The Seventh Circuit Holds that Class Action Waivers in Arbitration Agreements Are Unenforceable

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In recent years, there has been a vigorous debate over the legality of employee arbitration agreements containing a waiver of class or collective actions. In particular, there has been a growing conflict between the National Labor Relations Board ("NLRB" or "the Board"), which has determined that, under the National Labor Relations Act ("NLRA"), such agreements illegally prevent employees from exercising their right guaranteed by Section 7 to act "in concert for their mutual aid and protection," and the federal courts, which have refused to enforce the Board’s orders to that effect and have upheld such agreements by endorsing a liberal policy favoring the enforcement of arbitration agreements under the Federal Arbitration Act ("FAA").

In January 2012, the Board ruled that an employer violated Section 7 of the NLRA by requiring employees to agree to mandatory arbitration of employment disputes and to forego class and collective action as a condition of their employment. In re D.R. Horton, 357 NLRB 2277 (2012). The Fifth Circuit Court of Appeals thereafter refused to enforce the Board’s order, concluding that the decision violated the FAA, and nearly all federal courts that have since addressed the issue have decided not to follow the Board’s view—until now.

On May 26, 2016, in Lewis v. Epic Systems Corp., No. 15-2997, 2016 WL 3029464 (7th Cir. May 26, 2016), the Seventh Circuit broke ranks with the other federal circuits and agreed with the Board, ruling that an employer’s arbitration agreement requiring employees to bring wage-and-hour claims against the company in individual arbitrations and prohibiting class and collective actions, violates the NLRA. Days later, on June 2, a panel of a different court, the Eighth Circuit in St. Louis, sided with the majority (although without acknowledging the Seventh Circuit’s decision to the contrary), rejecting in relevant part the NLRB’s view in Cellular Sales of Missouri, LLC v. NLRB, Nos. 15-1620 & 15-1860.

The Seventh Circuit’s decision creates a conflict among the circuit courts that the Supreme Court surely will have to resolve.

I. Legal Background

A. Rights Under The NLRA

Section 7 of the NLRA 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.” 29 U.S.C. § 157. Section 8(a)(1) makes it “an unfair labor practice for an employer to interfere with, restrain, or coerce employees in the exercise of the rights guaranteed in section [7].” Id., § 158. Both union and non-union employees are protected by the NLRA when engaging in concerted activities designed to improve their terms and conditions of employment or otherwise improve their lot as employees. Eastex, Inc. v. NLRB, 437 U.S. 556, 565 (1978).

B. Rights Under The FAA

A decade prior to the 1935 passage of the NLRA, Congress enacted the FAA to counter widespread judicial hostility to arbitration agreements. The FAA provides that “[a] written provision in . . . a contract . . . to settle by arbitration a controversy thereafter arising out of such contract . . . shall be valid, irrevocable, and enforceable.” 9 U.S.C. § 2. The Act’s “saving clause,” however, states that arbitration agreements are enforceable “save upon such grounds as exist at law or in equity for the revocation of any contract.” Id. The Supreme Court declared that “[b]y agreeing to arbitrate a statutory claim, a party does not forgo the substantive rights afforded by the statute; it only submits to their resolution in an arbitral, rather than a judicial, forum.” Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc., 473 U.S. 614, 628 (1985).

C. The D.R. Horton Decision

The D.R. Horton case arose out of an effort by a superintendent of a home construction company to initiate arbitration on behalf of himself and a nationwide class of similarly situated superintendents alleging that their employer misclassified them as exempt under the FLSA. The employer refused to arbitrate on the grounds that the superintendent had signed an arbitration agreement that required all claims be arbitrated individually and prohibited the arbitration of collective claims. The superintendent filed an unfair labor practice charge with the NLRB and the Board determined the agreement violated Section 7.

The Board’s decision was based on two key findings. First, it concluded that employees coming together to bring a class proceeding to address workplace issues, like wages, constitutes a form of concerted activity protected by Section 7. Accordingly, it determined that D.R. Horton’s arbitration agreement, precluding employees from filing any joint, class, or collective claims in any forum, arbitral or judicial, violated Section 8(a)(1). Second, the Board found there was no conflict between the FAA and NLRA because the FAA does not require contracting parties to forgo substantive rights created by statute, and the “right” to act “concertedly,” including through collective legal action, is a substantive right under the NLRA.

II. Lewis vs. Epic Systems Corporation

A. The Facts

The facts in the Lewis case are straightforward. Epic Systems sent an email to employees with an arbitration agreement mandating that the employees:

- Pursue wage-and-hour claims through individual arbitration;
- Waive “the right to participate in or receive money or any other relief from any class, collective, or representative proceeding;” and
- If the collective-action waiver is deemed unenforceable, proceed with any collective claim in court, not arbitration.
2016 WL 3029464, at *1. The plaintiff, a “technical writer” at Epic, acknowledged his acceptance of the agreement, but later filed a collective action in federal court on the ground that Epic had misclassified its technical writers, including himself, as exempt employees under the FLSA. Epic moved to dismiss the claim and compel individual arbitration. The district court held that the arbitration clause violated the NLRA because it interfered with the right to engage in concerted activities for mutual aid and protection and was therefore unenforceable.

B. The Decision

1. Filing a collective or class action lawsuit constitutes “concerted activit[y]” under Section 7, rendering Epic’s arbitration agreement unenforceable.

Section 7 provides employees with a right to engage in “other concerted activities” for the purpose of “other mutual aid or protection.” 29 U.S.C. § 157. The first part of the Seventh Circuit’s legal analysis examined whether that language encompasses class and collective actions. The court answered this inquiry in the affirmative.

The court first looked to precedent. It observed that both the Board and courts have long held that Section 7’s “other concerted activities” include “resort to administrative and judicial forums” and that filing a collective or class action suit constitutes “concerted activit[y]” under Section 7. Id. at *2 (quotation marks and citations omitted).

The court next turned to statutory text. Although the NLRA does not define “concerted activities,” the court noted that the ordinary meaning of the word “concerted” is: “jointly arranged, planned, or carried out; coordinated.” Id. (citing the New Oxford American Dictionary). The court concluded that given this meaning, “collective or class legal proceedings fit well within the ordinary understanding of ‘concerted activities.’” Id.

Finally, the court addressed the NLRA’s history and purpose. It observed that Congress enacted the NLRA with the understanding that “a single employee was helpless in dealing with an employer,” and with the purpose of “equaliz[ing] the bargaining power of the employee with that of his employer by allowing employees to band together in confronting an employer regarding the terms and conditions of their employment.” Id. According to the court, “[c]ollective, representative, and class legal remedies allow employees to band together and thereby equalize bargaining power.” Id. at *3. Epic attempted to counter the Board’s historical references by arguing that “because the Rule 23 class action procedure did not exist in 1935, when the NLRA was passed, the Act could not have been meant to protect employees’ rights to class remedies,” but the NLRB countered that position by highlighting the broad use of the language “other concerted activities for the purpose of . . . other mutual aid or protection,” and the pre-existence of other representative procedures well before the NLRA’s enactment (e.g., permissive joinder of parties). Id. at *4.

Based upon this analysis, the Seventh Circuit’s ruling as to the enforceability of the disputed arbitration agreement was inevitable. In short, Epic’s agreement prohibited any collective, representative, or class legal proceeding, which the court observed “runs straight into the teeth of Section 7.” Id. at *4. Accordingly, the court held that “Sections 7 and 8 of the NLRA render Epic’s arbitration provision unenforceable.” Id. at *5.
2. Section 7’s right to engage in “other concerted activity” is a substantive right, and accordingly, the FAA does not override the NLRA.

The latter half of the court’s opinion addressed Epic’s argument that “the FAA . . . trumps the NLRA.” Id. at *5. The court concluded “there is no conflict between the NLRA and the FAA.” Id. at *6. The FAA’s saving clause treats arbitration agreements as “valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract,” including illegality. Because agreements that deny employees’ rights to engage in concerted activities are illegal under the NLRA, reasoned the court, they are unenforceable pursuant to the FAA, leading the court to remark that “the NLRA and FAA work hand in glove.”

The court then adopted the NLRB’s rationale in D.R. Horton on the issue of substantive rights. The Supreme Court has recognized that the FAA protects the right of parties to agree to resolve statutory claims in an arbitral forum so long as the litigant can effectively vindicate his or her statutory rights through arbitration. In the NLRB’s D.R. Horton decision, it held that the right to engage in collective legal action is a “core substantive right protected by the NLRA”—rather than a procedural right—and therefore invalidating the class action waiver under the NLRA did not conflict with the FAA, because “the intent of the FAA was to leave substantive rights undisturbed.” 357 NLRB at 2286. Previously, the Fifth Circuit had rejected the NLRB’s analysis of the substantive/procedural rights distinction. It reasoned that the right to act collectively as a class is procedural and therefore can be waived in accordance with the FAA. D.R. Horton, Inc., 737 F.3d at 357.

In Lewis, the Seventh Circuit adopted the NLRB’s position. It held that Section 7’s rights are “substantive.” 2016 WL 3029464, at *9. In fact, it observed, “Section 7 is the NLRA’s only substantive provision.” As a result, it concluded that invalidating Epic’s arbitration agreement was consistent with the FAA because it denied or interfered with this substantive statutory right. Id. Based upon these two core rulings, the Seventh Circuit concluded “[b]ecause it precludes employees from seeking any class, collective, or representative remedies to wage-and-hour disputes, Epic’s arbitration provision violates Sections 7 and 8 of the NLRA,” and “[n]othing in the FAA saves the ban on collective action.” Id. at *10.

III. The Implications of Epic Systems

The Seventh Circuit’s decision has certainly shaken up the arbitration landscape, creating significant uncertainty.

As the decision now stands, pre-dispute arbitration agreements containing class or collective action waivers within the jurisdiction of the Seventh Circuit—covering Illinois, Wisconsin, and Indiana—are unenforceable under the NLRA. Further review of the decision seems likely, if not by the Seventh Circuit en banc, then by the Supreme Court. And the latter possibility itself is fraught with uncertainty given the current 4-4 composition of the Supreme Court and the death of Justice Antonin Scalia, who was among the Court’s most staunch defenders of arbitration.

Moreover, although the NLRB has been following D.R. Horton, the composition of the Board may turn over at the beginning of 2017 with the new White House administration. Accordingly, even the Board itself could reverse its direction with a change in Board membership.

In the interim, employers can be certain of one thing, which is that employees, unions, and the NLRB will invoke the Epic Systems decision to the maximum extent possible. Days after the Seventh Circuit published Epic Systems, the NLRB General Counsel cited it, urging the D.C. Circuit to enforce its order
invalidating a California car dealership’s mandatory arbitration policy because it precludes employees from pursuing class action claims. Clients with questions about how to proceed pending further developments, such as possible Supreme Court review, can call one of our attorneys to discuss options.

If you have any questions concerning these developing issues, please do not hesitate to contact any of the following Paul Hastings lawyers:

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