Arbitration at a Cross Road: Will the Supreme Court Hold the Federal Arbitration Act Trumps Federal Labor Laws?

By John Jay Range and Bryan Cleveland

The Supreme Court will shortly be considering three controversial cases that impact the employment agreements of millions of Americans. The National Labor Relations Board (NLRB) has held that it is an unfair labor practice under the National Labor Relations Act of 1935 (NLRA) for employers to require employees to sign mandatory arbitration agreements waiving any right to class, collective, or consolidated dispute resolution with other employees. The U.S. Circuit Courts of Appeals, however, had been unanimous in refusing to enforce this NLRB rule. That changed last year when both the Seventh and Ninth Circuits agreed with the NRLB, creating a circuit split with the Second, Fifth, and Eighth Circuits. To resolve the circuit split, the Supreme Court agreed to review the decisions of the Seventh and Ninth Circuits enforcing the NLRB rule, as well as a new decision of the Fifth Circuit denying enforcement of the rule.

This article discusses the development of the NLRB rule and the legal grounds on which the circuit courts split on the issue of enforcing that rule. It then previews the likely arguments that will be raised in support of and opposition to enforcement of the NLRB rule during oral argument before the Supreme Court. It also addresses the importance of these cases to current and future employment agreements. Finally, it discusses how the resolution of these cases could impact a wide range of consumer contracts that incorporate similar mandatory arbitration agreements.

In recent years, the Supreme Court has broadly construed the scope of the Federal Arbitration Act (FAA), preempting state laws that protect consumers from mandatory arbitration clauses included in form contracts. In its closing hours, the Obama administration pushed back on this expansion of the FAA, directing many agencies to craft rules barring the use of mandatory arbitration that excluded access to class action dispute resolution. The combination of the Trump administration, Republican control of Congress, and the appointment of Justice Neil Gorsuch may unwind some of these Obama anti-arbitration rules.

Employers Use Arbitration to Preclude Access to Class Action Litigation

Companies avoid class action litigation by including binding arbitration provisions in their contracts with employees and customers. The courts have historically enforced such agreements, staying litigation and compelling the parties to arbitrate their disputes. But the rules of most arbitral institutions allow parties to arbitrate on either an individual or class basis. Class arbitration presents significant procedural and due process concerns, such that most companies find class arbitration is an even less attractive option than class action litigation. To avoid this problem, arbitration agreements typically require employees and consumers to...
waive their right to class arbitration. These waiver provisions require that all disputes be arbitrated on an individual (i.e., bi-lateral) basis between the company and one of its employees or customers. In a series of cases, the Supreme Court has enforced these waivers, holding that the FAA preempts state laws seeking to invalidate them.9

The NLRB Holds That Waivers of Class Arbitration Constitute an Unfair Labor Practice
The NLRB held in In re D.R. Horton10 that an employer commits an unfair labor practice by requiring its employees to arbitrate disputes related to their employment on an individual basis. The NLRB found this practice violates Section 7 of the NLRA, which permits employees to engage in “concerted activities for the purpose of collective bargaining or other mutual aid or protection.”11 The NLRB held that the right to engage in “concerted activities” included a “substantive” statutory right to file legal actions—in court or in arbitration—in a joint, class, or collective capacity. The NLRB adopted its “Horton rule” invalidating class waivers in pre-dispute arbitration agreements even though the NLRA creates no private right of action on behalf of employees or anyone else. Further, since the waiver of class arbitration precluded employees from pursuing concerted legal action to address their wage claims, the NLRB concluded waivers constituted an unlawful labor practice under Section 8(a)(1) of the NLRA. In addition, the NLRB found that the language in Horton’s mandatory arbitration agreement “would lead employees reasonably to believe that they were prohibited from filing unfair labor practice charges with the Board,” leaving individual arbitration as their only remedy.12

Review of the NLRB’s Decision in the Circuit Courts
Horton challenged the NLRB’s decision in the U.S. Court of Appeals for the Fifth Circuit,13 disputing that Section 7 granted employees the substantive right to adjudicate claims on a joint, class, or collective basis. Further, it argued that the Board’s interpretation of Section 7 conflicted with the FAA by placing an impermissible burden on the right to arbitrate. Horton argued that barring waivers of class arbitration would indisputably make arbitration a less attractive option than litigation, thereby frustrating Congress’s intent that arbitration agreements should be enforced on an equal basis as all other contractual obligations.

The Fifth Circuit agreed and rejected the NLRB’s holding that Section 7 created a substantive statutory right to joint, class, or collective dispute resolution. The court noted that similar arguments had recently been considered and rejected in the context of other federal labor statutes by the Second14 and Eighth Circuits.15 These courts ruled that while the Fair Labor Standards Act (FLSA) creates an express right to bring a collective action, that right requires “an employee with a FLSA claim to affirmatively opt-in to any collective action.”16 The courts reasoned that “if an employee must affirmatively opt-in to any such class action, surely the employee has the power to waive participation in a class action as well.”17

The Fifth Circuit criticized the NLRB’s decision to prioritize the NLRA over the FAA.18 The court stated that “arbitration agreements must be enforced according to their terms,” save for two exceptions.19 First, “an arbitration agreement may be invalidated on any ground that would invalidate a contract under the FAA’s ‘savings clause.’”20 Second, “application of the FAA may be precluded by another statute’s contrary congressional command.”21 The FAA’s “savings clause” provides that a written arbitration agreement must be enforced according to its terms “save upon such grounds as exist at law or in equity for the revocation of any contract.”22 This means that traditional defenses to the enforceability of all contracts, such as illegality, fraud, duress, lack of consideration, etc., may be used to invalidate an arbitration clause. But the savings clause does not apply if the legal ground advanced for revocation is a law that specifically targets arbitration agreements to the exclusion of other contracts. Arguably, the NLRB’s Horton rule purports to be facially neutral because it applies equally to arbitration and litigation. But the Fifth Circuit found that the actual application of the rule placed an undue burden on arbitration, rendering use of the FAA’s saving clause inapplicable.23

The Fifth Circuit next addressed whether the NLRB contained a “contrary congressional command”24 to override the FAA. After examining the text of the statute and its legislative history, the court concluded there was neither explicit statutory language nor any recorded legislative history reflecting congressional intent for the NLRA to override the FAA.25 Further, the court could
find no “inherent conflict” between arbitration and the NLRA’s underlying purpose, noting labor disputes have had a long history of resolution through (bilateral) arbitration. In 2015, the Fifth Circuit reaffirmed this ruling in *Murphy Oil USA, Inc. v. N.L.R.B.*

Shortly thereafter, the Seventh and Ninth Circuits split with their sister circuits in holding that incorporating mandatory class arbitration waivers in employment agreements constituted an unfair labor practice. The Seventh Circuit concluded in *Lewis v. Epic Systems Corp.* that Section 7 of the NLRA creates a substantive right to joint, class, or collective adjudication. The court therefore held that the FAA’s savings clause voided class arbitration waivers in employment agreements. The Ninth Circuit, in *Morris v. Ernst & Young, LLP*, reached substantially the same result. Both courts rested their holdings on the FAA’s savings clause, finding that clause invalidated any arbitration provision that the NLRB had concluded was an unfair labor practice.

**The Supreme Court Grants Review of Three Related Cases**

The Supreme Court agreed to review *Murphy Oil, Epic Systems*, and *Ernst & Young* during its term beginning in October 2017. The Court agreed to address the following issue:

> Whether arbitration agreements with individual employees that bar them from pursuing work-related claims on a collective or class basis in any forum are prohibited as an unfair labor practice under 29 U.S.C. 158(a)(1), because they limit the employees’ right under the National Labor Relations Act to engage in “concerted activities” in pursuit of their “mutual aid or protection,” 29 U.S.C. 157, and are therefore unenforceable under the saving clause of the Federal Arbitration Act, 9 U.S.C. 2.

To resolve the issue, the Court will likely have to address at least the following questions. First, whether the NLRA contains a “contrary congressional command” overriding the FAA’s mandate that arbitration agreements be enforced as written. Second, whether the NLRB has correctly construed the right to “concerted activities” in Section 7 of the NLRA to create a substantive right to participation in a class or collective arbitration or litigation. Third, whether the NLRB’s *Horton* rule can be invoked under the FAA’s “savings clause” as “grounds as exist at law or in equity for the revocation of any contract” to void class action waivers.

At its core, the issue the Supreme Court must resolve is whether there is a conflict between the NLRA and the FAA and, if so, how that conflict should be resolved. In the recent past, the Court’s approach to federal statutory conflict issues involving the FAA has been to inquire whether the contested federal statute (here the NLRA) contains a “contrary congressional command” overriding the FAA’s mandate that “requires [an] arbitration agreement to be enforced according to its terms.” The Supreme Court has noted that if Congress issues a contrary command, it usually does so with “clarity” by mentioning arbitration expressly in the text of the statute. This is a demanding standard. It is clear that neither the text of the NLRA nor its legislative history contains language suggesting a “contrary congressional command,” and neither the Seventh nor Ninth Circuit actually found that the NLRA contained such a command in enforcing the NLRB’s ruling.

In the absence of a contrary congressional command, the FAA can be overridden, and the class action waiver invalidated, if the arbitration agreement “operate[s] . . . as a prospective waiver of a party’s right to pursue statutory remedies.” The “right to pursue statutory remedies” is violated when the arbitration clause prohibits assertion of a statutory right or cause of action. Since all the disputed arbitration agreements permit individual assertion of statutory rights, the issue is whether the statute creates a substantive right to participate in class rather than individual arbitration/litigation.

Section 7 of the NLRA does not mention “litigation,” “arbitration,” or “class actions” as examples of “concerted activities.” While the FLSA does mention collective litigation, most of the circuit courts have held that this is insufficient to create a non-waivable, substantive right to class arbitration/litigation. Prior Supreme Court cases have considered class actions as a “procedural right only, ancillary to the litigation of substantive claims.” If the Supreme Court were to continue to follow this precedent, and considering that the NLRA was enacted years prior to modern class action practice, it might be difficult to prevail on the argument that Congress intended the “concerted activities” provision in Section 7 to create a substantive statutory right to participate in class arbitration.
The Importance of the Supreme Court’s Decision Beyond Labor Relations

The NRLB’s Horton rule is just one of many agency rules seeking to limit use of mandatory pre-dispute arbitration clauses. In the final months of the Obama administration, various federal agencies drafted rules seeking to limit or prohibit such clauses, including specifically waivers of class arbitration. Congress has moved to invalidate some of these Obama rules under the Congressional Review Act (CRA). From its passage in 1996 until January 2017, the CRA had been invoked exactly once. Since the start of the Trump administration, however, at least 13 disapproval resolutions have been passed and many more have been proposed.

The CRA was used to invalidate Obama rules barring mandatory, pre-dispute arbitration agreements in newly executed federal procurement contracts issued by the General Services Administration having a value greater than $1 million. Similar CRA invalidation has been threatened against the Consumer Financial Protection Bureau’s anti-arbitration rule, which bars mandatory arbitration clauses prohibiting consumers from filing or participating in class actions concerning covered consumer financial products and services. The Federal Communications Commission’s plan to address mandatory arbitration clauses in contracts for communications services could be similarly affected. Consumer advocates worry that if Congress were to disapprove these rules, the CRA prohibits future adoption of a similar rule “unless the reissued or new rule is specifically authorized by a law enacted after the date of the joint resolution disapproving the original rule.”

Two other agency rules appear to have survived the CRA. The Department of Education’s rule prohibiting colleges that participate in the federal student loan program from including arbitration agreements in their contracts, and the Department of Labor’s final rule banning financial advisers from requiring mandatory arbitration clauses with class waivers in certain ERISA financial advisory contracts, were allowed to go into force. An adverse ruling from the Supreme Court on the NRLB’s Horton rule, however, might spur legal challenges to these rules.

On the other hand, if the NRLB’s Horton rule prevails, many employers will redraft their contracts to abandon arbitration, likely resulting in an increase in class action litigation. There is substantial evidence that given the choice between class arbitration and class action litigation, employers prefer the relative certainty and due process protection afforded by civil litigation under the Federal Rules of Civil Procedure. This preference is demonstrated by the widespread adoption of arbitration agreements that are self-voiding if a mandatory waiver of class arbitration is held to be unenforceable.

In summary, the stakes will be high for employers, employees and consumers alike when the Supreme Court addresses what to some observers may appear to be a minor issue of federal statutory interpretation.

In the United States, the once mundane world of alternative dispute resolution has become politicized and divided along party lines over the issue of employee and consumer access to class adjudication.

(Endnotes)

3. Morris v. Ernst & Young, LLP, 834 F.3d 975 (9th Cir. 2016), cert. granted, 137 S. Ct. 809 (Jan. 13, 2017) (No. 16-300).
5. Murphy Oil USA, Inc. v. N.L.R.B., 808 F.3d 1013 (5th Cir. 2015), cert. granted, 137 S. Ct. 809 (Jan. 13, 2017) (No. 16-307).
6. Owen v. Bristol Care, Inc., 702 F.3d 1050 (8th Cir. 2013).
7. Murphy Oil USA, Inc. v. N.L.R.B., 808 F.3d 1013 (5th Cir. 2015), cert. granted, 137 S. Ct. 809 (Jan. 13, 2017) (No. 16-307).
9. Sutherland v. Ernst & Young, LLP, 726 F.3d 290, 297–98 n.8 (2d Cir. 2013).
11. Id. at 2278.
12. Id.
14. Sutherland v. Ernst & Young, LLP, 726 F.3d 290 (2d Cir. 2013).
15. Owen v. Bristol Care, Inc., 702 F.3d 1050 (8th Cir. 2013).
16. Sutherland, 726 F.3d at 296. The FSLA provides with respect to protected collective actions that: “No employee shall be a party plaintiff to any such action unless he gives his consent in writing to become such a party and such consent is filed in the court in which such action is brought.” 29 U.S.C. § 216(b) (2012).
17. Sutherland, 726 F.3d at 297, quoting Owen, 702 F.3d at 1052–53.
19. Id.
20. Id.
21. Id.
24. Id.
25. Id. at 360–61.
26. Id. at 361, citing 14 Penn Plaza LLC v. Pyett, 556 U.S. 247, 257–58 (2009) for the proposition that “courts repeatedly have understood the NLRA to permit and require arbitration.”
27. 808 F.3d 1013 (5th Cir. 2015), cert. granted, 137 S. Ct. 809 (Jan. 13, 2017) (No. 16-307).
29. 834 F.3d 975 (9th Cir. 2016), cert. granted, 137 S. Ct. 809 (Jan. 13, 2017) (No. 16-300).
30. Certiorari was granted, and the cases consolidated, on January 13, 2017.
32. Both class litigation and arbitration are barred because the mere agreement to arbitrate precludes litigation, and the class waiver limits the parties to bilateral arbitration only.
34. Id. at 116.
35. Am. Express Co. v. Italian Colors Rest., 133 S. Ct. 2304, 2310 (2013), quoting Mitsubishi Motors Corp. v. Soler Chrysler–Plymouth, Inc., 473 U.S. 614, 637 n.19 (1985). Thus, the Fifth Circuit in Murphy Oil, despite refusing to enforce the overall NLRB decision, upheld the portion of the decision finding the arbitration clause did not make sufficiently clear to employees that they could pursue a collective administrative claim with the NLRB. 808 F.3d at 1019.
37. Ironically, one of Congress’s primary goals in adopting the FAA in 1925 was to validate use of mandatory, pre-dispute arbitration clauses in contracts because such clauses were invalid in many states at that time.
40. The Department of Health and Human Services rule barring nursing homes from including binding arbitration provisions in admission documents suffered a court defeat when the rule was stayed before it even went into effect. See Am. Health Care Ass’n v. Burwell, 217 F. Supp. 3d 921 (N.D. Miss. 2016). In April 2017, the Department decided to withdraw and reconsider the rule. In June 2017, the Trump administration suspended application of the Department of Education’s 2016 regulation prohibition on pre-dispute arbitration agreements, including class action waivers.
41. See, e.g., DIRECTV, Inc. v. Imburgia, 136 S. Ct. 463 (2015) (the arbitration clause provides that if the class arbitration waiver is unenforceable for any reason, the entire arbitration agreement is deemed to be unenforceable such that parties revert to litigation).