Ninth Circuit Invalidates Class Waiver in Arbitration Agreement

August 23, 2016

In a ruling that widens the divide between federal appellate courts, the Ninth Circuit sided today with the Seventh Circuit and the National Labor Relations Board ("NLRB") in holding that the class action waiver provision of a company's arbitration agreement with employees violates the National Labor Relations Act ("NLRA"). Prior to this decision, the Seventh Circuit was alone in its dissention from the federal majority with respect to this issue.

The United States Supreme Court in *AT&T Mobility v. Concepcion* made clear that class waivers are enforceable under the Federal Arbitration Act ("FAA"), at least in the context of consumer class actions, and that state laws that inhibit the full effectuation of the FAA are void. The NLRB, however, in its continuing bid to establish its relevance in the contemporary workplace, has challenged class waivers executed by employees; in *D.R. Horton, Inc. v. NLRB*, the NLRB held in 2012 that employees' Section 7 rights are violated by such waivers, and that the FAA does not override this right. The NLRB's ruling in *D.R. Horton* spawned a great deal of commentary and litigation – the NLRB's ruling that class waivers are unenforceable was itself rejected by an appellate court in the Fifth Circuit. A host of federal appellate courts, as well as lower courts, have also criticized the NLRB's ruling and refused to adopt its reasoning. Notably, the Fifth Circuit decision emphasized that the use of class action litigation is a procedural, rather than a substantive right, and that prohibiting class action waivers would discourage arbitration and, thus, violate the spirit and purpose of the FAA.

In *Morris v. Ernst & Young*, 9th U.S. Circuit Court of Appeals, No. 13-16599, the three-judge panel held 2-1 that Ernst & Young's arbitration agreement containing a class action waiver violated the NLRA. In doing so, the court summarily rejected the employer's argument that the FAA effectively supersedes the NLRA. Instead, the court reasoned that the FAA's "saving clause", which validates arbitration agreements save for instances in which grounds exist for their revocation, is rendered moot due to the fact that the contract requires employees to waive their substantive federal right to pursue legal claims together. Judge Sidney R. Thomas wrote for the majority: "The problem with the contract at issue is not that it requires arbitration…it is that the contract term defeats a substantive federal right to pursue concerted work-related legal claims."

In a pointed dissent, Judge Sandra S. Ikuta cited U.S. Supreme Court precedent in support of her position, setting the stage for the Highest Court to weigh in and clarify what, until today, appeared to be settled law. Per Judge Ikuta's dissent, Supreme Court precedent unequivocally requires that, when a party claims that a federal statute precludes the enforcement of an arbitration agreement, the courts should examine whether the cited federal statute includes a "contrary congressional command" that the regulation supersedes the FAA. Judge Ikuta further reasons that, after applying the requisite analysis, the Supreme Court has upheld the validity of every arbitration agreement it has addressed. Judge Ikuta's strongly-worded dissent describes the Ninth Circuit's reasoning as "specious because it is based on the erroneous assumption that the waiver of the right to use a

collective mechanism in arbitration or litigation is 'illegal,'…but such a waiver would be illegal only if it were precluded by a 'contrary congressional command' in the NLRA, and here there is no such command."

The *Morris* ruling does not change the law in most jurisdictions, including the Second, Fifth, Eighth, and Eleventh Circuits, which have rejected the NLRB's *D.R. Horton* decision and maintain that arbitration agreements with a waiver of class/collective actions are enforceable. In the states within the Ninth and similarly dissident Seventh Circuit, on the other hand, employers should assume that arbitration agreements that contain a waiver of class or collective actions are likely to be held to be invalid. Because the circuit split has widened regarding the impact of the NLRA on arbitration agreements in the employment context, the open question seems to when, and in what context, the issue will reach the United States Supreme Court. The uncertainty regarding the current makeup of the Supreme Court, in light of the death of Justice Scalia, only adds to the intrigue.