May 31, 2018

ADR Case Update 2018 - 11

U.S. Supreme Court

- **FAA TRUMPS CONCERTED ACTION, REQUIRES THAT ARBITRATION AGREEMENTS PROVIDING FOR INDIVIDUALIZED PROCEEDINGS BE ENFORCED**

  Epic Systems Corporation v Lewis et al., v. Morris et al., v. Murphy Oil USA
  2018 WL 2292444
  Supreme Court of the United States
  May 21, 2018

  Epic, a Wisconsin-based healthcare software company, had an arbitration agreement that required employees to resolve disputes through individual arbitration and to waive their rights to collective action. In 2015, employee Lewis sued Epic in federal court, individually and on behalf of similarly-situated employees, asserting that they had been denied overtime wages in violation of FLSA. Epic moved to dismiss, citing the waiver clause of the arbitration agreement. The court denied the motion, holding that it violated the right of employees to engage in concerted activities under §7 of the NLRA. The U.S. Court of Appeals for the Seventh Circuit affirmed and added that the waiver was also unenforceable under the savings clause of the FAA, which provides that arbitration agreements are to be enforced unless there are legal or equitable grounds that would render a contract unenforceable. The *Lewis* case was consolidated with *Ernst & Young v. Morris* and *NLRB v. Murphy Oil USA, Inc.*, both involving contracts that provided for individualized arbitration proceedings to resolve employment disputes. All cases raised the issue of whether a class action waiver in employment contracts was enforceable, given the potentially conflicting mandates of the FAA and the NLRA. *Certiorari* was granted.

  In a 5-4 majority opinion authored by Justice Neil Gorsuch, the Supreme Court of the United States held that there was no conflict between the FAA and the NLRA and that both were consistent with enforcing the class arbitration waiver. Although the FAA (1925) and the NLRA (1935) had long coexisted, the suggestion that they might conflict was new. Until recently, courts generally agreed that arbitration agreements like these should be enforced according to their terms. But in 2012, the NLRB asserted that the NLRA effectively nullified the FAA in cases such as these. This disagreement grew and the Court granted cert to clear the confusion, finding:

  1. **The FAA's savings clause did not provide a basis for refusing to enforce arbitration agreements waiving collective action procedures for claims under the FLSA and class**

action procedures for claims under state law. The FAA savings clause allows courts to refuse to enforce arbitration agreements "upon such grounds as exist at law or in equity for the revocation of any contract." The clause recognizes only defenses that apply to any contract, as a way to establish an equal treatment rule for arbitration contracts. The savings clause does not save defenses that target arbitration by name or more subtle methods, such as by "interfering with fundamental attributes of arbitration." In these cases, the employees objected to the agreements precisely because they required individualized arbitration proceedings instead of collective ones. In *Concepcion*, the Court rejected the argument that class action waivers were unconscionable in consumer contracts, finding that permitting classwide proceedings despite the traditionally individualized and informal nature of arbitration would sacrifice a principle advantage of arbitration – its informality. By attacking the individualized nature of the arbitration proceedings, the *Lewis* employees sought to interfere with arbitration's fundamental attributes. The employees' efforts to distinguish *Concepcion* fell short, "requiring" the Court to enforce, not override, the terms of the arbitration agreements.

2. **The provision of the NLRA that guarantees workers the right to engage in concerted activities for the purposes of collective bargaining or other mutual aid or protection, did not reflect a clearly expressed and manifest congressional intention to displace the FAA and to outlaw class and collective action waivers.** Section 7 of the NLRA guarantees workers "the right to self-organize, to form, join, or assist labor organizations, to bargain collectively through representatives of their own choosing, and to engage in other concerted activities for the purpose of collective bargaining or other mutual aid or protection." The Court rejected employees' argument to infer from this language a clear congressional command to displace the FAA and outlaw agreements barring collective action. Section 7 does not: express approval or disapproval of arbitration; mention class action (those procedures were hardly known when the NLRA was adopted in 1935); or hint at a wish to displace the FAA. The NLRA's catchall phrase "other concerted activities for the purpose of…other mutual aid or protection" does not encompass collective action. The language appears at the end of a detailed list of activities and should be construed as encompassing similar activities: things that employees do for themselves in the course of exercising their right to free association in the workplace. The structure of the NLRA pointed to the same conclusion, providing no information about what rules would govern class or collective action in court or in arbitration, but providing detailed regulatory regimes for concerted activities such as labor organization practices. And although Congress had demonstrated that it knows how to specify dispute resolution procedures or override the Arbitration Act, it had not done so with class waivers. Precedent supported this interpretation. Over the years, the Court heard and rejected efforts to conjure conflicts between the FAA and other federal statutes in all but one case (a temporary exception that has since been overruled). The Court stressed that the "absence of any specific statutory discussion of arbitration or class actions is an important and telling clue that Congress has not displaced the Arbitration Act."

3. **Supreme Court would not accord Chevron deference to NLRB's interpretation of federal statutes as outlawing class and collective action waivers by employees**. The employees argued that the Court must rule for them because of the deference the Court owed to an administrative agency's interpretation of the law. The *Chevron* Court justified deference on the premise that a statutory ambiguity represented an "'implicit' delegation to an agency to interpret a "'statute which it administers.'" Here, the Board wasn't just seeking to interpret the NLRA; it was seeking to interpret the statute in a manner that would limit the work of a second statute – the FAA. "And on no account might we agree that *Chevron* implicitly delegated to an agency authority to address the meaning of a second statute it does not administer." Another justification offered by the *Chevron* court for deference was that policy choices should be left to Executive Branch officials directly accountable to the people. The policy choices here were unclear, with competing briefs from the Board and from the Solicitor General.

Gorsuch concluded that the law was clear: Congress has instructed that arbitration agreements such as these should be enforced as written.

Justice Thomas concurred, saying that the employees also could not prevail under the plain meaning of the FAA. The FAA declares arbitration agreements valid and enforceable "save as upon such grounds as exist to revoke any contract." Grounds for revocation of a contract are those that concern the formation of an arbitration agreement. The *Lewis* employees argued that class waivers are unenforceable because the NLRB made them illegal. But illegality is a public policy defense – and did not concern whether the contract was properly made.

Justice Ginsberg dissented, arguing that the point of the NLRA was to reduce the power imbalance between employees and employers. She interpreted the catch-all provision broadly, saying "Suits to enforce workplace rights collectively fit comfortably under the umbrella 'concerted activities for the purpose of . . . mutual aid or protection." Ginsburg said the Federal Arbitration Act should not trump the NLRA's demands. The FAA was enacted to help merchants of roughly equal bargaining power to be able to resolve their disputes efficiently. Nothing in the FAA suggested that it should apply to arbitration provisions in employment contracts.

Federal Circuit Courts

- **NON-SIGNATORIES MAY COMPEL ARBITRATION**

  Green Tree Servicing, LLC v. Henry House et al.
  2018 WL 2204161
  United States Court of Appeals, Fifth Circuit
  May 14, 2018

  Henry House purchased a home from Jim Walters and Mid-State Trust. The sales contract included an Arbitration Agreement, providing for binding arbitration in accordance with JAMS Rules. Jim Walters assigned the contract to other entities, including Green Tree and Walter Investment Management Corp (WIMC). House and others (House parties) sued Walter Homes and some of the Green Tree parties in state court (the *Brown* case), alleging that they delivered a substandard dwelling through conspiracy, breach of contract, negligence, false statements/fraud, and deceit. Green Tree filed suit to compel arbitration of the claims against the Green Tree parties. The court granted the motion to compel, remanded the *Brown* case to state court, and stayed the *Brown c*ase pending arbitration. The House parties appealed.

  The United States Court of Appeals for the Fifth Circuit affirmed. As a threshold matter, the Court found that the court's order was final and appealable; language in the order that "any party may move to re-open this case," stated the law and did not vitiate the finality of the order; the remand and stay of *Brown* pending arbitration was to protect the federal court's judgment compelling arbitration and did not render it non-appealable; and though the parties appealed before *Brown* was remanded, the premature notice of appeal was effective because the order would have been appealable. The House parties contended that Green Tree and WIMC couldn't enforce the arbitration agreement because they were not signatories and because they didn't exist when the sales agreement was signed. In Mississippi, a non-signatory to an arbitration agreement may compel arbitration when it demonstrates intertwined claims through allegations of interdependent and concerted misconduct between a non-signatory and signatory with a close legal relationship. Both Green Tree and WIMC had close relationships with signatories to the agreement. The claim alleged that Green Tree and WIMC were co-conspirators in misconduct, giving them standing to enforce the agreement. That Green Tree and WIMC did not exist at the time the agreement was signed was irrelevant: the intertwined claims test does not require that a non-signatory exist when an agreement is signed. The House parties argued that they were not sophisticated enough to assent to delegation of arbitrability when they agreed to be bound by JAMS rules and that the court erroneously applied 2014 JAMS Rules rather than the Rules at the time of signing. Both arguments were raised for the first time on appeal and thus forfeited. The House parties' arguments that the Green Tree parties obtained the arbitration agreement by fraud were not specific to the arbitration agreement, falling short of the specificity requirements necessary when challenging an arbitration agreement.

- **PARTIES DELEGATED GATEWAY QUESTIONS TO ARBITRATOR**

  Arnold v. Homeaway, Inc. and Seim v. Homeaway, Inc.
  2018 WL 2222661
  United States Court of Appeals, Fifth Circuit
  May 15, 2018

  Both Arnold and Seim listed properties on Homeaway's short-term vacation rental site. Both filed claims against Homeaway, alleging that Homeaway's imposition of service fees on travelers was

contrary to prior representations and violated state law. In both cases, Homeaway moved to compel arbitration pursuant to the same arbitration clause in its Terms and Conditions with the parties (relying on the April 2016 Terms and Conditions for Arnold and the February 2016 Terms and Conditions for Seim.) The clause encompassed all claims (except small claims), including those predating the agreement, and provided for arbitration by AAA under AAA consumer rules. In Arnold's case, the court denied the motion to compel, finding that the April 2016 arbitration clause was illusory because Homeaway reserved the right to avoid arbitration at any point without notice. In Seim's case, the court granted the motion to compel, finding that the February 2016 arbitration clause encompassed any claims predating the February 2016 agreement. The court did not address the delegation clause in either case. In Arnold's case, Homeaway appealed the denial of the motion to compel. Seim appealed the granting of the motion to compel.

The United States Court of Appeals for the Fifth Circuit reversed the judgment in Arnold and affirmed the judgment in Seim. The Court found that Arnold was bound to arbitrate threshold questions relating to the arbitration provision. Arnold did not dispute the existence of a contract with Homeaway. Arnold raised a challenge to the validity of the arbitration agreement itself, arguing that the provision was illusory. Under the FAA, parties are free to delegate questions of validity of arbitration provisions to the arbitrator. The parties' stipulation that AAA rules would govern constituted clear and unmistakable evidence that these parties intended to delegate threshold questions to the arbitrator. Given that Arnold focused his illusory argument on the arbitration provision as a whole, rather than the delegation provision, the question had to go to the arbitrator, per *Rent-A-Center.* In Seim's case, the Court examined the same arbitration clause (though in the February 2016 Terms and Conditions), finding it contained clear and unmistakable evidence of the parties' intent to delegate gateway questions like scope to the arbitrator. The Court determined that the court was correct to order arbitration but should not have addressed threshold questions itself – and remanded for the parties to revisit these issues in arbitration.

- **ARBITRATION OF CONTEMPT PROCEEDINGS WOULD UNDERMINE BANKRUPTCY COURT'S AUTHORITY**

  In Re: Christopher Bateman
  2018 WL 2324207
  United States Bankruptcy Court, M.D. Florida, TAMPA DIVISION
  May 22, 2018

  Bateman purchased a cell phone from Verizon in 2011, entering into a service agreement which gave Verizon the power to unilaterally change the agreement at any time. Verizon did change the arbitration clause, which provided for all disputes, other than small claims, to be resolved through arbitration. In 2014, Bateman filed a Chapter 7 bankruptcy petition. The court granted the petition and issued a Discharge Order for Bateman's debts, including that owed to Verizon. Following the Order, Verizon's collection agent attempted to collect from Bateman. Bateman alleged that Verizon violated the Order and Verizon moved to compel arbitration.

  The United States Bankruptcy Court, M.D. Florida, Tampa Division denied the motion to compel. The Court found that while the arbitration agreement between Bateman and Verizon survived the bankruptcy, the motion for contempt did not fall within the scope of the agreement. The scope was broad, requiring arbitration of any dispute that in any way related to or arose out of this agreement; however, there was no nexus between the Motion and the Customer Agreement. Bateman did not argue that the debt collection attempt by Verizon violated the Customer Agreement; he sought an order holding that Verizon was in contempt for violating the Discharge Order. Enforcement of an arbitration provision under the FAA may be overridden by a contrary congressional command, as was the case here. Arbitration of the contempt proceedings for violating the discharge injunction would have conflicted with the Bankruptcy Code and undermined the Bankruptcy Court's authority to enforce its orders and exercise its powers of contempt.

California

- **ARBITRATOR CANNOT BIND NON-SIGNATORY**

  Benaroya v. Willis
  2018 WL 2252631
  Court of Appeal, Second District, Division 4, California
  May 17, 2018

  Benaroya Pictures entered an escrow agreement with Westside's President, actor Bruce Willis, agreeing to hold $8 million in trust for Willis' services in a movie. The agreement contained an arbitration agreement, providing that any dispute between parties shall be resolved through arbitration pursuant to JAMS rules. Willis filed a demand for arbitration, alleging that Benaroya Pictures breached the agreement by failing to pay him. Willis then moved to amend the arbitration demand to include Michael Benaroya as an additional party. Michael Benaroya opposed, saying that the question of binding a non-signatory to the agreement was for the court. The arbitrator granted the motion to amend and later issued an award in favor of Willis, finding that Michael Benaroya was the alter ego of Benaroya Pictures and that both were liable for $5 million in damages. The court granted the motion to confirm the award and Michael Benaroya appealed.

  The Court of Appeal, Second District, Division 4, California reversed and remanded. The JAMS Rules referenced in the arbitration agreement permitted an arbitrator to determine whom among signatories were the proper parties to the dispute – but not whether a non-signatory could be compelled to arbitrate. California law is clear that "an arbitrator has no power to determine the rights and obligations of one who is not a party to the arbitration agreement. The question of whether a non-signatory is a party to an arbitration agreement is one for the trial court in the first instance." Willis contended that even if the alter ego issue should have been decided by the court and not the arbitrator, any error was harmless since there was overwhelming evidence of the alter ego status. The arbitrator, however, called it a close call and the impact of the award was not harmless in binding a non-signatory through a process by which he did not agree. The case was remanded to vacate the award and enter a new order to grant the award only as to Benaroya Pictures.

Washington State

- **DISABILITY DISCRIMINATION CLAIM PRECLUDED BY ARBITRATION FINDINGS**

  Scholz v. Washington State Patrol
  2018 WL 2248506
  Court of Appeal of Washington, Division 3
  May 17, 2018

  The Washington State Patrol (Patrol) terminated Officer Scholz's employment due to untruthfulness and violation of Patrol rules following a highway accident in 2012. Scholz's Union grieved the termination, which was denied. The Union and the Patrol proceeded to arbitration, per the collective bargaining agreement. The arbitrator found that the Patrol had just cause to terminate Scholz's employment, noting that Scholz had been untruthful and that his evidence of acute anxiety disorder did not excuse his untruthfulness. Scholz later filed a disability discrimination claim. The court dismissed the claim, finding it precluded by the arbitrator finding of just cause and, thus, barred by collateral estoppel. Scholz moved for reconsideration, asserting that the issues presented in the arbitration and litigation were different. The court denied the motion and Scholz appealed.

  The Court of Appeal of Washington, Division 3 affirmed. For collateral estoppel, or issue preclusion, what matters is "whether facts established in the first proceeding foreclose the second claim." That is what happened here. To prove a disability discrimination claim, Scholz had to

show that he was 1) disabled; 2) subject to an adverse employment action; 3) doing satisfactory work; and 4) discharged under circumstances that raised a reasonable inference of unlawful discrimination. The arbitrator's finding that Scholz "'knowingly and intentionally lied to his superiors (in the wake of the accident)…to minimize his role in causing an unsafe condition" on the highway proved fatal to Scholz's ability to demonstrate #3. Scholz failed to offer evidence to support #4 – that his mental health disorder gave rise to a reasonable inference of unlawful discrimination. Facts determined in the arbitration made it impossible for Scholz to establish elements of a disability discrimination claim.

-

Case research and summaries by Richard Birke, Executive Director, JAMS Institute.

Contact:
David Brandon
Program Manager
JAMS Institute
Telephone: 415-774-2648
Email: dbrandon@jamsadr.com