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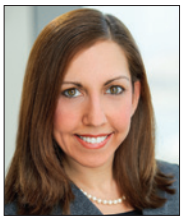
LABOR RELATIONS

Expert Analysis

Supreme Court Review: An Arbitration Trilogy



By **David E. Schwartz**

And **Risa M. Salins**

With a trio of decisions this term, the Supreme Court added to its growing body of arbitration jurisprudence. On the heels of its landmark decision last term in *Epic Systems Corp v. Lewis*, 138 S. Ct. 1612 (2018), upholding class action waivers in employment arbitration agreements, the court now decided whether the Federal Arbitration Act (FAA) authorizes class arbitration based on an arbitration agreement that does not clearly provide for such proceedings; whether the court or an arbitrator decides if a dispute is covered by an arbitration clause; and whether independent contractors in the transportation industry may be bound by arbitration agreements in light of the FAA's exclusion for "contracts of employment" of certain transportation workers. This month's column discusses these three key rulings and the impact each is likely to have on the arbitration of employment-related claims.

Class Arbitration

In *Lamps Plus v. Varela,* 139 S. Ct. 1407 (2019), the Supreme Court ruled 5-4 that courts may not compel class-wide arbitration where an arbitration agreement is ambiguous as to whether the parties agreed to arbitrate on a class basis. With this decision, the court reaffirmed and extended its 2010 holding in *Stolt-Nielsen S.A. v. AnimalFeeds Int'l*, 559 U.S. 662 (2010), that parties may not be compelled to submit to class arbitration under the FAA where the arbitration agreement is silent on the issue of class arbitration.

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The dispute in *Lamps Plus* arose when an individual filed a class action lawsuit in court against his former employer after the tax information of approximately 1,300 of the company's employees, including his, was compromised. However, the employees had entered into arbitration agreements as a condition of their employment. The company moved to compel arbitration, based on the individual's arbitration agreement, and dismiss the class allegations. The district court granted the company's motion to compel arbitration but held the case was arbitrable on a class basis. The U.S. Court of Appeals for the Ninth Circuit affirmed, distinguishing *Stolt-Nielsen* because there was no stipulation that the arbitration agreement was silent about class arbitration. Instead, the Ninth Circuit found the agreement was ambiguous with respect to class arbitration and, applying California contract principles, construed the ambiguity against the former employer as the drafter of the agreement.

The Supreme Court reversed, in a majority opinion authored by Chief John Justice Roberts. The court, citing the "fundamental difference between class arbitration and the individualized form of arbitration envisioned by the FAA" (e.g., the former lacking the speed, efficiency and lower costs of the latter), reasoned it is incumbent on courts to ensure the parties clearly consented to

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class proceedings. Overruling the Ninth Circuit, the court explained California's rule interpreting ambiguous contracts against the drafter should only apply as a last resort, and the state law principle must yield to "the foundational FAA principle that arbitration is a matter of consent."

A forceful dissenting opinion written by Justice Ruth Bader Ginsburg, and joined by Justices Stephen Breyer and Sonia Sotomayor, contends "'Congressional correction of the Court's elevation of the FAA over' the rights of employees and consumers 'to act in concert' remains 'urgently in order.'"

Lamps Plus gives employers comfort that class arbitration will not be permitted unless an arbitration agreement expressly provides for it. However, best practice to avoid class arbitration, particularly in light of *Epic Systems*, is to include an express class and collective action waiver. In addition, given Justice Ginsburg's invitation for potential future legislation that would make class arbitration more widely available, employers are advised to continue reviewing their arbitration agreements periodically.

Arbitrability Determinations

In *Henry Schein v. Archer & White Sales*, 139 S. Ct. 524 (2019), the Supreme Court unanimously held that a court may not override a contractual agreement that delegates arbitrability questions to an arbitrator, even if the court finds a claim of arbitrability for a particular dispute is "wholly groundless."

The parties in *Schein* entered into a distribution contract that provided for arbitration of any dispute arising under or related to the contract, except for, among other things, actions seeking injunctive relief. One party to the contract, a dental products distributor, brought an antitrust action against defendants who manufactured dental equipment. Defendants moved to compel arbitration based on the distribution contract. The distributor objected to arbitration because it partially sought injunctive relief which, it argued triggered the carveout from arbitration. Defendants argued the distribution contract delegated questions of arbitrability to the arbitrator because the contract expressly incorporated the arbitration rules of the American Arbitration Association (AAA), which provide that only arbitrators have the authority to resolve threshold questions of arbitrability.

The Supreme Court's decision in 'New Prime v. Oliveira' is significant for any employer engaged in interstate or foreign commerce that relies on independent contractors.

Relying on precedent of the U.S. Court of Appeals for the Fifth Circuit, the district court recognized a "wholly groundless" exception and denied the defendants' motion to compel arbitration. Under the "wholly groundless" exception, which also had been recognized by the Fourth, Sixth and Federal Circuits, where a party's claim of arbitrability is frivolous or "wholly groundless," a court, rather than an arbitrator, may resolve the threshold question of arbitrability regardless of whether the parties agreed to have arbitrability questions decided by an arbitrator. The Fifth Circuit affirmed.

The Supreme Court reversed, concluding the "wholly groundless" exception is inconsistent with the FAA and the court's precedent. The court explained it must interpret the FAA as written, and the FAA provides courts must enforce arbitration agreements according to their terms, including agreements that an arbitrator, rather than a court, will resolve the threshold issue of arbitrability. It further stated that it has consistently held parties may delegate threshold arbitrability questions to the arbitrator, so long as the parties' agreement does so by "clear and unmistakable" evidence. The court remanded the case to the Fifth Circuit to address whether the contract at issue—which incorporated AAA rules—contained such clear and unmistakable evidence to delegate the arbitrability question to an arbitrator.

Following *Schein*, it remains uncertain whether a contract's incorporation of arbitration association rules, such as AAA rules, that grant arbitrators the power to resolve threshold arbitrability questions provides sufficient evidence to delegate arbitrability questions to the arbitrator. Therefore, employers are advised to specify in arbitration agreements who has authority to determine whether a dispute is arbitrable instead of relying on references to arbitration rules.

Independent Contractors

The Supreme Court's decision in *New Prime v. Oliveira*, 139 S. Ct. 532 (2019), is significant for any employer engaged in interstate or foreign commerce that relies on independent contractors. The dispute in *New Prime* involved an

exception contained in §1 of the FAA. This exception provides that nothing in the FAA shall compel arbitration in disputes involving "contracts of employment" of certain "workers engaged in foreign or interstate commerce."

In this case, a former truck driver, who provided services to a trucking company under an operating agreement that described him as an independent contractor, brought a class action lawsuit in federal court alleging he was denied lawful wages under the Fair Labor Standards Act and state minimum wage laws, among other claims. The trucking company moved to compel arbitration based on the arbitration provision in the operating agreement. The company maintained the driver was an independent contractor, and so was not exempt under §1 of the FAA. Two issues were raised in this case: (1) whether a court or an arbitrator must determine whether the arbitration agreement was governed by the FAA where a contract provides questions of arbitrability are to be decided by an arbitrator; and (2) whether the term "contracts of employment" in §1's exception also reaches contracts with independent contractors.

The U.S. Court of Appeals for the First Circuit affirmed the district court's order denying the trucking company's motion to compel arbitration. At the outset, the First Circuit held a court and not an arbitrator should decide whether the FAA applies to the parties' contract. Then it found the exception under §1 of the FAA for "contracts of employment" of certain transportation workers includes contracts with independent contractors.

In an 8-0 decision in which Justice Brett Kavanaugh took no part, the court affirmed the First Circuit's holdings on both issues. On the first issue, the court explained, "The parties' private agreement may be crystal clear and require arbitration of every question under the sun, but that does not necessarily mean the [FAA] authorizes a court to stay litigation and send the parties to an arbitration forum." Thus, the court held that before immediately referring all cases with arbitration clauses to an arbitrator (under §§3 and 4 of the FAA), lower courts must first determine whether a contract is covered by or exempted from §1 or §2 of the FAA.

On the second issue, the court reasoned that when Congress adopted the FAA in 1925, the ordinary meaning of a "contract of employment" was nothing more than an agreement to perform work. Neither legal dictionaries nor the court's precedent from this time period defined the term or used it in a way that would exclude independent contractors, suggesting it was not a term of art with any specialized meaning. Therefore, the court concluded the term "contracts of employment" in §1 is broad enough to encompass independent contractor relationships. Accordingly, it affirmed the First Circuit's determination that the lower court lacked authority to order arbitration of the truck driver's claims.

State Legislation

Recent New York state legislation in reaction to the #MeToo movement, effective July 2018, specifically prohibits agreements requiring arbitration to resolve claims of sexual harassment. See N.Y. C.P.L.R. §7515(a)(2). Notably, however, on June 26, 2019, one federal district court has found such legislation is preempted by the FAA, citing several recent Supreme Court cases such as *Epic Systems* and *Lamps Plus*. See *Latif v. Morgan Stanley & Co., LLC et al.*, Case No. 1:18-cv-11528 (S.D.N.Y. June 26, 2019). This is just one district court decision which is not binding on other district court judges, but certainly a notable development.

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Employers are advised to review and update their arbitration agreements in light of these recent decisions and also stay abreast of federal and state legislation in this area.