Mass Action

As class action waivers proliferate, claims involving thousands of victims could morph into costly mass arbitration actions – and push defendants to settle. *Hose v. WIS* is the test case.

By Joshua Konecky and Leslie Joyner

The right to a jury trial is a quintessential component of our justice system, or so it would seem. The Seventh Amendment to the U.S. Constitution provides: "In Suits at common law, where the value in controversy shall exceed twenty dollars, the right of trial by jury shall be preserved...." (U.S.C.A. Const. Amend. VII.) The California Constitution and California statues also afford the right to a jury trial in various civil actions. (*Shaw v. Superior Court* (2017) 2 Cal.5th 983, 993.)

Although not as longstanding as the jury trial, another core component of our judicial system is the class action procedure. "Courts long have acknowledged the importance of class actions as a means to prevent a failure of justice in our judicial system." (*Linder v. Thrifty Oil Co.* (2000) 23 Cal.4th 429, 434.) Indeed, one of California's most historic justices previously made this observation about the importance of class actions: "A company which wrongfully exacts a dollar from each of millions of customers will reap a handsome profit; the class action is often the only effective way to halt and redress such exploitation." (*Linder v. Thrifty Oil Co.*, *supra*, 23 Cal.4th p. 446 [quoting Justice Tobriner's concurring opinion in *Blue Chip Stamps v. Superior Court* (1976) 18 Cal.3d 381, 387].) Our State's Supreme Court also has recognized that class actions may provide the only realistic or practical way to safeguard employment rights for lower-waged workers. (See *Gentry v. Superior Ct.* (2007) 42 Cal.4th 443, 459.)

Appreciation for the importance of class actions in the fair and efficient administration of justice also comes from our nation's highest court:

> The policy at the very core of the class action mechanism is to overcome the problem that small recoveries do not provide the incentive for any individual to bring a solo action prosecuting his or her rights. A class action solves this problem by aggregating the relatively paltry potential recoveries into something worth someone's (usually an attorney's) labor.

(*Amchem Products, Inc. v. Windsor* (1997) 521 U.S. 591, 617, 117 S.Ct. 2231, 2246 [citation omitted].)[1]

But other than this purported service to justice and efficiency, what else do jury trials in civil cases and class actions have in common? Answer: They can both be "waived" by signing mandatory arbitration agreements in employment and consumer contracts of adhesion. And, the waiver is valid even if signing the contract is a mandatory condition for the job or consumer transaction.

Since the turn of the century, there have been an ever-increasing number of decisions that favor the enforcement of contracts requiring people to arbitrate their disputes individually (outside the judicial system), over providing access to jury trials and class action proceedings for similarly-situated individuals. On October 2, 2017, the United States Supreme Court held oral argument on the most recent case on its docket that pits the enforcement of mandatory arbitration contracts against the possibility of collective litigation in court. (See *Epic Systems Corp. v. Lewis* (U.S. Jan. 13, 2017) Dkt 16-285, 2017 WL 125664.)[2] A 5-4 decision in favor of forced individual arbitration would not be an unreasonable prediction.

So what happens if the Supreme Court continues to uphold contracts of adhesion that require individuals to arbitrate their disputes on an individual basis before private arbitrators, rather than in class or collective actions before juries? One possibility is that each potential jury trial or class action will multiply and be replaced by hundreds and thousands of individual arbitrations. Indeed, with ever more ubiquitous social media platforms and sophisticated Internet communications, the word of potential legal actions (or arbitrations) to vindicate legal rights can now flow ever more freely between consumers, employees and legal counsel – both prospective and retained. Without the class action device to consolidate and simplify proceedings, litigants and their attorneys may now attempt to bring multiple individual arbitrations in various locations at once, potentially with little or no court supervision at all.

Conversely, the underlying fee-shifting statutes that still apply to arbitration proceedings under the contract law of unconscionability mean that the claimants' attorneys may still be able to recover their reasonable fees and costs in each arbitration proceeding. In addition, employers and other corporations who require their employees and consumers to sign individual arbitration agreements and class action waivers, may find themselves needing to pay tens of millions of dollars in arbitral fees and costs (in addition to attorneys' fees and costs) to resolve what used to be brought as a single class action in court. (See, e.g., *Armendariz v. Foundation Health Psychcare Services, Inc.* (2000) 24 Cal.4th 83, 113 [mandatory employment arbitration agreement impliedly obliges the employer to pay all types of costs that are unique to arbitration].)

It remains to be seen whether and how this "new normal" will play out. One possible test case – actually, 13,803 possible test arbitrations – is discussed below. First, we provide a brief overview of the legal landscape pertaining to mandatory arbitration agreements and class action waivers.

The legal landscape for forced arbitration and class action waivers

First enacted February 12, 1925, and codified July 30, 1947, the Federal Arbitration Act (FAA) provides in pertinent part:

> A written provision in any maritime transaction or contract evidencing a transaction involving commerce to settle by arbitration a controversy thereafter arising out of such contract or transaction ... shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract.

(9 U.S.C. § 2.)

Fast forward nearly 100 years, the practice of including arbitration agreements in contracts of adhesion, whether in the employment or consumer contacts, has gained considerable traction. As the courts began to uphold arbitration clauses in adhesion contracts ("save upon such grounds as exist at law or in equity for the revocation of any contract"), employers and other companies began to up the ante: Now, the typical contract not only has an arbitration clause, but also an arbitration clause that includes a "class action waiver." While there are variations on the theme, a class action waiver is generally a provision in the contract that requires any claims to be brought only in an individual capacity, and not as a plaintiff or class member in a class or representative proceeding. (See, e.g., *AT&T Mobility, LLC, v. Concepcion* (2011) 563 U.S. 333, 336, 131 S.Ct. 1740, 1745.) In today's day and age, it seems difficult to find a contract that does not require consumers and employees alike to "agree" to waive their rights to both a

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jury trial and to participate in a class or collective action.

In the now abrogated decision of *Discover Bank v. Superior Court* (2005) 36 Cal.4th 138, the California Supreme Court had held that class action waivers in consumer contracts of adhesion were unconscionable, at least for disputes that "predictably involve small amounts of damages, and when it is alleged that the party with the superior bargaining power has carried out a scheme to deliberately cheat large numbers of consumers out of individually small sums of money." (*Id.* at pp. 162-163.) The *Discover Bank* court had held that the Federal Arbitration Act does not preempt this rule. (*Id.* at p. 167.)

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Two years later, the California Supreme Court held that class arbitration waivers in employment contracts could not be enforced if the trial court determined, based on specified factors, that class arbitration would be a significantly more effective way of vindicating the rights of affected employees than individual arbitrations. (*Gentry v. Superior Ct.*, *supra*, 42 Cal.4th at 450.)

Then the Supreme Court of the United States spoke.

In *AT&T Mobility v. Concepcion, supra,* a 5-4 majority sharply critiqued and overruled the "*Discover Bank* rule" set forth by the California Supreme Court. Writing for this narrow majority, Justice Scalia wrote that the FAA pre-empted California's decisional law barring enforcement of a class-arbitration waiver. (563 U.S. at p. 352, 131 S.Ct. at p. 1753.) The majority found that California's law conditioning enforcement of arbitration on the availability of class procedures "interfere[d] with fundamental attributes of arbitration and thus create[d] a scheme inconsistant with the FAA." (*Id.* at p. 344, 131 S.Ct. at p. 1748.) The decision emphasized its preference for the informality of arbitration over the "procedural morass" of class litigation, and rejected the argument that class arbitration was necessary to prosecute claims "that might otherwise slip through the legal system." (*Id.* at pp. 348, 351, 131 S.Ct. at pp. 1751, 1753.)

Building on *AT&T Mobility*, another five-justice majority[3] of the Supreme Court later went on to hold, in the context of antitrust claims, that the FAA mandates enforcement of mandatory class action waivers, even where the costs of arbitrating the federal statutory right at issue would exceed the potential recovery. (*American Exp. Co. v. Italian Colors Restaurant* (2013) 570 U.S. 228, 231, 133 S.Ct. 2304, 2307.) Again writing for the majority, Justice Scalia found that the "antitrust laws do not guarantee an affordable procedural path to the vindication of every claim." (*Italian Colors*, *supra*, 570 U.S. at p. 233, 133 S.Ct. at p. 2309.) The majority went on to conclude that the FAA's command to enforce a contract "trumps any interest in ensuring the prosecution of low-value claims." (*Id.* at p. 238, n.5, 133 S.Ct. at p. 2312, n.5.) Making the enforceability of contracts paramount, the high court construed the FAA to favor the absence of litigation (even litigation that might otherwise be brought to vindicate a substantive right) over the invalidation of a contractual term calling for the waiver of a class action. (*Id.* [citing *AT&T Mobility, supra,* 563 U.S. at 344, 131 S.Ct. at p. 1748; *Volt Information Sciences, Inc. v. Board of Trustees of Leland Stanford Junior Univ.*, 489 U.S. 468, 487, 109 S.Ct. 1248].)

Still, the majority in *Italian Colors* did recognize the "effective vindication" exception to the mandate for enforcement of an arbitration clause. (*Italian Colors, supra*, 570 U.S. at p. 235, 133 S.Ct. at p. 2310.) Under the "effective vindication" rule, the arbitration of a statutory claim will be compelled so long as that claim can be effectively vindicated in the arbitral forum. (See *Mitsubishi Motors Corp. v. Soler Chrysler–Plymouth, Inc.* (1985) 473 U.S. 614, 637, 473 S.Ct. 3346, 3359 ["[S]o long as the prospective litigant effectively may vindicate [his or her] statutory cause of action in the arbitral forum, the statute will continue to serve both its remedial and deterrent function."]; *Green Tree Fin. Corp.–Ala. v. Randolph* (2000) 531 U.S. 79, 90, 121 S.Ct. 513, 521; see also *Gilmer v. Interstate/Johnson Lane Corp.* (1991) 500 U.S. 20, 28, 111 S.Ct. 1647, 1653.)

The *Italian Colors* majority opined that the "effective vindication" rule "would certainly cover a provision in an arbitration agreement forbidding the assertion of certain statutory rights. And it would perhaps cover filing and administrative fees attached to arbitration that are so high as to make access to the forum impracticable." (*Italian Colors*, *supra,* 570 U.S. at p. 236, 133 S.Ct. at p. 2310-2311 [citing *Green Tree Financial Corp.–Ala. v. Randolph* (2000) 531 U.S. 79, 90, 121 S.Ct. 513, 522 ("It may well be that the existence of large arbitration costs could preclude a litigant such as [plaintiff] from effectively vindicating her federal statutory rights in the arbitral forum.")].) According to the majority, however, "the fact that it is not worth the expense involved in *proving* a statutory remedy does not constitute the elimination of the *right to pursue* that remedy." (*Italian Colors*, *supra,* 570 U.S. at p. 236, 133 S.Ct. at p. 2310-2311 [citation omitted].) The majority further intimated that the exception rarely, if ever, applies. (*Italian Colors*, *supra*, 570 U.S. at pp. 235-236, 133 S.Ct. at pp. 2310-2311.)[4]

While the Supreme Court was addressing whether forced arbitration and class action waivers could deny the ability to enforce statutory rights, another debate concerning class action waivers was percolating up through the courts as well. This next question invokes another federal statute that has been on the books for nearly a hundred years as well: The National Labor Relations Act (NLRA), signed into law by President Franklin Roosevelt on July 5, 1935.

Section 7 of the NLRA gives employees "the right to self-organization, 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." (29 U.S.C. § 157.) In 2012, the National Labor Relations Board (NLRB) held that an employer unlawfully interferes with this right if it requires employees to sign an arbitration agreement waiving their right to pursue class and collective claims in all forums. (*D.R. Horton,*

Inc. (2012) 357 N.L.R.B. 184.) The Fifth Circuit, however, has twice rejected the NLRB's analysis of arbitration agreements. (See *D.R. Horton, Inc. v. NLRB* (5th Cir. 2013) 737 F.3d 344, 357, 360–62; and *Murphy Oil U.S.A., Inc. v. NLRB* (2015) 808 F.3d 1013, 1015.) Under the law of the Fifth Circuit, an employer does not commit unfair labor practices by requiring employees to sign its arbitration agreement or seeking to enforce that agreement in federal district court. (*Id.*)

The Second and Eighth Circuits have reached the same conclusion as the Fifth Circuit. (*Owen v. BristolCare, Inc.* (8th Cir. 2013) 702 F.3d 1050; *Sutherland v. Ernst & Young, LLP* (2d Cir. 2016) 726 F.3d 290.)

Meanwhile, our Ninth Circuit has reached the opposite conclusion. (*Morris v. Ernst & Young, LLP* (9th Cir. 2016), 834 F.3d 975, 981-982.) In *Morris*, the Ninth Circuit held that a "lawsuit filed in good faith by a group of employees to achieve more favorable terms or conditions of employment is 'concerted activity' under § 7 of the [NLRA]." (*Id.* at pp. 981-982.) The Ninth Circuit further held the FAA has a savings clause that prohibits enforcement of arbitration agreements that defeat substantive federal rights. (*Id.* at 986.) Under the Ninth Circuit's analysis, the right to engage in concerted activities, including the right to participate in collective lawsuits, "are the central, fundamental protections of the Act," and thus fall within the savings clause of the FAA. (*Id.*)

The Seventh Circuit is in accord with the Ninth. In *Lewis v. Epic Sys. Corp.* (7th Cir. 2016) 823 F.3d 1147, it reasoned that, although the FAA has a policy of favoring arbitration, that policy cannot "immunize" an illegal and unenforceable arbitration agreement – i.e., a compulsory waiver that "precludes employees from seeking any class, collective, or representative remedies to wage-and-hour disputes." (*Id.* at p. 1161.)

On January 13, 2017, the United States Supreme Court granted certiorari in *Murphy Oil*, *Morris*, and *Lewis*. The Court consolidated the appeals and heard oral argument on October 2, 2017. While Justice John Roberts expressed concern that a ruling in favor of the employees would invalidate employment agreements covering 25 million people, Justices Breyer and Ginsburg questioned whether enforcing the FAA would undermine the central objective of the labor laws, particularly when the costs of arbitrating would exceed the value of the individual's claim. (See Howe, Amy, SCOTUSblog, Oct. 2, 2017, http://www.scotusblog.com/2017/10/argument-analysis-epic-day-employers-arbitration-case/.) The Supreme Court has not issued its opinion as of the date of submission of this article. As mentioned above, a 5-4 decision is not unreasonable to expect.

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A brave new world – Case study (part 1)

While we await the high court's next pronouncement on arbitration clauses and class action waivers, there is at least one interesting case currently pending in the federal court system that might test whether individual arbitrations do in fact provide a viable alternative to representative actions. The case is *Richard Hose, et. al. v. Washington Inventory Service, Inc., et. al.*, Case No. 3:14-cv-02869-WQH-RBB (S.D. Cal.) ("*Hose v. WIS*"). In *Hose v. WIS*, the plaintiff-employees are low wage hourly employees who allege that the defendant-employer denies them minimum wage and overtime by having them work "off-the-clock."

The original plaintiff filed the case under a provision of the federal Fair Labor Standards Act (FLSA) that explicitly authorizes collective actions. (29 U.S.C. § 216(b).)[5] Within months after the filing, approximately 33 current and former employees of the defendant submitted opt in consent forms to join the case. After pre-certification discovery, the plaintiffs brought a motion for "conditional certification" of the FLSA claims under § 216(b), while the defendant brought a motion to compel arbitration of the claims of 13 of the individuals who had already opted in to the case under the FAA. After extensive briefing on both motions and an evidentiary hearing on the motion to compel arbitration, the court granted conditional certification and ordered that a letter be sent to potential members of the collective providing them with notice of the case and an opportunity to opt-in to it as a party plaintiff. (Dkt. No. 94.)[6] In a subsequent order, the court authorized a specific notice and opt-in procedure. (Dkt. No. 104.) After the class notice was issued, the court granted the motion to compel arbitration of the 13 individuals. (Dkt. No. 119.)[7]

Meanwhile, within 60 days of the sending of the FLSA notice pursuant to the conditional certification order, approximately 14,688 more individuals submitted opt-in consent forms expressing their desire to join the claims and to have plaintiffs' counsel represent them in the matter. (Dkt. Nos. 113-162.) This prompted the defendant to bring two more motions to compel arbitration for most, but not all, of the opt-in plaintiffs (the employment of a few hundred opt-in plaintiffs' pre-dated the defendant's roll-out of its mandatory arbitration program). The plaintiffs opposed the motions, arguing that the fees, costs and logistics of bringing some 14,000 individual claims of low wage employees in individual arbitrations effectively prohibited the employees from asserting their substantive minimum wage and overtime rights. (Dkt. No. 174.) The plaintiffs also argued that the class action waiver impermissibly infringed their right to engage in concerted activity under the NLRA. (*Id.*)[8] Ultimately, the court dismissed the plaintiffs' first argument as "too speculative to justify the invalidation of an arbitration agreement" under *Green Tree*, *supra*, 531 U.S. at 91, and rejected the second one under *Johnmohammadi v. Bloomingdale's, Inc.* (9th Cir. 2014) 755 F.3d 1072, because the arbitration agreements had an opt-out clause. (Dkt. No. 189, at pp. 7-12.) The court granted the motions to compel arbitration for the lion's share of opt-in plaintiffs. The court stayed (but did not dismiss) the claims of the individuals compelled to arbitration, specifically ordering that "the parties are directed to proceed to arbitration in accordance with the terms of the [arbitration agreement]." (*Id.* at p. 17.)

As a result of the defendant's forced arbitration program and successful motions to compel arbitration, the company

now faces the prospect of approximately 13,803 individual arbitrations, in addition to litigation of the claims of a few hundred more who remain in the conditionally certified collective action in court. As of October 1, 2017, the AAA charges the individual employee an administrative "non-refundable filing fee capped at $300" and charges the employer a "non-refundable filing fee of $1,900." (https://www.adr.org/sites/default/files/Employment_Arbitration_Fee_Schedule.pdf.) Employers must also pay a $750 "case management fee" per individual arbitration. In *Hose v. WIS*, the employer's filing fees alone would add up to more than $36,500,000. Of course, this does not include the additional fees and the costs of the arbitrators, which are expenses unique to arbitration and must therefore be borne solely by the employer as well. (*Armendariz, supra*, 24 Cal.4th at 113.) It also does not include the attorney fees and costs that the defendant will need to pay its lawyers to defend each arbitration, or the attorney fees and costs it may need to pay to the individual employees who prevail in their arbitrations, under the fee shifting provisions of the FLSA (29 U.S.C. § 216(b).) The costs of arbitrating all the individual claims may approach nine figures – more than the employees were seeking in the collective action.

The last items on the court's docket for this case concern a joint statement from the parties that they are engaged in mediation discussions and have agreed to stay the case and the filing of arbitrations pending the outcome of those discussions. (Dkt Nos. 197-202.) Perhaps by the next publication of *Forum*, there will be more to report.

Conclusion

Companies and employers continue to require that their employees and consumers sign contracts with arbitration clauses that waive the right to jury and concerted activity, and the courts are trending (for now) in favor of enforcing these provisions. As a result, the class action device could morph into a mass action model, using the power of the Internet, technology and social networking to build individual cases. Whether this can and will happen remains to be seen. If it does, then the promoters of jury and class action waivers may have bitten off more than they bargained for. If it doesn't, then it is unclear whether our legal system will ever again be able to guarantee a meaningful forum to seek legal redress for its most vulnerable people. ■

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[1] The U.S. Supreme Court also regards class actions as "an exception to the usual rule that litigation is conducted by and on behalf of the individual named parties only." (*Wal-Mart Stores, Inc. v. Dukes* (2011) 564 U.S. 338, 348, 131 S.Ct. 2541 [internal quotation marks omitted].)

[2] The authors make no prediction as to how the Supreme Court will decide *Epic Systems* or the related cases that have been consolidated with it as part of the grant of certiorari.

[3] *Italian Colors* was a 5-3 decision as Justice Sotomayor did not take part in the decision.

[4] Justice Kagen, joined by Justices Ginsburg and Breyer, issued a scathing dissent. The dissent reasoned that the arbitration clause was invalid under the "effective vindication

rule" because it effectively prevented the small merchants from pursing an antitrust action against American Express, thereby allowing Amex to insulate itself from antitrust liability. (*Italian Colors, supra*, 570 U.S. at pp. 240-253, 133 S.Ct. at pp. 2313-2320 [Kagen, J., dissenting].)

[5] Section 216(b) provides in pertinent part: "An action to recover the liability prescribed in either of the preceding sentences [for minimum wage, overtime and liquidated damages] may be maintained against any employer (including a public agency) in any Federal or State court of competent jurisdiction by any one or more employees for and in behalf of himself or themselves and other employees similarly situated. No employee shall be a party plaintiff to any such action unless he gives his consent in writing to become such a party and such consent is filed in the court in which such action is brought." (29 U.S.C. § 216(b).)

[6] Under Supreme Court authority, the named plaintiff in an action brought under 29 U.S.C. § 216(b), may ask the court to oversee the process of providing potential members of the collective with notice of the case and the procedure for submitting a written consent to join the action, if they wish to "opt-in" as a party plaintiff. (*Hoffman-La Roche, Inc., v. Sperling* (1989) 493 U.S. 165, 172-173.) This typically occurs through a motion for conditional certification and to facilitate notice.

[7] Notice to putative class members of a collective action under the FLSA properly comes before the determination of whether and which individuals may have signed binding arbitration agreements. (See, e.g., *Shaia v. Harvest Management Sub LLC* (N.D. Cal., Apr. 13, 2015) 306 F.R.D. 268, 276 [reasoning that the question of whether employees are precluded from participation based on having allegedly signed arbitration agreements was "not properly before the court at this first stage of the certification."]; *Deatrick v. Securitas Security Services USA, Inc.* (N.D. Cal., Oct. 20, 2014) 2014 WL 5358723 at *3-*4; see also *Lloyd v. J.P. Morgan Chase & Co.* (S.D.N.Y. Apr. 1, 2014) 2014 WL 2109903, at *2 [ordering notice to all members of the collective regardless of "whether they had signed an arbitration agreement" because plaintiffs "who were not parties to the action at the time of [the order compelling arbitration] could not be bound by it."]; *Sylvester v. Wintrust Fin. Corp.* (N.D. Ill. Sept. 30, 2013) 2013 WL 5433593, at *9; *Arnold v. DirectTV, Inc.* (E.D. Mo. Dec. 4, 2012) 2012 WL 6026472, at *3.)

[8] On the merits, the plaintiffs argued that the defendant only instituted the forced arbitration program to insulate themselves from liability, having been put on notice from earlier lawsuits of systemic deficiencies in the company's policies for recording all time worked and paying all wages owed.