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Navigating In The New Era Of Class Action Waiver Law

Law360, New York (May 21, 2014, 10:16 PM ET) -- Cases involving arbitration agreements with class action waivers have been in the headlines a lot lately. For companies, the underlying issue in these cases is often a simple one: Can they require an employee to sign an arbitration agreement waiving his or her right to bring class or collective action claims?

The simplicity of the issue belies its significance. If such agreements are enforceable, then a company may be able to effectively shield itself from class or collective action liability by entering into arbitration agreements with its workforce. Courts have historically greeted class waivers with a heavy dose of skepticism, but class waivers are undergoing something of a renaissance. Spurred by U.S. Supreme Court precedent embracing arbitration, courts are increasingly enforcing class and collective action waivers in employment cases. But, while many courts are more open to class waivers, obstacles to enforcement remain. Companies therefore need to understand how the law is developing and remain on the lookout for common pitfalls.

A New Era: AT&T Mobility LLC v. Concepcion

Courts' historic reluctance to enforce class action waivers stemmed in large measure from common law rules prohibiting class waivers in consumer cases. The California Supreme Court adopted such a rule in Discover Bank v. Superior Court.[1] Discover Bank held that class action waivers in consumer arbitration agreements are unconscionable — and thus unenforceable — if the agreement is one of adhesion, little damages are at issue and is carried out as part of a broader scheme to defraud parties with inferior bargaining power. Despite these apparent limitations, courts frequently found that class action waivers were unenforceable under this test.

The Supreme Court considered the Discover Bank rule in AT&T Mobility LLC v. Concepcion.[2] Foretelling its ultimate holding in the case, the Supreme Court began its analysis with the observation that "[w]hen a state law prohibits outright the arbitration of a particular type of claim, the analysis is straightforward: The conflicting rule is displaced by the [Federal Arbitration Act]." The Supreme Court then concluded that the Discover Bank rule stood as "'an obstacle to the accomplishment and execution'" of Congress' purposes in passing the FAA and was therefore "preempted by the FAA."

Importantly, the Supreme Court did not rule that class action waivers are immune from judicial review. Rather, it reiterated that the FAA "preserves generally applicable contract defenses." Although the full meaning of this remains the subject of debate, the Supreme Court's basic framework is clear: Courts may invalidate agreements with class waivers on grounds applicable to all contracts — such as failure of consideration — but laws amounting to a per se ban on class waivers are invalid and preempted by the FAA.

The Developing Trend: Applying Concepcion in Employment Cases

But just how far does this "basic" framework extend? As noted above, Concepcion was a consumer case. And, in Concepcion's immediate aftermath, it was not clear that lower courts were going to apply Conception outside of the consumer setting, especially in employment cases.

In Brown v. TrueBlue Inc.,[3] for example, the court "pause[d]" to consider whether the fact that Concepcion involved a "consumer contract" limited its application in cases involving "employment contract[s]." While the court ultimately found no basis for "carving out an exception" to Concepcion for employment contracts, its analysis reflects the early uncertainty about Concepcion's reach.

This hesitancy to embrace Concepcion with respect to employment law was, with some exceptions discussed below, short-lived. Recognizing the breadth of Concepcion's language, courts quickly adopted its reasoning and now generally uphold class action waivers, even in employment cases.

Indeed, the trend is so strong that one court — believing class waivers disproportionally benefit companies over employee — upheld a class waiver in an arbitration agreement even though it considered doing so was "unappetizing," "lamentable" and possibly "unjust."[4] The court concluded that it must nevertheless enforce such waivers because it was "not at liberty to ignore the decisions of the United States Supreme Court."

As another court recently observed, Concepcion is "both broad and clear" that state laws that preclude enforcement of contracts for individual arbitration are preempted by the FAA "irrespective of whether class arbitration is desirable."[5]

A Snag in the Trend: D.R. Horton Inc. v. NLRB

In the midst of this authority enforcing class action waivers, one contrary case captured observers' attention like a fire bell in the night. In In re D.R. Horton Inc.,[6] theNational Labor Relations Board considered whether class action waivers infringe upon employees' rights to engage in protected concerted action under Section 7 of the National Labor Relations Act.

The NLRB found that they do; the board concluded that because employees' right to engage in protected concerted action is substantive, relying on that substantive right to ban class waivers does not conflict with the FAA because "the intent of the FAA [i]s to leave substantive rights undisturbed."

The NLRB did, however, concede that there may be "tension" between a rule invalidating class waivers under the NLRA and Concepcion. But, in a passage that stood out to employment class action litigators, the NLRB dismissed that tension as "limited" because employment class actions often involve only a "specific subset of a company's employees."

The NLRB went on to assert that the "average number of employees employed by a single employer" is only "20." Seemingly overlooking the fact that a class of 20 persons would almost certainly never satisfy Rule 23(a)'s numerosity requirement, the NLRB then concluded that because "most classwide employment cases" involve classes that are "so limited in size," arbitration of class claims in employment cases is actually "akin to an individual arbitration proceeding." Accordingly, it held that barring class waivers and requiring companies to arbitrate employment cases on a class basis would not significantly alter the characteristics that make arbitration desirable, namely, speed, cost, informality and risk.

Restoring the Trend: D.R. Horton Inc. v. NLRB

The NLRB's reasoning in D.R. Horton is extraordinary not only because it overlooks the realities of modern employment litigation — particularly the enormous expense and complexity of defending class claims — but also because it is difficult to square with Concepcion.

That is what the Fifth Circuit thought when it overruled the NLRB's decision in December 2013 in D.R. Horton Inc. v. NLRB.[7] In particular, it concluded that the NLRB failed to give "proper weight" to the FAA and, by extension, Concepcion. It held that the use of class action procedures is a procedural — and not a substantive — right and that there is no substantive right to use class procedures in the NRLA or related employment statutes. It also held that nothing in the NLRA suggested that Congress intended it to trump the strong policy in favor of arbitration established in the FAA.

The NLRB petitioned the Fifth Circuit for a rehearing, but the court rejected that request last month.[8] In doing so, the Fifth Circuit remained in the company of every other circuit court that has considered the NLRB's rationale, all of which reject it and hold that arbitration agreements containing class action waivers are enforceable.[9]

Lingering Pitfalls

Where does all of this leave class action waivers? The trend in favor of enforcing class action waivers is unmistakable. But it is relatively new and the law has yet to emerge from its nascent stage. Companies considering using class action waivers should be mindful of the following potential pitfalls:

First, the NLRB's decision in D.R. Horton is still controlling in some forums. Although every federal circuit court that has considered the issue has rejected the NLRB's reasoning in D.R. Horton, the NLRB generally takes the position that when one circuit overrules one of its decision, the decision nevertheless remains binding at the administrative level until it is overturned by the Supreme Court. Furthermore, although

every federal circuit court that has considered the NLRB's decision has rejected its reasoning, some district courts nonetheless have adopted the NLRB's analysis.[10]

Second, and relatedly, while federal courts have generally been uniform in enforcing class action waivers — and state courts have been less consistent. New Mexico, for example, continues to take the position that class waivers may be invalidated post-Concepcion on the basis of generally applicable state public policy supporting the use of the class action device.[11] California is another wild card, with courts coming down on both sides of the issue.[12] The California Supreme Court granted review of Iskanian v. CLS Transportation of Los Angeles and recently heard oral argument; its decision should clarify the law in California. But the current uncertainty in California shows that companies must understand how the jurisdictions in which they operate have responded to class waivers when drafting arbitration agreements.

Third, companies thinking that courts will simply rubber stamp class action waivers after Concepcion should think again. Nothing in Concepcion or any of the cases that follow it changes the fact that arbitration is fundamentally a matter of contract. Courts continue to closely scrutinize contractual language when deciding whether disputes fall within an agreement's scope. For example, in Russell v. Citigroup Inc.,[13] the defendant argued that an arbitration agreement stating it applied to "all employment-related disputes" that "arise" in the employment relationship applied retroactively to claims that occurred before the parties signed the agreement. The court disagreed, finding that the agreement's use of the term "arise" rather than "arose" or "have arisen" indicated that the agreement only applied to claims arising after the parties signed it. Companies therefore need to carefully consider the precise language used in arbitration agreements to ensure that it is broad enough to cover all intended disputes.

Fourth, companies should not let the glare from favorable class waiver cases obscure the fact that Concepcion reiterated that, under the FAA, arbitration agreements remain subject to generally applicable contract defenses. Thus, courts may invalidate arbitration agreements with class waivers based on defenses that apply to all contracts, such as fraud, duress or unconscionably.[14] Of these, companies drafting arbitration agreements should be particularly vigilant about unconscionability. Clauses that limit damages a plaintiff could otherwise recover, require the plaintiff to arbitrate in a distant forum or permit the defendant to unilaterally select the arbitrator have all been found unconscionable as too "one-sided" even post-Concepcion.[15]

These potential pitfalls aside, class waivers may provide companies with an important tool in limiting exposure to class or collective actions. Companies still must exercise caution to ensure not only that the language they use in arbitration agreements is broad enough, but also that the language is enforceable in specific jurisdictions. When drafted properly and tailored to appeal to the tendencies of the jurisdiction, class action waivers have the potential to effectively protect companies from costly and complex class litigation.

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[1] 113 P.3d 1100 (Cal. 2005).

[2] 131 S. Ct. 1740 (2011).

[3] 2011 U.S. Dist. LEXIS 134523 (M.D. Pa. Nov. 22, 2011).

[4] Porreca v. Rose Grp., 2013 U.S. Dist. LEXIS 173587 (E.D. Pa. Dec. 11, 2013).

[5] Williams v. Nabors Drilling USA, LP , 2014 U.S. Dist. LEXIS 23841 (W.D. Pa. Feb. 25, 2014) (quotation omitted).

[6] 2012 NLRB LEXIS 11 (N.L.R.B. Jan. 3, 2012).

[7] 737 F.3d 344 (5th Cir. 2013).

[8] 737 F.3d 344 (5th Cir. 2013), reh'g denied, (5th Cir. Apr. 16, 2014).

[9] Richards v. Ernst & Young, LLP , 734 F.3d 871, 873–74 (9th Cir. 2013); Sutherland v. Ernst & Young LLP , 726 F.3d 290, 297–98 n. 8 (2d Cir. 2013); Owen v. Bristol Care, Inc.702 F.3d 1050, 1055 (8th Cir. 2013).

[10] See, e.g., Herrington v. Waterstone Mortg. Corp., 2014 U.S. Dist. LEXIS 9992, at *2-3 (W.D. Wis. Jan. 28, 2014) (refusing to reconsider an earlier decision adopting the NLRB's position even after the Fifth Circuit reversed it).

[11] THI of N. M. at Hobbs Ctr., LLC v. Patton, 741 F.3d 1162, 1169 (10th Cir. 2014) (discussing New Mexico Law).

[12] Compare Truly Nolen of Am. v. Superior Court , 145 Cal. Rptr. 3d 432 (Ct. App. 2012) (finding class waivers in employment agreements are unconscionable if class arbitration would be a more effective means of vindicating plaintiffs' rights), with Iskanian v. CLS Transp. Los Angeles, LLC, 142 Cal. Rptr. 3d 372 (Ct. App. 2012) (enforcing a class action waiver).

[13] 2014 U.S. App. LEXIS 6210 (6th Cir. Apr. 4, 2014).

[14] In re Checking Account Overdraft Litig., 685 F.3d 1269 (11 Cir. 2012).

[15] See Newton v. Am. Debt. Servs., Inc., 594 F. App'x 962 (9th Cir. 2013).

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