Supreme Court Decision On Arbitration Clauses Could Significantly Reduce Employer Exposure to Class Claims

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Savvy employers always need to be on the look-out for ways to mitigate the ever-growing risks posed by increasingly burdensome state and federal employment laws. Later this year, the U.S. Supreme Court will have the chance to breathe new life into an old, but effective risk-mitigation tool for employers – the mandatory individual arbitration clause.

Individual Arbitration Clauses, The FAA and The NLRA

Businesses often agree with their vendors and customers to refer claims to individual arbitration, waiving their right to class litigation and class arbitration. Such mandatory individual arbitration clauses are a popular way for businesses to limit risk and the Supreme Court has approved of their use on several occasions. The Court has yet to consider these clauses in the employment context however, where federal policy and precedent have been in tension in recent years.

The tension rests in conflicting understandings of the relationship between the Federal Arbitration Act (FAA) and the National Labor Relations Act (NLRA). The FAA requires courts to enforce agreements to arbitrate disputes. Exceptions to enforcement exist where (1) a contrary congressional command overrides the FAA or (2) the agreement is void for illegality. On the other hand, the NLRA protects the rights of employees to self-organize, bargain collectively, and engage in other "concerted activities" for the employees' mutual aid and protection. It is an unfair labor practice for any employer to interfere with these rights.

The Conflict Between the National Labor Relations Board and some Federal Courts

In many instances, the FAA and NLRA coexist without issue. The harmony ends, however, when an agreement to arbitrate waives an employee's right to bring class claims against the employer, but the employee attempts to do so anyway. If the NLRA protects the employee's right to engage in collective action, how can this protection be reconciled with an agreement requiring the employee to arbitrate claims individually?

For the National Labor Relations Board (the Board)—the agency that enforces the NLRA—no reconciliation is possible. Since 2012, the Board has taken the position that arbitration clauses purporting to prevent employees from pursuing their work-related claims on a collective or class basis are illegal. Accordingly, these provisions are not just exempt from enforcement under the FAA, but even asking an employee to accept them is an unfair labor practice under the NLRA. In response to the Board's stance, many employers updated their forms to drop mandatory individual arbitration provisions.

When the Board's position was challenged in the federal courts, results diverged. Some courts agreed with the Board's position. Other courts reached a contrary conclusion. These courts held that the NLRA did not provide a right to class adjudication of claims and contained no congressional command overriding the FAA. The class mechanism, they reasoned, was a procedural tool, not a substantive right. Accordingly, these courts ruled that the class waivers in mandatory individual arbitration provisions did not violate the NLRA and must be enforced under the FAA. The federal court of appeals responsible for Massachusetts and Rhode Island has yet to take a side in this dispute.

In light of the judicial divide over whether the Board has interpreted the NLRA/FAA correctly, the Board has

chosen to enforce its interpretation of the two laws against employers nationwide, including in jurisdictions where the courts have rejected the Board's position. The practical effect of the Board's policy, therefore, is to limit employers using mandatory individual arbitration clauses to two categories. First, employers who operate in a jurisdiction where the Board's position has been rejected and who have the inclination and resources to litigate with the Board over the clauses. Second, employers who are unknowingly using old forms that contain the once popular (but now arguably illegal) clauses.

The Supreme Court Steps In and the Board Responds

Amidst this conflict among the Board and the lower federal courts, the U.S. Supreme Court has agreed to resolve the dispute over the proper application of the NLRA and FAA. Granting review in three cases earlier this year, the Court will decide whether class waivers in employer/employee arbitration agreements are illegal under the NLRA or enforceable under the FAA (with or without an opt-in/opt-out provision).

In response to the Court's grant of review, the Board's General Counsel issued Operations Management Memo 17-11. Therein, the Board instructed its regional offices to propose the informal settlement of disputes involving mandatory individual arbitration clauses, conditioned on the Board's position prevailing before the Court. If the parties refuse to settle, the regional office is to prosecute charges against employers where appropriate. Put another way, the Board intends to continue to enforce its reading of the NLRA and FAA against employers until the Supreme Court instructs otherwise.

Ramifications of a Potential Supreme Court Decision

Separate and apart from the Board, the implications of the Court's review are significant. A decision upholding the class waivers in mandatory individual arbitration clauses would provide a green light for employers to limit their exposure from alleged violations of employment laws. One of the greatest risks of violating an employment law rests with the fact that an infraction is often not isolated to one employee, but rather may affect many employees. Plaintiffs' lawyers search for such conditions because bringing class claims against employers (whether meritorious or not) is far more likely to result in a big payday for plaintiffs' lawyers than prosecuting an individual employee's claim. This is because the higher litigation costs and potential damages associated with class proceedings place significant pressure on employer-defendants to settle. A decision upholding class waivers in mandatory individual arbitration clauses would give employers an important tool to mitigate against class claims and make themselves a less attractive target to plaintiffs' lawyers. At the same time, such a decision would preserve the principal advantages of individual arbitration: informality, less process, and less cost than class litigation or class arbitration.

A decision against the class waivers, of course, would have the opposite effect. Employers who had contracted to avoid class actions and class arbitration would suddenly be vulnerable to these collective proceedings and all the expense, exposure, and pressure to settle that go with them. Additionally, those same employers—whether because they consciously sought to include mandatory individual arbitration clauses in their employment contracts or just forgot to update their forms—would be subject to greater risk of class claims about their very use of the clauses. After all, in the event the Court agrees with the Board and holds mandatory individual arbitration clauses illegal under the NLRA and unenforceable under the FAA, employers who use the provisions will become an easy and obvious target for plaintiffs' lawyers, given the increased attention the clauses will likely receive as the Court's decision approaches. The stakes of a decision either way, therefore, are quite high.

The Supreme Court is likely to hear oral arguments this fall, with a decision before the end of the year or early next year. Stay tuned.

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