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CLIENT ALERT

Seventh Circuit Invalidates Class and Collective Action Waivers in Arbitration Agreements

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On May 26, 2016, the U.S. Court of Appeals for the Seventh Circuit became the first federal circuit court to hold, consistent with the National Labor Relations Board's view in *D.R. Horton, Inc*., that an employer could not enforce an agreement requiring an employee individually to arbitrate his wage and hour claim, because doing so would violate his rights under the National Labor Relations Act (NLRA). To date, all other federal circuit courts that have considered similar disputes have reached a contrary result, setting up a circuit split that may be cited as a basis for seeking Supreme Court review.

Background – The NLRB's *D.R. Horton* Precedent, Invalidating Class or Collective Action Waivers in Arbitration Agreements, and the Federal Circuit Courts' Rejection of *D.R. Horton* and Approval of Class Action Waivers

Perhaps more than at any point in its 80-year history, the National Labor Relations Board (NLRB or Board) has come under fire in recent years for various actions that have been perceived as hostile to employer and business interests. And on few subjects has the criticism been louder than with respect to the current Board majority's persistent adherence to the view that arbitration agreements requiring employees to waive employment-related class and collective actions are unlawful – therefore, unenforceable – under the NLRA. The Board has held to this view despite its rejection by five federal circuit courts.

Employers have long favored arbitration agreements as practical tools to mitigate exposure to costly and risky employment litigation, while providing employees a speedy and responsive forum to address workplace disputes. As a substitute for litigation, arbitration is often cheaper and faster, affords greater confidentiality, and is generally considered a more predictable alternative to trial by jury. These perceived benefits were magnified when the Supreme Court ruled in 2011, in *AT&T Mobility v. Concepcion*, that the Federal Arbitration Act (FAA) preempts state laws that prohibit contracts from requiring arbitration of disputes while disallowing class-wide arbitration.

With its 2012 decision in *D.R. Horton, Inc*., the NLRB has tried to stymie employer efforts to require individual arbitration of employment claims. The Board instructed in *D.R. Horton* that "an individual who files a class or collective action regarding wages, hours or working conditions, whether in court or before an arbitrator . . . is engaged in conduct protected by Section 7 [of the NLRA]." Thus, the Board held, arbitration agreements requiring claims to be arbitrated only on an individual basis violate the Act.

The Board has consistently applied *D.R. Horton* to invalidate arbitration agreements purporting to require waivers of employee rights to pursue employment-related class and collective actions, regardless of whether the agreements allow employees to "opt out" of the waivers. However, until last week, the Board's decisions in *D.R. Horton* and its progeny have been curbed by the federal courts, which have consistently rejected the Board's view, and instead upheld class and collective action waivers. The Fifth Circuit, in particular, refused to enforce the Board's decision in *D.R. Horton* itself, holding, contrary to the Board, that the NLRA contains no congressional mandate establishing employee rights to engage in collective actions. Therefore, the Fifth Circuit concluded, the FAA and its clear mandate in favor of arbitration have priority.

Late last year in *Murphy Oil USA, Inc*., the Fifth Circuit issued a similar decision, again declining to enforce a Board order that would have struck down a mandatory arbitration agreement. The Second, Eighth, Ninth, and Eleventh Circuits have followed the Fifth Circuit in rejecting the Board's view on this issue.

The Seventh Circuit's Decision in *Lewis v. Epic Systems Corp*., Accepting the NLRB's Position and Creating a Circuit Split on the Issue

Last week, in *Lewis v. Epic Systems Corp*., the U.S. Court of Appeals for the Seventh Circuit became the first circuit court to agree with the NLRB and hold that an employer could not enforce an agreement that required an employee individually to arbitrate his or her wage and hour claim, because doing so would violate his rights under the NLRA.

The matter arose when Epic Systems, a health care software company, implemented an arbitration policy mandating that wage and hour claims be brought only through individual arbitration, and that employees waived their right to participate or receive money from "any class, collective, or representative proceeding" concerning such matters. The company did not request or require formal acceptance of this policy by the employees, but stated that employees were "deemed to have accepted the agreement" by continuing to work at Epic. The company did not allow employees the option of opting out of the arbitration provision.

Later, employee Jacob Lewis sued Epic in federal court, alleging he and his fellow software writers were improperly denied overtime pay as a result of being incorrectly classified as exempt under the Fair Labor Standards Act (FLSA) and Wisconsin law. Epic moved to dismiss the action and to compel individual arbitration. The district court denied Epic's motion, and the Seventh Circuit affirmed.

Contrary to every other circuit to consider the issue, the Seventh Circuit agreed with the NLRB that Epic's mandatory arbitration program "runs straight into the teeth of Section 7 [of the NLRA]." According to the Seventh Circuit, the NLRA's legislative history and purpose evince a clear intent to include representative, class, and collective actions as within the scope of "concerted activity" protected by the Act. Moreover, even if Section 7 were considered to be ambiguous in this regard – and the Seventh Circuit emphasized it was not – the Board's interpretation of the statute as protecting employee rights to engage in representative, class, and collective actions was entitled to *Chevron*-level deference.

Then, having determined that representative, collective, or class legal proceedings constitute Section 7 activity, the Seventh Circuit had little trouble declaring that Epic's agreement, which purported to "stipulate away employees' Section 7 rights," was unenforceable.

The Seventh Circuit acknowledged in *Lewis* that its decision goes against the weight of authority, specifically referencing a Ninth Circuit decision holding that an arbitration agreement mandating individual arbitration may be

enforceable where the employee has the right to opt out of the agreement without penalty. The Epic agreement included no such opt out provision, however, so the Seventh Circuit determined it had "no need" to resolve any possible differences with the Ninth Circuit's approach.

The Seventh Circuit likewise acknowledged the Fifth Circuit's contrary decision in *D.R. Horton*. Unlike the Fifth Circuit, however, the Seventh Circuit found "no conflict between the NLRA and the FAA, let alone an irreconcilable one." Rather, the Seventh Circuit reasoned that the FAA's "savings clause," which confirms that arbitration agreements are enforceable "save upon such grounds as exit at law or in equity for the revocation of any contract," avoided any such conflict.

Thus, far from conflicting with the FAA, the Seventh Circuit observed that the NLRA is pro-arbitration. In fact, the Seventh Circuit surmised that "it is entirely possible that the NLRA would not bar Epic's [mandatory individual arbitration] provision if it were included in a collective bargaining agreement." Nor would Epic's agreement have run afoul of the NLRA if it had "permitted collective arbitration." But, neither circumstance was present—Epic's agreement was *not* collectively bargained and it *did* purport to restrict class or collective claims. Therefore, it violated the NLRA and could not be enforced.

Implications of *Lewis*, in the Seventh Circuit and Beyond

Notably, the Seventh Circuit panel that decided *Lewis* circulated its opinion to all active judges on the Seventh Circuit, but "[n]o judge wished to hear the case en banc." As a result, the panel decision in *Lewis* is final, and Epic's only potential recourse is a petition to the Supreme Court, citing the split in circuit authority as a basis for review on *certiorari*. And with a continued vacancy on the high Court following Justice Scalia's passing, this scenario sets up the same political chess match that pundits have envisioned with respect to other contested legal issues.

In the meantime, employers in the Seventh Circuit (Illinois, Indiana, and Wisconsin), should consider that mandatory class action waivers in certain arbitration agreements may not be enforced by federal courts in their circuit. One significant limitation to the Seventh Circuit's holding in *Lewis* (as well as to the Board's in *D.R. Horton*), is that the decisions are grounded in protecting against involuntary waivers of Section 7 rights under the NLRA. To that end, the decisions are limited in their application to "employees" who have such rights under the NLRA. Individuals who do not qualify as "employees" – with "supervisors" and "managers" being the most notable exclusions – do not have Section 7 rights. As a result, *Lewis* and *D.R. Horton* are not applicable to arbitration agreements with such "non-employees."

Additionally, it remains to be seen whether the inclusion of an "opt out" clause, or the provision of separate consideration for the agreement, may yield a different result, even with respect to arbitration agreements applicable to employees. And, given the Seventh Circuit's level of deference to the Board in *Lewis*, it similarly remains to be seen whether the Seventh Circuit might change its view if potential future changes in the composition of the Board lead the agency to overturn *D.R. Horton*.

For now at least, employers in the Seventh Circuit should review their mandatory arbitration agreements (to the extent they have them), paying particular attention to whether the agreements purport to restrict class or collective actions and if so, whether employees can "opt out" without losing employment. Employers in other circuits should continue to expect that agreements requiring individual arbitration of employment-related claims will not pass muster before the NLRB, but may nevertheless be enforceable under the current law of their circuit.

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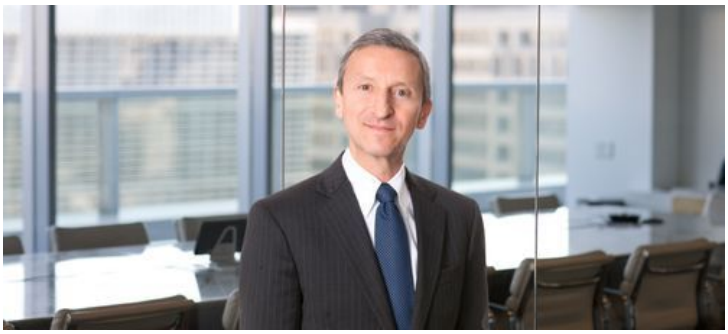

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