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## Seventh Circuit finds Class Action Waivers in Arbitration Agreements are Illegal and Unenforceable under the NLRA

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On May 26, 2016, the U.S. Court of Appeals for the Seventh Circuit issued its decision in *Lewis v. Epic-Systems Corp.*, finding that the company's arbitration agreement, which prohibits employees from participating in "any class, collective or representative proceeding," violated the employees' right to engage in concerted activity under the National Labor Relations Act (NLRA). The Seventh Circuit became the first circuit court to agree with the NLRB's position in *D.R. Horton*.<sup>1</sup> The Second, Eighth, and most notably, the Fifth Circuit have rejected this stance, with the Ninth Circuit acknowledging that trend.<sup>2</sup> The decision therefore creates a circuit split, and given the importance of the issue, sets the stage for potential Supreme Court review. In the meantime, class and collective action waivers will not be enforced in federal courts sitting in Illinois, Indiana and Wisconsin, the states within the Seventh Circuit's jurisdiction. The very same agreement should be enforced in federal courts sitting in the circuits that have rejected *D.R. Horton*, and federal courts sitting within circuits that have yet to opine on the matter will have a choice. Further muddling the matter, state courts will not necessarily feel bound by the NLRB, thus creating more opportunity for inconsistency and confusion in a high-stakes area of the law.<sup>3</sup>

### Background

Lewis, a technical writer, entered into an arbitration agreement with his employer, Epic-Systems. In the agreement, Lewis waived his "right

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1 *D.R. Horton Inc.*, 357 NLRB 184 (2012).

2 See *Murphy Oil U.S.A., Inc. v. NLRB*, 808 F.3d 1013 (5th Cir. 2015); *Richards v. Ernst & Young, LLP*, 744 F.3d 1072, 1075 n.3 (9th Cir. 2013); *D.R. Horton, Inc. v. NLRB*, 737 F.3d 344 (5th Cir. 2013); *Sutherland v. Ernst & Young LLP*, 726 F.3d 290, 297 n.8 (2d Cir. 2013); *Owen v. Bristol Care, Inc.*, 702 F.3d 1050, 1052 (8th Cir. 2013).

3 See, e.g., *Iskaniyan v. CLS Transportation Los Angeles, LLC*, 59 Cal. 4th 348 (2014) (California Supreme Court rejecting *D.R. Horton* and enforcing mandatory arbitral class action waiver).

to participate in or receive money or any other relief from any class, collective, or representative proceeding.” The agreement also provided that by continuing to work at Epic-Systems, Lewis was deemed to have accepted its terms. Lewis later filed a suit in federal court in Wisconsin on behalf of himself and other technical writers alleging the company had violated the Fair Labor Standards Act (FLSA) by misclassifying and depriving them of overtime.

Epic-Systems moved to dismiss Lewis’s claim and compel individual arbitration. Lewis, however, responded that the agreement’s class and collective action waiver was unenforceable because it interfered with his right to engage in concerted activities under Section 7 of the NLRA. The district court agreed with Lewis’s arguments and Epic-Systems appealed to the Seventh Circuit.

## Seventh Circuit’s Decision

The Seventh Circuit began its analysis by adopting the NLRB’s reasoning—first promulgated in *D.R. Horton*—that engaging in class, collective or representative proceedings is “concerted activity” and a protected right under Section 7 of the NLRA, and thus it would be an unfair labor practice under Section 8 of the NLRA for an employer “to interfere with, restrain, or coerce employees in the exercise” of this right. According to the court, the NLRA’s legislative history and purpose indicated that “concerted activity” unambiguously includes representative, class, joint and collective actions. And even if the court were to find the term “concerted activity” ambiguous, it would then have to give deference to the NLRB’s interpretation of that term and find the class action waiver to be unlawful.

In reaching its decision, the Seventh Circuit rejected Epic-Systems’ three principal arguments. First, the company argued that since class actions under Rule 23 of the Federal Rules of Civil Procedure did not exist when Congress enacted the NLRA in 1935, Congress could not have intended Rule 23 class actions to be “concerted activity” under the NLRA. The court, however, held that “concerted activity” is not limited to what was “concerted activity” in 1935. Also, the arbitration agreement not only waived Rule 23 class actions, it waived all forms of representative, collective or joint proceedings, and these types of proceedings, including collective actions under §216(b) of the FLSA, existed prior to 1935.

Second, the Seventh Circuit rejected the argument, supported by all the other circuits that had ruled on the matter, that the arbitration agreement must be enforced under the Federal Arbitration Act (FAA). The court even went so far as to state that “it is not clear to us that the FAA has anything to do with this case.” Still, the court proceeded to determine whether there was a conflict between the FAA’s mandate to place arbitration agreements on the same footing as any other contract and its interpretation of the NLRA. In doing so, the court addressed the FAA’s “savings clause,” contained in 9 U.S.C. § 2, which provides that arbitration agreements are “enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract.” The court found the savings clause provided a way to harmonize the NLRA and FAA in finding the agreement’s class waiver to be unenforceable. According to the court, the agreement is illegal under the NLRA, and because an illegal agreement is not enforceable under the FAA’s savings clause, there is no conflict between the FAA and NLRA.

Finally, Epic-Systems contended that even if Section 7 protects a right to class or collective actions, the right is merely procedural not substantive, and the FAA requires enforcement of the agreement since it does not involve the forfeiture of a substantive right. The court rejected this argument because it found the right to engage in “concerted activity” through class or collective actions is a substantive right under the NLRA, even though the class action device itself is procedural. Since the arbitration agreement required employees to relinquish a right that the NLRB has declared to be substantive, it was not enforceable under the FAA.

## What Has Changed, What Remains the Same, and What Comes Next?

There are several takeaways from the Seventh Circuit's decision.

First, what has changed: of most immediate concern, some class and collective action waivers are no longer enforceable in federal courts sitting in the Seventh Circuit. A class action waiver contained in an arbitration agreement entered into by employees as a condition of continued employment will not be enforced by federal courts sitting in Illinois, Indiana and Wisconsin. The court, however, did not extend its ruling to arbitration agreements that give employees a time period to opt out and do not require consent as a mandatory term of employment. It is worth noting that the NLRB has not distinguished between "opt-out" agreements with class action waivers and others, finding all violate the NLRA.<sup>4</sup>

Second, two things remain the same. The Board will continue to find that arbitration agreements with class or collective action waivers violate the NLRA. But should the Board do so, employers can still seek redress from favorable circuits as long as the employer conducts business in the circuit or if the alleged unfair labor practice occurred in the circuit. Employers can also appeal to the D.C. Circuit. Moreover, individual plaintiffs raising the *D.R. Horton* line of attack (as did the plaintiff in *Epic-Systems*) are likely to find success in the Seventh Circuit, failure in the circuits that have rejected *D.R. Horton*, and an uncertain outcome elsewhere. It is harder to anticipate how courts will respond in a nationwide class action involving identical arbitration agreements containing class action waivers.

The split in the circuits promises only more turmoil and expensive, time-wasting litigation, thwarting Congress's intent in passing the FAA "to move the parties to an arbitrable dispute out of court and into arbitration as quickly and easily as possible" so as not to "frustrate[] the statutory policy of rapid and unobstructed enforcement of arbitration agreements."<sup>5</sup> What comes next will most likely involve the input of the Supreme Court or even changes to the Board itself. If the Board chooses to seek Supreme Court review of the Fifth Circuit's *Murphy Oil* decision, it must do so before August 11, 2016. It is not yet clear whether *Epic-Systems* will seek rehearing before the Seventh Circuit, which seems a doomed path as the court already announced that *en banc* review would not be available, or whether the company will file a petition for review with the Supreme Court.

Moreover, what happens if the Supreme Court takes the case, decides it before a new Justice is approved, but is split 4-4? The answer is that the Seventh and Fifth Circuit opinions will stand, and nothing will be settled. Also, there is another wild card to consider: the NLRB consists of five individuals who are political appointees, and a change in administration in January could mean a change in control of the Board. In this regard, the numerous NLRB decisions based on the *D.R. Horton* theory have included strong dissents by Board members in the minority. Much of the Seventh Circuit's opinion depended heavily on its "deferral" to the Board's interpretation of the NLRA, but what if the Board, and that interpretation, changes? Fasten your seatbelts for a bumpy ride (with apologies to Bette Davis).

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4 See, e.g., *On Assignment Staffing Services, Inc.*, 362 NLRB No. 189 (2015).

5 *Moses H. Cone Memorial Hospital v. Mercury Constr. Corp.*, 460 U.S. 1, 22-23 (1983).