

Are Employment Class Actions Headed Toward an Epic Fail?

By Alejandro Caffarelli

In the 2016 case of *Lewis v. Epic Systems Corp.*,¹ the Seventh Circuit Court of Appeals held that class action waivers in employee arbitration agreements violate the National Labor Relations Act (NLRA)² in that they hinder an employee's right to engage in protected, concerted activity. The Court reasoned that such agreements are not subject to mandatory arbitration under the Federal Arbitration Act (FAA)³ because they are subject to the FAA savings clause, which, among other things, voids "illegal" arbitration agreements. In the 2017-18 term, the United States Supreme Court will hear Epic Systems' appeal, which was consolidated with *Ernst & Young v. Morris*⁴ and *National Labor Relations Board v. Murphy Oil USA, Inc.*,⁵ two other cases that also analyzed the interplay between the FAA and the NLRA. Among lawyers who represent employees, the outcome is highly anticipated. Not just because it will be the first FAA case decided by Justice Gorsuch, but also because it could be a turning point in employment law class action jurisprudence, significantly shifting the balance of power between labor and management.

The Evolution of the FAA – a Tool for Business Becomes a Weapon

In 1925, the FAA was enacted in response to judicial hostility to the private arbitration of commercial disputes. And in the following decades, application of the FAA was principally limited to inter-corporate contracts and other transactions. In the mid-1980s, however, employers began inserting mandatory arbitration clauses into employment agreements. At first blush, the FAA contains a clause that appears to exclude employment cases. Section 1 states that "nothing herein contained shall apply to contracts of employment of seamen, railroad employees, or any other class of workers engaged in foreign or interstate commerce."⁶ Given the Supreme Court's historically broad application of the term "interstate commerce" as it pertains to the Commerce Clause in the U.S. Constitution, it seems logical that the FAA would not apply to any employment cases. Every worker engages in "commerce" (as defined by Congress). But in 1991, the Supreme Court in *Gilmer v. Interstate/Johnson Lane Corp.* indeed applied the FAA to an employment case, ruling that an employee was required to arbitrate his age discrimination claim.⁷

Although there was some initial ambiguity due to the fact that the contract in *Gilmer* involved an employment agency, the Supreme Court erased all doubt in 2001 by holding in *Circuit City Stores, Inc. v. Adams* that the FAA applied to all contracts of employment, except those involving workers who (like seamen and railroad workers) were engaged in transportation across state lines.⁸ The Supreme Court's interpretation of Section 1 in *Circuit City* was quite curious, since Section 2 clearly states that the entire scope of the FAA is limited to contracts "evidencing a transaction involving commerce." Apparently, "commerce" as defined in Section 1 is not the same "commerce" as defined in Section 2. This is not surprising. As most advocates for employees have become painfully aware over the past few decades, it seems that management gets to toss the arbitration coin and the rules according to the Supreme Court always appear to be "heads I win, tails you lose."

The service industry and employers across the country quickly took notice of the Supreme Court's leanings, so from the 1990s on, mandatory arbitration clauses became omnipresent—embedded in the fine print in a broad range of industries: from cable television and credit cards to education, telecommunications, and internet service providers. Most online transactions that require a user to "click to accept" typically contain an arbitration clause. In the employment context, arbitration clauses are usually tucked into the packet of employment materials most new hires sign when starting a new job.

Because arbitration clauses are usually incorporated into larger agreements or described as a positive thing (who on earth could oppose fast, easy, and fair dispute resolution!?) many people who are subject to arbitration clauses do not even realize that they exist, much less understand their true impact. These “agreements” are referred to as mandatory or forced arbitration because a consumer who does not agree will be denied the product or service, and applicants for employment will simply not be hired. An employee thus has no real choice or ability to reject or negotiate the applicability or terms of arbitration. And as a practical matter, most new hires are simply relieved to get a job and would rightfully conclude that challenging a new employer’s policies on or before their first day is not a good career move.

Flush from their successes banishing individual consumers and employees from the courthouse and away from meddlesome juries, business set its sights on a much bigger fish, the *de facto* elimination of class actions. Class action waivers started appearing in consumer contracts and, more recently, in employment contracts.

In 2011, the Supreme Court finally addressed class action waivers in *AT&T Mobility LLC v. Concepcion*, a consumer case.⁹ In *Concepcion*, an AT&T customer brought a class action alleging that the company had engaged in fraudulent practices by charging \$15-per-phone sales taxes to customers promised “free” cell phones as an incentive to sign a service contract. It was hardly the type of damages that would motivate a customer to file an individual claim, but in the aggregate likely resulted in thousands, if not millions, of dollars for the benefit of AT&T.

AT&T’s customer agreement included an arbitration clause containing a class action waiver. The plaintiff argued that the class-action waiver was unconscionable given the low value of individual claims. The Ninth Circuit agreed and, after applying a California statutory rule to determine whether a class action waiver is unconscionable,¹⁰ denied AT&T’s motion to compel arbitration on an individual basis. The Supreme Court reversed, holding that the California rule was preempted because it specifically targeted and thus “interfered with” arbitration.

Justice Scalia, writing for the majority, disparaged the use of class arbitration and expressed his distaste for class actions generally, stating that class arbitrations impose unacceptable risks for defendants, who could face a significant judgment when numerous small claims were aggregated and yet would lose their right to judicial review. Scalia concluded that “[a]rbitration is poorly suited to the higher stakes of class litigation.”

Some lower courts initially limited the *Concepcion* holding to consumer cases, but over time, most courts extended it to encompass employment cases. Moreover, although the *Concepcion* case was about preemption of a specific state law, many courts have read it more broadly to disallow all challenges to class-action waivers on the basis of unconscionability.

In June 2013, the Supreme Court took another bite at the issue in *American Express Co. v. Italian Colors Restaurant*.¹¹ The case involved a class action brought by a group of merchants alleging that their American Express contracts violated the Sherman Antitrust Act. American Express moved to compel individual arbitration based upon the class action waiver, and the district court granted the motion. The merchants contended that arbitration of the antitrust claim on an individual basis would be extremely complicated and cost hundreds of thousands of dollars for an average recovery of only about \$5,000. In a nutshell, the merchants argued that without the ability to bring a class or collective action, they would *de facto* lose their ability to “effectively vindicate” their substantive rights.

The Supreme Court upheld the class-action waiver and Justice Scalia, again writing for the majority, seemingly shut the door on the effective-vindication doctrine. He called the doctrine “*dicta*,” and that, at most, it might apply to “filing and administrative fees attached to arbitration that are so high

as to make access to the forum impracticable.” Scalia added, “the fact that it is not worth the expense involved in proving a statutory remedy does not constitute the elimination of the right to pursue that remedy.” Justice Kagan delivered a scathing dissent, arguing that “[t]he monopolist gets to use its monopoly power to insist on a contract effectively depriving its victims of all legal recourse” and that without the effective-vindication doctrine, companies have every incentive to draft their agreements to extract backdoor waivers of statutory rights.”¹²

Although *Italian Colors* involved a commercial dispute between merchants and a credit card processing company, the majority’s decision has significant consequences for employment cases, which often involve smaller amounts of individual damages that may be uniformly incurred by a large number of employees. By narrowing the effective-vindication doctrine, the Court continued to undermine challenges to class-action waivers in arbitration clauses.

The Seventh Circuit Draws a Line in the Sand

With the *Concepcion* and *Italian Colors* decisions percolating through the lower courts, and few practitioners believing that employment class actions waivers would be treated any differently than consumer class action waivers, the National Labor Relations Board issued *In re D.R. Horton, Inc.* (“*Horton I*”).¹³ In *Horton I* and subsequent decisions,¹⁴ the Board took the position that class action waivers in employment laws violated the National Labor Relations Act (“NLRA”) and were thus unenforceable. The premise underlying the Board’s decision was that the FAA conflicted with the NLRA’s guarantee that employees had an absolute right to engage in concerted, protected activity—one that could not be waived as a matter of law. Unfortunately, the Fifth Circuit Court of Appeals did not agree and in *D.R. Horton Inc. v. NLRB* (“*Horton II*”) denied enforcement of the Board’s Order.¹⁵ The Fifth Circuit was later joined by the Second and Eighth Circuits, which also held that class waivers in employment law are enforceable.

District courts across the country mostly fell in line with *Horton II* until mid-2016, when the Seventh Circuit Court of Appeals issued the *Epic* decision. *Epic* was authored by Chief Judge Diane Wood, a highly-respected jurist who was interviewed by President Obama for a position on the Supreme Court.¹⁶ In *Epic*, the Seventh Circuit criticized the Fifth Circuit in *Horton II* for “mak[ing] no effort to harmonize the FAA and NLRA.” Noting that illegality is a ground preventing enforcement of an arbitration provision under the FAA’s saving clause, *Epic* held that “[b]ecause ... [a class action waiver] ... is unlawful under Section 7 of the NLRA, it is illegal, and meets the criteria of the FAA’s saving clause for non-enforcement.” *Epic* thus insisted that the FAA and NLRA “be harmonized ... [as] according to all the traditional rules of statutory construction, they must be ... through the FAA’s saving clause.”

The Seventh Circuit’s *Epic* analysis focused on what it described as the substantive rights underlying Section 7 of the NLRA, which “provides that ‘[e]mployees shall 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.’”¹⁷ Adding that “both courts and the [NLRB] have held that filing a collective or class action suit constitutes ‘concerted activit[y]’ under Section 7,” the Seventh Circuit confirmed that “[t]he NLRA’s history and purpose confirm that the phrase ‘concerted activities’ in Section 7 should be read broadly to include resort to representative, joint, collective or class legal remedies.”

Epic also held that Section 7 rights are substantive, and “not ... merely [] procedural” Although the Fifth Circuit had reached the opposite conclusion with regard to class action procedures under Federal Rule of Civil Procedure 23, the Seventh Circuit distinguished the authority cited in *Horton*

II—stating that “just as the NLRA is not Rule 23,” it is not comparable to those statutory schemes that do not themselves guarantee a right to take concerted action.

Referring to the text of the NLRA itself, the Seventh Circuit concluded that the right to take collective action could not be merely procedural because “Section 7 is the NLRA’s only substantive provision,” and “concerted activity aimed at improving wages, hours or working conditions through litigation or arbitration lies at the core of the rights protected by Section 7.” It stressed that the rights guaranteed by Section 7 covered not only collective bargaining, “but also “employees’ ‘right to ... engage in other concerted activities for ... other mutual aid or protection.’” On August 22, 2016, the Seventh Circuit was joined by the Ninth Circuit, which held that Section 7 of the NLRA establishes a substantive right to concerted activity and, thus, renders class action waivers in employment contracts unenforceable.¹⁸

EPIC at the Supreme Court, and the Future of Class Action Waivers

Both *Concepcion* and *Italian Colors* were 5-4 decisions in which now-deceased Justice Scalia cast a deciding vote. If the Supreme Court determines that the rights guaranteed by the NLRA are procedural, it is likely that the votes of the remaining eight justices in *Epic* will mirror their votes in those two cases—giving newly-appointed Justice Gorsuch the swing vote. Justice Scalia was the driving force behind *Concepcion* and *Italian Colors*, and his absence will deprive class action foes of a forceful and vociferous advocate. Needless to say, it will be interesting to see how Scalia’s absence impacts the Court’s analysis of the FAA.

In light of the new power dynamic on the Supreme Court, counsel for Lewis should keep a tight focus on the unique interplay between the FAA and the NLRA, and be prepared to distinguish *Concepcion* and other recent Supreme Court precedent without criticizing it. That will mean pointing out that the offensive law in *Concepcion* was a state rule, and therefore the underlying issue was at the core one of federal preemption. In contrast, the NLRA is a federal statute, which contrary to state laws, must be harmonized with other federal laws such as the FAA. As a federal statute, the NLRA cannot be “preempted” by another federal statute. It will also be necessary to address the Supreme Court’s driving concern in *Concepcion*—that the California rule at issue was hostile to arbitration by design, whereas the NLRA focuses on concerted activity, and that it otherwise embraces and encourages arbitration in the context of labor relations.

And finally, preserving employment class actions means moving away from *Horton I*, minimizing any reliance on the *Chevron* doctrine of deferring to administrative interpretations, and basing the analysis on the Supreme Court’s own statutory interpretation of the NLRA to define class and collective actions as types of statutorily protected activity. It has been well documented that Gorsuch appears to be a skeptic of *Chevron* deference.¹⁹ As recently as 2016, Judge Gorsuch specifically dissented to argue against deferring to the NLRB in *NLRB v. Community Health Services, Inc.*²⁰ In her opinion, Judge Wood in *Epic* focused instead on traditional rules of statutory interpretation, Supreme Court precedent interpreting the key provisions of the NLRA, and the statutory language itself—not the NLRB’s position or *Horton I*. In light of the current composition of the Supreme Court, counsel for Lewis would be well advised to follow Judge Wood’s lead.

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¹ *Lewis v. Epic Systems Corp.*, 823 F.3d 1147 (7th Cir. 2016).

² 29 U.S.C. § 151 *et seq.*

³ 9 U.S.C. § 1 *et seq.*

⁴ *Sutherland v. Ernst & Young LLP*, 726 F.3d 290 (2d Cir. 2013).

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

⁶ 9 U.S.C. § 1.

⁷ *Gilmer v. Interstate/Johnson Lane Corp.*, 500 U.S. 20 (1991).

⁸ *Circuit City Stores, Inc. v. Adams*, 532 U.S. 105 (2001).

⁹ *AT&T Mobility v. Concepcion*, 563 U.S. 333 (2011).

¹⁰ California's three prong test looks to whether (1) the agreement is a contract of adhesion, (2) the dispute is likely to involve small amounts of damages, and (3) the party with superior bargaining power took advantage of a large numbers of consumers. *Laster v. AT & T Mobility LLC*, 584 F.3d 849, 854 (9th Cir. 2009).

¹¹ *American Express Co. v. Italian Colors Restaurant*, 133 S. Ct. 2304 (2013).

¹² *Id.* at 2315.

¹³ *In re D.R. Horton Inc.*, 357 NLRB No. 184, 2012 WL 36274 at *17 (2012) (*enf. denied in part*, 737 F.3d 344 (5th Cir. 2013)).

¹⁴ See e.g., *Murphy Oil USA Inc.*, 361 NLRB No. 72, 2014 WL 5465454 (2014), (*enf. den.*, 808 F.3d 1013 (5th Cir. 2015)); *Ralphs Grocery Company and Terri Brown*, 363 NLRB No. 128, 2016 WL 737041 (2016).

¹⁵ *D.R. Horton Inc. v. NLRB*, 737 F.3d 344, 358-362 (5th Cir. 2013).

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http://www.abajournal.com/news/article/obama_interviews_7th_circuit_judge_diane_wood_for_potential_supreme_court_n/.

¹⁷ *Epic Systems*, 823 F.3d at 1151 (*quoting* 29 U.S.C. § 157).

¹⁸ *Morris v. Ernst & Young, LLP*, 834 F.3d 975 (9th Cir. 2016).

¹⁹ <http://www.scotusblog.com/2017/03/roots-limits-gorsuchs-views-chevron-deference/>.

²⁰ 812 F.3d 768 (10th Cir. 2016) (Gorsuch, J., dissenting).