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War Of The Employment Class Waivers: 6th Circ. Weighs In

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For most wage and hour practitioners, the enforceability of class action waivers in arbitration agreements is arguably one of the most significant wage and hour issues of this decade. The existence of an arbitration agreement with a class action waiver could spell the end of the class action before it even began. For years the enforceability of class action waivers has been litigated in numerous states and jurisdictions, with the latest national dispute centering over what is commonly known as the Horton rule.

In January 2012, the National Labor Relations Board in In re D.R. Horton Inc. 357 NLRB No. 184 (Jan. 3, 2012) (Horton I) held that requiring an employee to sign an arbitration agreement and waive the right to bring a class action constitutes an unfair labor practice under the National Labor Relations Act. Horton I triggered five years of contentious, multijurisdictional litigation concerning the enforceability of class action waivers, which the U.S. Supreme Court is slated to (hopefully) resolve during the October 2017 term. In June, the Sixth Circuit in NLRB v. Alternative Entertainment Inc., 2017 U.S. App. LEXIS 9272 (6th Cir. May 26, 2017) joined the Seventh and Ninth Circuits in upholding Horton I, thereby evening the circuit split, countering the Second, Fifth and Eighth Circuits which rejected Horton I and enforced class action waivers.

This article examines the "war of the waivers" in the circuit courts and predicts how the U.S. Supreme Court will rule regarding the so-called Horton rule. This article further evaluates the future of group-based wage and hour claims with a case study on the California experiment: the Private Attorneys General Act of 2004.

Which Should Come First, the FAA or the NLRA?

Resolving the argument over the enforceability of class action waivers is akin to asking the proverbial question: Which came first, the chicken or the egg? The circuit courts which rejected Horton I argued that under the Federal Arbitration Act's (FAA) liberal policy favoring arbitrations, arbitration agreements with class action waivers should be enforced. Conversely, the circuit courts which embraced Horton I asserted that class action waivers interfere with employees' right to engage in concerted activity and are, therefore, unenforceable under the NLRA. This section examines the rationale employed by circuit courts on both sides of the divide.

Under FAA, Arbitration Agreements Must Be Enforced According to Terms

Between January 2012 and May 2016, the tide of enforcing class action waivers appeared ineluctable as the Second, Fifth and Eighth Circuits all decided that arbitration provisions mandating individual arbitration of employment-related claims are enforceable under the FAA notwithstanding the NLRA. See Sutherland v. Ernst & Young LLP, 726 F.3d 290 (2d Cir. 2013); Murphy Oil USA Inc. v. NLRB, 808 F.3d 1013 (5th Cir. 2015), cert. granted 137 S. Ct. 809 (2017); D.R. Horton Inc. v. NLRB, 737 F.3d 344 (5th Cir. 2013) (Horton II); Owen v. Bristol Care Inc., 702 F.3d 1050 (8th Cir. 2013).

The Fifth Circuit in Horton II was the first federal appellate court to examine Horton I, and its decision served as the foundation for other courts upholding the enforceability of class action waivers. In Horton II, the Fifth Circuit "start[ed] with the requirement under the FAA that arbitration agreements must be enforced according to their terms." 737 F.3d at 358.

The Fifth Circuit relied on the U.S. Supreme Court's decision in AT&T Mobility LLC v. Concepcion (2011) 563 U.S. 333 to reject the board's argument that the Horton rule fell within the FAA savings clause. Specifically, the U.S. Supreme Court in Concepcion held that the FAA's savings clause was inapplicable to the California Discover Bank rule that prohibited class action waivers in consumer arbitration agreements, because "[r]equiring the availability of classwide arbitration interferes with fundamental attributes of arbitration and thus creates a scheme inconsistent with the FAA." Horton II, 737 F.3d at 359-60. The Fifth Circuit held that the Horton I, like Concepcion, prohibits class action waivers and therefore does not fall within the savings clause.

The Fifth Circuit then examined the issue of whether the NLRA contains a congressional command to override the FAA. The court found that neither the NLRA's statutory text nor its legislative history showed any intent to prohibit class action waivers in arbitration agreements. Id. at 360-61. The court also found that there is no inherent conflict between the FAA and the NLRA's purpose because "the NLRA was enacted and reenacted prior to the advent in 1966 of modern class action practice." Id. at 363.

NLRA Prohibits Any Contractual Provision Interfering with Right to Concerted Activity

After four years of uncompromised consistency, momentum shifted. On May 26, 2016, the Seventh Circuit in Lewis v. Epic Systems Corporation, 823 F.3d 1147 (7th Cir. 2016), cert. granted 137 S. Ct. 809 (2017), became the first federal appellate court to hold that class action waivers violate the NLRA and that the Horton rule fell within the FAA's savings clause. Less than three months later, the Ninth Circuit in Morris v. Ernst & Young, 834 F.3d 975 (9th Cir. 2016)), cert. granted 137 S. Ct. 809 (2017), reached the same conclusions. Finally, on May 26, 2017, the Sixth Circuit created an even three-to-three circuit split with its decision in NLRB v. Alternative Entertainment Inc.

In contrast to Horton II, the Sixth Circuit in Alternative Entertainment began by examining the NLRA and observed that the "NLRA prohibits mandatory arbitration provisions barring collective or class action suits because they interfere with employees' right to engage in concerted activity, not because they mandate arbitration." 2017 U.S. App. LEXIS 9272 at *18. Because the NLRA prohibits class action waivers on grounds that would apply to any contractual provision, the FAA's savings clause is triggered. Id. at *16-17.

The Sixth Circuit also distinguished Concepcion and observed that Concepcion dealt with a rule that is

hostile to arbitration, whereas "the NLRA is, if anything, in favor of arbitration." Id. at *21. The court further noted that Concepcion dealt with consumer contracts while its case is about labor law and rights granted by the NLRA, and that the Discover Bank rule is a judicially crafted state law, whereas the NLRA is a congressionally enacted federal statute. Id. at *26.

How Will the Supreme Court Decide the Chicken or the Egg Question?

The Horton I dispute is obviously spirited and supported by persuasive arguments on both sides of the divide; it is, nonetheless, possible to predict how the U.S. Supreme Court will rule by examining how justices have ruled in recent decisions on the enforceability of class action waivers.

In 2011, the court in Concepcion struck down the Discover Bank rule that prohibited class action waivers in consumer arbitration agreements. The justices were split four to four along the ideological divide (Chief Justice John Roberts, Justices Clarence Thomas, Samuel Alito, and the late Antonin Scalia on one end and Justices Stephen Breyer, Ruth Bader Ginsburg, Sonia Sotomayor, and Elena Kagan on the other) and Justice Anthony Kennedy cast the deciding swing vote, siding with the conservative bloc.

In 2013, the court in American Express Co. v. Italian Colors Restaurant, 133 S. Ct. 2304 (2013) rejected the argument that class action waivers contravened the policies of the antitrust laws and held that class action waivers are enforceable under the FAA. The justices again voted along the ideological divide (Justice Sotomayor was recused) and Justice Kennedy again issued the swing vote.

Since Concepcion and Italian Colors, the only change to the composition of the Supreme Court was Justice Neil Gorsuch taking the seat of Justice Scalia, and it is widely expected that Justice Gorsuch will take up the conservative mantle of his predecessor. For instance, Justice Gorsuch has consistently endorsed the view that the board should have a more limited scope of authority and has emphasized the FAA's requirement that arbitration agreements be treated just like other contracts. We therefore anticipate that the court will strike down the Horton rule via a five-to-four vote as it did in Concepcion and would have done in Italian Colors but for Justice Sotomayor's recusal.

Looking to the Great California Experiment — PAGA

While the war of the waivers rages in federal courts, California has been experiencing its own conflict over class action waivers. On June 23, 2014, the California Supreme Court issued its landmark decision on class action waivers — Iskanian v. CLS Transportation Los Angeles LLC, 59 Cal. 4th 348 (2014), cert. denied 135 S. Ct. 1155 (2015). Iskanian involved three notable rulings. First, Iskanian held that Concepcion overruled the Gentry rule (a counterpart to the Discover Bank rule), which had the de facto effect of invalidating class action waivers in employment arbitration agreements. Second, Iskanian sided with Horton II to hold that class action waivers are enforceable notwithstanding the NLRA. Third, and importantly here, Iskanian held that class action waivers are inapplicable to representative actions under PAGA.

The PAGA permits an "aggrieved employee," acting as a proxy or agent of the state's labor law enforcement agencies, to bring a civil action on behalf of other current and former employees to recover civil penalties for violations of the California Labor Code. Of the civil penalties recovered, 75 percent goes to the California Labor and Workforce Development Agency, leaving the remaining 25 percent for the aggrieved employees. The civil penalties recovered on behalf of the state under PAGA are distinct from statutory damages that the employee may recover (e.g., unpaid overtime wages versus civil penalties for violations of the overtime statute).

Iskanian first found that, under California law, an employee's right to bring a PAGA representative action cannot be waived through a pre-employment arbitration agreement. Id. at 382-83. It then held that a PAGA representative action lies outside of the FAA's coverage because it is not a private dispute between an employer and an employee, but a form of qui tam action between the employer and the state through its agent, the aggrieved employee. Id. at 386-87. The court observed that, in a PAGA action, the aggrieved employee is recovering civil penalties — not statutory damages or penalties — and that the government is the real party in interest. Id. at 387.

The waivability of PAGA claims remains heavily litigated. Since Iskanian, the U.S. Supreme Court twice denied a writ of certiorari arising from state court decisions, first of the Iskanian decision on Jan. 20, 2015, and then of its sister decision, Brown v. Superior Court, 176 Cal. Ratr. 3d 266, on June 1, 2016. Then on Sept. 28, 2015, the Ninth Circuit issued a decision in Sakkab v. Luxottica Retail North America, Inc., 803 F.3d 425 (9th Cir. 2015), holding that the Iskanian rule prohibiting waivers of PAGA claims do not conflict with the FAA.

If the U.S. Supreme Court were to strike down the Horton rule, the country can expect to see a decrease in class and collective actions from widespread use of arbitration agreements with class action waivers. Some states would likely be incentivized to enact quasi-class mechanisms similar to the PAGA to ensure that employees have access to group-wide remedies for wage and hour violations. If that happens, the Iskanian rule could very well take the national stage in another war of the waivers.

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