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Table of Contents

Editorial

Editorial
Stavros Brekoulakis 273

Articles

Resolving Art-Related Disputes Outside the Courtroom: A Reflective Analysis of the Procedural Aspects of ADR
Alexandra Goetz-Charlier 274

Proving Your Nationality: As Easy as it Seems?
Joost van Dam 289

“Hard” Tools for Controlling Discovery Burdens in Arbitration
Steven C Bennett 296

Due Process “Paranoia”: Turning Away from Judicial Attitudes and Looking for Answers Within
Sameer Sharma 315

Lectures, Presentations and Conference Papers

International Arbitration Guidelines: Safe Ports for Arbitral Storms III
Tim Hardy, Simon Nesbitt QC and Paul Klaas 327

Cases

Epic Clash Between Elephants and Yellow Dogs: US Supreme Court Upholds Enforceability of Employment Contracts that Provide for Individualised Arbitration
Steven P Caplow 336

Do Fraudulent Documents, Used to Trigger Payment under a Letter of Credit, Engage Public Policy Reasons to Refuse Enforcement of International Arbitration Awards?
Anthony Edwards 342

NEC3 Case Law Review
Albert Yeu 348

Review of the Administration of Civil Justice: A Submission in Support of Arbitration
Christopher V S Doyle 362

Book Reviews
Gordon Blanke 370

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Cases

Epic Clash Between Elephants and Yellow Dogs: US Supreme Court Upholds Enforceability of Employment Contracts that Provide for Individualised Arbitration

Steven P Caplow

Abstract

This case required the US Supreme Court to harmonise the statutory direction of Congress to respect the dignity of agreements to arbitrate, and to protect the right of workers to act collectively for their mutual aid or protection. The court's majority concluded that it need not choose, but were such a choice necessary, it would side in favour of upholding agreements to arbitrate.

Introduction: Epic Systems Corp v Lewis[1]

The US Supreme Court has regularly issued decisions addressing the enforceability of agreements to arbitrate, and class arbitration waivers that require parties to adjudicate their disputes in individual arbitration proceedings. In every instance, a majority of the court has upheld the arbitration provision. Most recently, the court examined these issues in the context of employment agreements in which the projected cost of pursuing the claim individually, rather than on a class wide basis, exceeded the anticipated recovery. The plaintiffs in three cases, consolidated for consideration of the court, argued that their right to engage in concerted activities for their mutual aid or protection—enshrined in a federal labour statute—rendered invalid their employment agreements that required them to arbitrate individually all disputes. In a 5 to 4 decision, building on its earlier opinions, the court's majority ruled that under the clear mandate of the Federal Arbitration Act (FAA or Arbitration Act), the arbitration agreements and class waivers were enforceable.

Congress' enactment of the Arbitration Act swings the balance in favour of arbitration

Traditionally, English courts considered irrevocable arbitration agreements as ousting the courts of jurisdiction, and refused to enforce such agreements for this reason. This view was adopted by US courts as part of the common law up to the time of the adoption of the Arbitration Act.[2] In 1925, Congress passed the FAA, which directed US courts to abandon their hostility and instead treat arbitration agreements as "valid, irrevocable, and enforceable".[3] While it is possible that through this legislation Congress intended merely to level the playing field, to the US Supreme Court, enactment of the FAA established a "liberal federal policy *favoring* arbitration agreements".[4] As the court's majority recently explained:

[1] *Epic Systems Corp v Lewis* 138 S Ct 1612 (21 May 2018).
[2] *Scherk v Alberto-Culver Co* 417 US 506 (1974) at 510 n 4.
[3] Federal Arbitration Act 9 USC § 2.
[4] *Moses H Cone Memorial Hospital v Mercury Construction Corp* 460 US 1 (1967) at 24 (emphasis added).

> "You might wonder if the balance Congress struck in 1925 between arbitration and litigation should be revisited in light of more contemporary developments. You might even ask if the Act was good policy when enacted. But all the same you might find it difficult to see how to avoid the statute's application."[5]

But even this liberal policy in favour of upholding arbitration agreements has its limits. Under the so-called "savings clause" in s 2 of the FAA, parties may challenge an arbitration provision "upon such grounds as exist at law or in equity for the revocation of any contract".[6] The savings clause essentially operates as a type of equal-treatment rule. The savings clause recognises only defences that challenge the enforceability of an arbitration agreement, if the defence—like unconscionability, duress or fraud—equally applies to any other contract.

A long string of US Supreme Court decisions has examined the question of whether a particular state law defence applies to "all" contracts, or instead targets arbitration agreements such that they are pre-empted as a matter of federal law under the FAA. In some of the court's earlier cases, there was little doubt that the state law defence would apply exclusively to invalidate an arbitration agreement. For example, in *Doctor Associates v Casarotto*, the court considered a Montana statute, which required that if an agreement contained an arbitration provision, it needed to be disclosed by being "typed in underlined capital letters on the first page of the contract".[7] The court readily concluded that the Montana statute should be pre-empted because it singled out arbitration provisions for suspect status.

Later decisions required a more searching inquiry as to whether a state law defense to enforcement would by name or more subtle methods operate to discriminate against arbitration agreements. In its landmark *AT&T Mobility LLC v Concepcion*[8] decision, the US Supreme court addressed the enforceability of a cellular telephone contract that provided for arbitration of all disputes, and did not permit class wide arbitration. Applying California law,[9] the lower courts invalidated the arbitration provision as unconscionable because it disallowed class wide proceedings. The Supreme Court acknowledged the particular complexity of evaluating whether a generally applicable doctrine—here unconscionability—had been applied in a fashion that disfavoured or interfered with arbitration. In a sharply divided decision, the court's majority ruled that mandating class wide adjudication uniquely and improperly interfered with the fundamental attributes of arbitration. To the majority, California law operated to "manufacture" class arbitration, by exceeding the scope of the parties' "consensual" bilateral agreement, and sacrificed the informality, and savings in time and cost achieved by arbitrating such disputes individually.[10] *Concepcion* established that even facially neutral state law defences enumerated in the FAA savings clause, like unconscionability, were subject to federal pre-emption if they have the effect of disfavouring arbitration.

In another important case in the development of this line of authority, *American Express Co v Italian Colors Restaurant*,[11] the US Supreme Court examined the enforceability of class wide arbitration waivers with respect to a plaintiff asserting a federal statutory claim. In *Italian Colors*, the owner of a small restaurant (Italian Colors) alleged that American Express had used its monopoly power to force merchants to accept a form contract that violated the federal antitrust laws. Arguing that the cost to prove its claim could exceed US $1 million, in order to obtain a potential individual recovery of US $12,850 (US $38,549

[5] *Epic Systems Corp v Lewis* 138 S Ct 1612 (2018) at [1621]–[1622].
[6] FAA 9 USC § 2.
[7] *Doctor Associates v Casarotto* 517 US 681 (1996).
[8] *AT&T Mobility LLC v Concepcion* 563 US 333 (2011).
[9] Although the case involved California's so-called *Discover Bank* rule, which established the standards for unconscionability of class waivers in consumer arbitration agreements, California law equally prohibits waivers of class litigation. *America Online Inc v Superior Ct* 90 Cal App 4th 1 (2001) at [17]–[18]. Therefore, on its face, California law did not discriminate against arbitration agreements.
[10] *AT&T Mobility LLC v Concepcion* 563 US 333 (2011) at [348].
[11] *American Express Co v Italian Colors Restaurant* 570 US 228 (2013).

if trebled pursuant to US antitrust law),[12] the restaurant owner claimed that the class arbitration waiver operated to prevent it from effectively vindicating its federal statutory rights. The restaurant owner proposed that invaliding the class arbitration waiver would harmonise the competing federal policies of the federal antitrust laws with the FAA.[13] Although recognising that the restaurant owner's claims were economically viable only if the costs were shared across a class of similar claimants, the court's majority nonetheless upheld the class arbitration waiver.

Majority decision: Congress does not "hide elephants in mouseholes"

The recent *Epic* decision called for the US Supreme Court to apply its rules of decision to three consolidated cases, in which employees who had signed class arbitration waivers, sought to assert class wide claims under federal statutes authorising collective action. The Supreme Court spends little time on the underlying facts of these cases, other than to state that the case of Stephen Morris, a junior accountant at Ernst & Young LLP (EY), was representative. Apparently, EY emailed its employees an arbitration agreement containing such a class arbitration waiver with the understanding that continued employment would indicate assent.[14] After his employment ended, Mr Morris filed claims in federal court alleging EY had misclassified its junior accountants as professional employees such that in violation of the Fair Labor Standards Act (FLSA) and California law, it did not pay them overtime. Despite the arbitration provision and the class waiver, Mr Morris sought to pursue the federal claim as a nationwide class under FLSA's collective action provision.[15] For its part, EY filed a motion to compel individualised arbitration of Mr Morris' claim. In response—invoking the FAA's savings clause—Mr Morris argued that a separate federal statute, the National Labor Relations Act (NLRA), rendered the EY class arbitration waiver illegal as a matter of federal law. Specifically, Mr Morris relied on s 7 of the NLRA which 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*."[16]

In other words, although Mr Morris sought financial relief under the collective action provision of the FLSA, he based his challenge to the validity of the arbitration agreement on the concerted activities provision of the NLRA.

Describing Mr Morris' legal theory as an "interpretive triple bank shot" for which "just stating the theory is enough to raise a judicial eyebrow", the majority observes that Mr Morris does not "offer the seeming more natural suggestion" that the FLSA itself, rather than the NLRA, overcomes the FAA.[17] Answering its own rhetorical question, "Why not?" the majority explains that an earlier decision by the US Supreme Court, *Gilmer v Interstate/Johnson Lane Corp*, foreclosed the argument that the FLSA itself displaced the FAA,[18] and that every federal circuit to consider the question thereafter had held that the FLSA allows agreements for individualised arbitration. The "triple bank shot" refers to the

[12] *American Express Co v Italian Colors Restaurant* 570 US 228 (2013) at [231].
[13] *American Express Co v Italian Colors Restaurant* 570 US 228 (2013) at [235].
[14] The dissent describes this as presenting the employees with a "Hobson's choice: accept arbitration on their employer's terms of give up their jobs", *Epic Systems Corp v Lewis* 138 S Ct 1612 (2018) at [1636] n 2. However, for the purposes of deciding the case, the employees did not actually allege duress or unconscionability. *Epic Systems Corp v Lewis* 138 S Ct 1612 (2018) at [1622].
[15] Fair Labor Standards Act 29 USC § 216(b) (authorising actions "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").
[16] National Labor Relations Act 29 USC § 157 (emphasis added).
[17] *Epic Systems Corp v Lewis* 138 S Ct 612 (2018) at [1626].
[18] *Gilmer v Interstate/Johnson Lane Corp* 500 US 20 (1991) at 32.

fact that rather than directly ask the court to revisit its long-standing *Gilmer* decision addressing the FLSA, Mr Morris sought to invalidate the class arbitration waiver under the NLRA so that he could in turn pursue his FLSA claim on a class wide basis.

As to whether the NLRA itself serves to invalidate the class arbitration waiver, the court's majority buries Mr Morris' interpretation of the statute in a flood of Latin rules of construction and elephant tropes. Starting with the Latin, the majority contends that s 7 of the NLRA focuses on the right to organise unions and bargain collectively, without any mention of arbitration or collective action procedures. Under the canon of ejusdem generis, the court states that when a general term follows more specific terms in a list, the general term is unusually understood to embrace only objects similar in nature to those objects enumerated by the preceding specific words.[19] Under the canon, the majority concludes the NLRA statutory phrase "other concerted activities" refers to employees exercising their right to free association in the workplace, not to the highly regulated activities of class litigation in the courtroom. The majority also makes much of the fact that the NLRA provision does not speak to the question of arbitration: "It does not even hint at a wish to displace the Arbitration Act".[20] When Congress wishes to speak to an issue, like the interplay between the NLRA and the earlier enacted FAA, it does not "hide elephants in mouseholes".[21] Extending the metaphor, the majority suggests that it is "more than a little doubtful that Congress would have tucked into the mousehole of [NLRA] Section 7's catchall term an elephant that tramples the work done by these other laws; [and] flattens the parties' contracted-for-dispute resolution procedures".[22] Based on its examination of the NLRA, the majority finds no clear and manifest congressional intent to displace the Arbitration Act and outlaw agreements like those of the employees.

At its core, the majority rejects the suggestion, whether textual or contextual, that any conflict exists between the FAA and the NLRA. Under established precedent, a party seeking to suggest that two statues cannot be harmonised and that one displaces the other faces a "heavy burden" of showing clearly expressed congressional intent.[23] Reviewing its history of decisions over the years that have examined such potential conflicts, including *Italian Colors*, the court concludes that in every case it has "rejected efforts to conjure conflicts between the Arbitration Act and other federal statutes".[24] The majority then squares its analysis with the dissent on how to reconcile the conflicting policies of the NLRA and the FAA. In this summation, the majority pairs the dissent's argument that the NLRA is the more specific provision because it "speaks directly to group action by employees", with the majority's analysis that the Arbitration Act "speaks directly to the enforceability of arbitration agreements".[25] As to these competing objectives—employee collective action versus arbitrability of disputes—the court's majority plainly states, "if forced to choose between the two, we might well say the Arbitration Act offers the more on-point instruction".[26] And with those words, the majority concludes that "arbitration agreements, like those before us must be enforced as written".[27] Building on its *Gilmer* decision holding that the FLSA does not displace the FAA, the court here rejects the argument that the NLRA serves to invalidate the employees' class arbitration waivers.

[19] *Epic Systems Corp v Lewis* 138 S Ct 612 (2018) at [1625].
[20] *Epic Systems Corp v Lewis* 138 S Ct 612 (2018) at [1624].
[21] *Epic Systems Corp v Lewis* 138 S Ct 612 (2018) at [1627] (quoting *Whitman v American Trucking Associations Inc* 531 US 457 (2001) at [468].
[22] *Epic Systems Corp v Lewis* 138 S Ct 612 (2018) at [1627].
[23] *Epic Systems Corp v Lewis* 138 S Ct 612 (2018) at [1624].
[24] *Epic Systems Corp v Lewis* 138 S Ct 612 (2018) at [1627].
[25] *Epic Systems Corp v Lewis* 138 S Ct 612 (2018) at [1631].
[26] *Epic Systems Corp v Lewis* 138 S Ct 612 (2018) at [1632].
[27] *Epic Systems Corp v Lewis* 138 S Ct 612 (2018) at [1632].

Dissent decision: Congress acted to invalidate take-it-or-leave-it "yellow dog" labour contracts

If the majority has elephants, the dissent has yellow dogs. The dissent sets out a history lesson to explain why the court majority's "elevation of the FAA over workers' rights to act in concert" is "egregiously wrong".[28] The dissent offers a reminder of discredited US Supreme Court decisions issued in the early 1900s that—relying on the doctrine of "contractual liberty" between employees and employers to set the terms of employment—invalidated federal and state laws intended to protect the right of workers to organise.[29] During this early period, as a condition of employment, employers commonly required employees to sign "yellow dog contracts" that directed employees to abstain from joining labour unions or engaging in concerted activities.[30] However, in the 1930s, the Great Depression shifted the political winds in favour of worker rights. Not dissimilar to its earlier direction to the courts to treat arbitration agreements with greater favour, Congress enacted a series of federal laws designed to safeguard the right of employees to act collectively. In 1932, Congress enacted the Norris-LaGuardia Act (NLGA), and then in 1935, the NLRA, which further authorised employees to engage in concerted activity for their mutual aid or protection and established the National Labor Relations Board to oversee enforcement of the Act. According to the dissent, for the next 75 years, decisions of the board authorised collective and class suits to adjudicate the terms and conditions of employment.[31] Based on the NLRA's historical context, and its own detailed textual analysis of this Act, the dissent concludes that employer-dictated collective action waivers are illegal.

The dissent also offers a starkly different take on the history of the FAA. According to the dissent, judicial hostility to arbitration created a backlog in the court system that delayed the resolution of commercial disputes. In response, the business community came together with the goal of "enabl[ing] merchants of roughly equal bargaining power to enter into binding agreements to arbitrate commercial disputes".[32] Moreover, the dissent cites the FAA's legislative history to show that Congress did not intend the statute to even apply to employment contracts.[33] Indeed, as enacted, s 1 of the FAA excludes "contracts of employment of seamen, railroad employees, or any other class of workers engaged in foreign or interstate commerce".[34] Although later in *Circuit City Stores Inc v Adams*,[35] the US Court ruled that the Arbitration Act's exemption for employment contracts excluded only transportation workers' contracts. To the dissent, Congress intended the FAA to address purely commercial matters, not employment disputes.

The dissent contends that contrary to this congressional intention, as a result of US Supreme Court decisions like *Gilmer* and *Circuit City*, there has been steady growth in the use of arbitration clauses in employment contracts. In 1992, only 2.1% of non-unionised companies included mandatory arbitration agreements, while today this number has increased to almost 54%.[36] Further, there has been similar growth in the use of class waivers, which are now estimated to cover about 23% of non-unionised employees.[37] Citing statistics that in New York City, low wage workers lose nearly US $3 billion per year in legally owed

[28] *Epic Systems Corp v Lewis* 138 S Ct 612 (2018) at [1633].
[29] *Epic Systems Corp v Lewis* 138 S Ct 612 (2018) at [1634].
[30] *Epic Systems Corp v Lewis* 138 S Ct 612 (2018) at [1634].
[31] *Epic Systems Corp v Lewis* 138 S Ct 612 (2018) at [1637].
[32] *Epic Systems Corp v Lewis* 138 S Ct 612 (2018) at [1643] (emphasis omitted).
[33] *Epic Systems Corp v Lewis* 138 S Ct 612 (2018) at [1643].
[34] FAA 9 USC § 1.
[35] *Circuit City Stores Inc v Adams* 532 US 105 (2001) at [109].
[36] *Epic Systems Corp v Lewis* 138 S Ct 612 (2018) at [1644] (citing Economic Policy Institute (EPI), Alexander Colvin, "The Growing Use of Mandatory Arbitration" (27 September 2017) 1–2, 4).
[37] *Epic Systems Corp v Lewis* 138 S Ct 612 (2018) at 1644 (citing Nantiya Ruan, "What's Left To Remedy Wage Theft? How Arbitration Mandates That Bar Class Actions Impact Low-Wage Workers" [2012] Mich St L Rev 1103, 1129); Economic Policy Institute (EPI), Alexander Colvin, "The Growing Use of Mandatory Arbitration" (27 September 2017) 6.

wages, the dissent contends that state and federal regulators lack the resources to uphold enforcement of employment laws.[38] Using another claim against EY as an example—in which the claimant purportedly would have needed to spend US $200,000 to pursue individual arbitration of a claim for US $1,867.02 in overtime plus an equivalent amount in liquidated damages—the dissent expresses the concern that it will not be economical for private parties to pursue such claims.[39]

The dissent closes on sharp terms stating these "untoward consequences" do not stem from "legislative choices", but rather:

> "take-it-or-leave-it labor contracts harking back to the type called 'yellow dog' and the readiness of this court to enforce those unbargained-for agreements. The FAA demands no such suppression of the right of workers to take concerted action for their 'mutual aid or protection'."[40]

Ultimately, the court must balance its fear of a return to the days of yellow dog contracts that restrict collective action by workers, against the elephantine policy that favours upholding class arbitration waivers. In a close decision, the court's narrow majority weights in favour of protecting arbitrability in employment agreements.

[38] *Epic Systems Corp v Lewis* 138 S Ct 612 (2018) at [1647] (citing Annette Bernhardt, "Broken Laws, Unprotected Workers: Violations of Employment and Labor Laws in America's Cities" (2009) 6).

[39] *Epic Systems Corp v Lewis* 138 S Ct 612 (2018) at [1647] (citing *Sutherland v Ernst & Young LLP* 768 F Supp 2d 547 (SDNY 2011) at [552]).

[40] *Epic Systems Corp v Lewis* 138 S Ct 612 (2018) at [1649].