedent *D.R. Horton, Inc.*, 357 NLRB No. 184 (2012), in which the NLRB held that Sections 7 and 8 of the NLRA prohibit employers from entering into agreements with employees which bar access to class or collective remedies. The *Morris* court found that, under the NLRA, employees "must be able to initiate a work-related legal claim together in some forum, whether in court, in arbitration, or elsewhere." Additionally, the court found that these rights are non-waivable; thus, E&Y's arbitration agreement could not be enforced.

The Ninth Circuit's decision in *Morris* followed the Seventh Circuit's decision in *Lewis v. Epic Systems Corporation*, 823 F.3d 1147 (7th Cir. 2016). In that case, the employer (Epic) sent an arbitration agreement to certain employees via e-mail which mandated that claims be brought through individual arbitration and stated that employees waived "the right to participate in or receive money or any other relief from any class, collective, or representative proceeding." Employees were deemed to have accepted the arbitration agreement if they continued to work for Epic; they were given no right to opt out. The e-mail requested that employees review the arbitration agreement and acknowledge their consent. A technical writer, Jacob Lewis, registered his agreement to the arbitration clause, but later brought suit against Epic alleging that the company misclassified him as exempt in violation of the FLSA and Wisconsin law. Epic moved to dismiss and to compel arbitration. The district court denied Epic's motion.

On appeal, the Seventh Circuit affirmed, deferring to NLRB precedent and rejecting Epic's argument that actions brought pursuant to Rule 23 of the Federal Rules of Civil Procedure are excluded from Section 7's reach because Rule 23 class action procedures did not exist when the NLRA was passed. The court found that Section 7 was to be "construed broadly" to include concerted activities that were not available at the time of the NLRA's enactment.

The *Lewis* court also found that there was no conflict between the NLRA and the Federal Arbitration Act (FAA) because arbitration agreements that violate the NLRA fall within the FAA's savings clause which provides that arbitration agreements are valid "save upon such grounds as exist at law or in equity for the revocation of any contract." Relying on its conclusion that arbitration agreements containing class and collective action waivers are illegal under the NLRA, the court held that such agreements meet the criteria for non-enforcement under the FAA's savings clause.

Finally, the *Lewis* court rejected the argument that the FAA required enforcement of Epic's arbitration agreement because Section 7 rights to pursue matters collectively involve only a procedural and not a substantive right. The court noted that, even if the class action device is procedural, the right to engage in concerted activity is substantive as it "lies at the heart of the restructuring of employer/employee relationship that Congress meant to achieve in the [NLRA]."

In reaching its decision, the court in *Lewis* acknowledged that it was creating a circuit split. The prior courts of appeals to address the issue had rejected the NLRB's *D.R. Horton* position and found that class action waivers in arbitration agreements did not violate the NLRA. *See, e.g., Owen v. Bristol Care, Inc.*, 702 F.3d 1050 (8th Cir. 2013); *Sutherland v. Ernst & Young LLP*, 726 F.3d 290 (2d Cir. 2013); *D.R. Horton, Inc. v. NLRB*, 737 F.3d 344 (5th Cir. 2013). The *Lewis* court found that none of those courts had "engaged substantively with the relevant arguments."

The *Lewis* court also recognized that the Ninth Circuit had held that arbitration agreements mandating individual arbitration may be found enforceable if they include an opt-out provision. *See Johnmohammadi v. Bloomingdales, Inc.*, 755 F.3d 1072 (9th Cir. 2014). The *Lewis* court noted that the Ninth Circuit's *Johnmohammadi* decision conflicted with an earlier decision from the Seventh Circuit but did not resolve the issue, finding that it was undisputed that Epic's arbitration agreement made employees' consent a condition of continued employment.

Several days after the *Lewis* decision and without acknowledging that Seventh Circuit case, the Eighth Circuit Court of Appeals re-affirmed its position that arbitration agreements that include class and collective action waivers do not violate the NLRA. *See Cellular Sales of Missouri, LLC v. NLRB*, 824 F.3d 772 (8th Cir. 2016).

Bound by precedent, district courts sitting in the Seventh Circuit (Illinois, Indiana, and Wisconsin) and the Ninth Circuit (California, Washington, Montana, Idaho, Oregon, Nevada, Arizona, Alaska, Guam and Hawaii) will be required to find arbitration agreements unenforceable if they include class and collective action waivers and were required as a condition of continued employment. Under the *Johnmohammadi* decision, district courts sitting in the Ninth Circuit may find such agreements enforceable if they include an opt-out provision. In *Lewis,* the Seventh Circuit left open the possibility that arbitration agreements subject to Illinois, Indiana, or Wisconsin law could be found enforceable if they contain an opt-out provision and were not made a condition of continued employment. Given the circuit split, it is likely that the Supreme Court will address these issues in the near future. In the meantime, companies with arbitration agreements governed by Seventh Circuit or Ninth Circuit precedent should consult with counsel regarding those agreements.

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