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Employer Update

The Fifth Circuit Reverses the NLRB's Ruling in *D.R. Horton* That Class-Action Waivers Contained in Mandatory Arbitration Agreements Violate the NLRA

By Lawrence J. Baer and Kendra Okposo

In This Issue

Recently, arbitration of class-based claims has been a hotly contested issue in the courts and before the National Labor Relations Board (NLRB or Board). The debate exposes the tension that exists between the trend by courts to favor private dispute resolution in the form of arbitration and the courts' and the Board's equally compelling desire to ensure that important statutory rights – both substantive and procedurals – afforded litigants by Congress and state legislatures are protected.

Faced with an onslaught of employment-related lawsuits, which increasingly are commenced as class or collective actions, employers have sought to keep such disputes out of the courts by requiring employees to resolve their disputes through arbitration and limit the scope of their disputes to individual – and not class-based – arbitration proceedings.

Generally, the courts, including the United States Supreme Court, have been supportive of employers' efforts and enforced such mandatory arbitration agreements under the auspices of the Federal Arbitration Act (FAA), which strongly favors enforcement of a party's private agreement to arbitrate. In 2011, in a non-employment dispute, the Supreme Court determined in *AT&T Mobility LLC v. Concepcion*, 131 S. Ct. 1740 that the FAA preempted a California state law that invalidated, as unconscionable, class-action waivers in consumer arbitration agreements. The Supreme Court held that the FAA preempted the state law because it interfered with the objectives of the FAA by targeting and disfavoring arbitration agreements. The Supreme Court held that "[r]equiring the availability of classwide arbitration interferes with the fundamental attributes of arbitration and creates a scheme inconsistent with the FAA."[1] Such a requirement would result in more expensive, formal, and time-consuming arbitrations, which would give employers less incentive to resolve claims privately through arbitration.

While the Supreme Court's decision in *Concepcion* appeared to provide employers with an important and effective tool to combat their ongoing inundation with employment-related class claims, one year later in *D.R. Horton, Inc.*, 2012 WL 36274 (N.L.R.B. Jan. 3, 2012), the NLRB determined that the class-action waivers contained in mandatory arbitration agreements with employees violated the National Labor Relations Act (NLRA) by interfering with employees' rights to engage in protected, concerted activities. Thus, the NLRB's ruling threw into doubt whether class-action

waivers contained in employment-related arbitration agreements were enforceable.

Subsequent to the Board's *D.R. Horton* decision, however, numerous federal circuit courts of appeal declined to follow the NLRB's rationale and continued to enforce class-action waivers contained in employment-related mandatory arbitration agreements.[2]

The Fifth Circuit found that the NLRB erred in its determination by providing greater weight to the NLRA than the FAA.

Last month, on December 3, 2013, on direct appeal from the Board's *D.R. Horton* decision, the United States Court of Appeals for the Fifth Circuit rejected the NLRB's determination that D.R. Horton had interfered with its employees' rights, and held that the Board decision did not give proper weight to the FAA.

Background

The FAA was enacted in 1925 for the purpose of ensuring the enforcement of arbitration agreements in accordance with their terms. Under the FAA, an arbitration agreement "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 (emphasis added). Thus, an agreement to arbitrate will be enforceable unless, under the so-called "savings clause" exception, the agreement may be lawfully revoked. Additionally, under the FAA, an agreement to arbitrate contrary to a "congressional command" will not be enforced. A congressional command to deny enforcement may be gleaned from a conflicting statute's text, its legislative history, or in an inherent conflict between the arbitration agreement and the statute's underlying purpose.

In *D.R. Horton*, the NLRB examined the employer's Mutual Arbitration Agreement (MAA) which D.R. Horton's employees were required to sign as a condition of employment. The MAA required employees to arbitrate their disputes with D.R. Horton related to their wages, hours, or other working conditions and precluded employees from filing class or collective actions.

The NLRB held that, notwithstanding the FAA, the MAA unlawfully restricted employees' rights to engage in protected, concerted activities under Section 7 of the NLRA, by prohibiting employees from prosecuting their employment-related class claims in an administrative or judicial forum.[3] The NLRB additionally held that D.R. Horton committed an unfair labor practice in violation of Section 8(a)(1) of the NLRA by including ambiguous language in the MAA that could reasonably lead employees to conclude that they were prohibited from filing an unfair labor practice charge with the Board. In reaching its determination, the Board concluded that the MAA was revocable as contrary to the provisions of Section 7 of the NLRA, and thus the savings clause of the FAA applied. The NLRB compared the MAA to any private contract that would be unenforceable, if it conflicted with the provisions of the NLRA.

Fifth Circuit Decision

On December 3, 2013, a Fifth Circuit panel rejected the NLRB's finding that D.R. Horton had interfered with its employees' rights protected under Section 7 of the NLRA, and found that the NLRB erred in its determination by providing greater weight to the NLRA than the FAA.

The court explained that the use of class-action procedures is not a substantive right. The court pointed to other employment-related statutes, such as the Fair Labor Standards Act and the Age Discrimination in Employment Act, under which courts have held that no substantive right exists to proceed collectively as a class.

The FAA and *Concepcion*

The court considered the FAA's savings clause, on which the NLRB relied, to support its conclusion that the MAA could not be lawfully enforced. The court disagreed with the NLRB's conclusion based on the Supreme Court's rationale in *Concepcion*. The Fifth

Circuit concluded that, like the California statute at issue in *Concepcion*, the Board's decision prohibiting class-action waivers would effectively discourage arbitration, which is contrary to the provisions of the FAA.

The second exception to the FAA's general provisions favoring arbitration requires a congressional command in the competing statute that overrides the FAA's mandate. The Fifth Circuit examined the text of the NLRA to determine whether it contained such a congressional command. It found that the NLRA does not expressly provide for employee class or collective actions. Further, the court examined the legislative history of the NLRA and found no legislative history disfavoring of arbitration. The court determined that no inherent conflict exists between the FAA and the NLRA's purposes, as courts, and indeed the NLRB itself, have repeatedly declared the NLRA to permit, and even encourage, arbitration.

Finally, the Fifth Circuit noted the other circuit court decisions considering this issue, cited at note 2 above, as further support for its reasoning.

Although the court concluded that the class-action waiver contained in the MAA must be enforced, it held that the provision of the MAA, under which employees waived "the right to file a lawsuit or other civil proceeding" relating to their employment, could lead employees to reasonably conclude that they were prohibited from filing unfair labor practice charges with the NLRB. Thus, the above-quoted provision violated Section 8(a)(1) of the NLRA by interfering with rights and activities protected by Section 7. Therefore, the court affirmed the NLRB's order requiring D.R. Horton to modify that provision of the MAA to make clear that it did not prohibit the filing of an unfair labor practice charge with the NLRB.

Notwithstanding the clear and consistent message delivered to the NLRB by the courts, on January 17, 2014, an NLRB Administrative Law Judge (ALJ) issued a decision in *Leslie's Poolmart, Inc.*, 2014 WL 204208 (N.L.R.B. Jan. 17, 2014) following the now reversed Board decision in *D.R. Horton*, which the ALJ considered binding precedent. Thus, until such time as the Supreme Court considers the issue, employers may be faced with the unpleasant prospect of an adverse determination by the NLRB, followed by an appeal to a circuit court seeking reversal, when attempting to enforce a class-action waiver contained in a mandatory arbitration agreement.

1. *AT&T Mobility LLC v. Concepcion*, 131 S. Ct. 1740, 1748 (2011).
2. See generally, *e.g., Sutherland v. Ernst & Young LLP*, 726 F.3d 290 (2d Cir. 2013); *Owen v. Bristol Care, Inc.*, 702 F.3d 1050 (8th Cir. 2013); *Richards v. Ernst & Young, LLP*, 2012 WL 4437601 (9th Cir. Aug. 21, 2013).
3. *In re D.R. Horton Inc.*, 2012 WL 36274, at *1 (N.L.R.B. Jan. 3, 2012).

Fifth Circuit Grants Broad Discretion to Plan Administrator Under "Arbitrary and Capricious" Standard

By Paul Wessel, Steven Margolis, and Brian Hamano

Introduction

In a recent decision of the US Court of Appeals for the Fifth Circuit, *Wall v. Alcon Labs, Inc.*,[1] the court ruled that a plan administrator had broad discretion under the "arbitrary and capricious" standard for determinations made with respect to a noncompetition clause pursuant to its administrative authority under an employee benefit plan. In *Wall*, a former employee filed suit against both (1) a plan administrator for denying supplemental executive retirement plan (SERP) benefits and (2) his former employer for refusing to vest his rights in previously awarded restricted stock units (RSUs) after the employee gave notice of his intent to retire and take a position with a competing company. The plan administrator denied SERP benefits on the grounds that the employee's subsequent employment violated noncompete covenants in the SERP, and the employer refused to accelerate the vesting of the employee's RSUs because it determined that the employee's post-change of control termination was not for "good reason" under the terms of the award. The Fifth Circuit agreed with the plan administrator and employer, denying both of the employee's claims.

Background

George Wall worked for Alcon Laboratories, Inc. (Alcon), a pharmaceutical company, from 1998 until he resigned in 2010. Mr. Wall participated in the Alcon Supplemental Executive Retirement Plan (ASERP), which provided pension benefits upon retirement, subject to compliance with noncompetition restrictions following retirement. Mr. Wall was also granted RSU awards, which vested over time and provided for accelerated vesting if he resigned for "good reason" within two years after a "change of control."

Mr. Wall's role with Alcon began to change in connection with the sale of Alcon to Novartis (following the sale of an initial minority interest in 2008 and a sale of a controlling interest in 2010). Mr. Wall was reassigned to different supervisors three times and his position title was changed from "Senior Director" to "Project Head IV, Pharm." Mr. Wall also received unfavorable performance reviews and received a smaller raise and bonus than otherwise expected. Ultimately, Mr. Wall met with the human resources director of Alcon on November 4, 2010, to discuss the possibility of his retirement. That same day, Mr. Wall was offered a new job as Vice President of Product Development with Otonomy, Inc. (Otonomy), a clinical stage bio-pharma company, which he accepted on November 20, 2010. Three days later, Mr. Wall announced his intention to retire from Alcon on December 31, 2010.

In connection with his retirement, Mr. Wall sent a letter to Alcon on December 1, 2010, requesting (1) his ASERP benefits upon his retirement and (2) accelerated vesting of RSUs previously awarded to him in 2009 and 2010 on the basis that his resignation occurred within two years following a "change of control" and was for "good reason," claiming he had suffered a "material diminution in [his] authority, duties, or responsibilities." Alcon requested that Mr. Wall provide additional information, including his new employer and the nature of his duties, so that the ASERP administrative committee (the ASERP Committee) could determine whether Mr. Wall's new employment violated the non-compete or confidentiality covenants under the plan. Mr. Wall refused to provide that information to Alcon for several months. In addition, in a December 17, 2010, e-mail to Mr. Wall, Alcon's counsel responded that Mr. Wall had failed to provide a "good reason" for his retirement and was only entitled to vesting of one-third of his 2009 RSUs and none of his 2010 RSUs.

In June 2011, the ASERP Committee denied Mr. Wall's ASERP benefits because he had violated the ASERP's non-compete provision.[2] The ASERP Committee learned that Otonomy previously issued a press release announcing Mr. Wall's hiring, referencing his prior experience with Alcon and mentioning Alcon products. In addition, the ASERP Committee learned that Otonomy was developing medication for ear infections which would compete with Alcon products.

Mr. Wall appealed both the ASERP Committee's finding and Alcon's determination that he had failed to retire for "good reason," which appeal was subsequently denied. Mr. Wall then filed suit in the Northern District of Texas seeking to recover unpaid ASERP benefits and vesting of his unvested RSUs, alleging that (1) Alcon's denial of benefits owed to him under Alcon's plan violated the Employee Retirement Income Security Act of 1974 (ERISA) and (2) Alcon's failure to vest the 2009 and 2010 RSUs constituted a breach of contract.

District Court Ruling

The District Court[3] granted summary judgment in favor of Alcon on both issues. The District Court affirmed the ASERP Committee's denial of ASERP benefits in a pretrial conference and considered only the breach of contract claim in its January 30, 2013, opinion.

The District Court dismissed Mr. Wall's contention that he had retired for "good reason" on the grounds that (i) Mr. Wall had failed to provide Alcon with the requisite 30-day cure period provided under the terms of the underlying award agreements, since the December 1, 2010, notice letter he sent indicated that December 17, 2010, would be his last day of work and (ii) even assuming the proper cure period was given, Mr. Wall had not suffered the requisite material diminution in his authority, duties, or responsibilities.[4]

Fifth Circuit Appeal

On appeal, the Fifth Circuit addressed two issues: (1) whether the ASERP Committee's determination that Mr. Wall's employment with Otonomy violated the non-compete clause and was arbitrary and capricious, and (2) whether Mr. Wall retired for "good reason" and satisfied the 30-day written notice/cure requirement.

The *Wall* decision indicates that the Fifth Circuit reads the "arbitrary and capricious" standard to provide broad support to ERISA administrators, particularly with regard to decisions to deny benefits to departing employees who have not strictly followed applicable covenants in benefits plans.

The standard of review for summary judgment in appeals of a decision of an ERISA plan administrator is the "abuse of discretion" standard, characterized by a decision that is not based on evidence that clearly supports the basis for its denial and is not arbitrary and capricious. Here, the Fifth Circuit found that the ASERP Committee's denial was not arbitrary and capricious. Mr. Wall argued that the non-competition covenant did not prohibit his association with Otonomy, since Otonomy's allegedly competitive product was still in development (as opposed to being for sale in competition with Alcon). The Fifth Circuit rejected this argument, reading the covenant not to require a competitor to be manufacturing competing products, rather only that Alcon be producing something. The Fifth Circuit also pointed out that Mr. Wall would not have extracted a $50,000 promise from Otonomy to pay legal fees *ex ante* if he truly believed such an interpretation of the noncompete to be unreasonable.

Secondly, the Fifth Circuit read the "good reason" termination provision in the RSU award agreements to require Mr. Wall to provide notice to Alcon of such "good reason" and afford Alcon a 30-day cure period. The Fifth Circuit adopted the District Court's reasoning on this issue, agreeing that even if Mr. Wall's December 1 letter gave sufficient notice to Alcon of Mr. Wall's "good reason," it did not provide for the requisite 30-day opportunity to cure, since Mr. Wall had indicated that he had no intention of returning to Alcon and had already accepted Otonomy's offer.

Practical Implications for Employers

The *Wall* decision indicates that the Fifth Circuit reads the "arbitrary and capricious" standard to provide broad support to ERISA administrators, particularly with regard to decisions to deny benefits to departing employees who have not strictly followed applicable covenants in benefits plans. In *Wall*, the Fifth Circuit restated this standard as follows: "[i]f the plan fiduciary's decision is supported by substantial evidence and is not arbitrary and capricious, it must prevail."[5] The Fifth Circuit also noted that "review of the administrator's decision need not be particularly complex or technical; it need only assure that the administrator's decision fall somewhere on a continuum of reasonableness – even if on the low end."[6] This is a far more favorable standard than a "*de novo*" review of an employer or administrator's determination, which may otherwise apply under a contract or a benefit plan in the absence of plan administration and interpretation language that provides for sufficient discretion. Accordingly, employers should consider reviewing existing employee benefit plans for appropriate plan administration language, and consider (where appropriate) including restrictive covenants in benefit plans, to benefit from the more lenient "arbitrary and capricious" standard of review.

1. *Wall v. Alcon Labs, Inc.*, No. 13-10117 (5th Cir. 2014).
2. As a condition to receiving ASERP benefits, Mr. Wall was not allowed to associate with any business that "competes with the products manufactured and sold or services provided by the Alcon Affiliated Companies." Alcon denied benefits on the grounds that Alcon and Otonomy both were

competing in the market for treatments of *Otitis Media* (an ear condition).

3. *Wall v. Alcon Labs, Inc.*, No. 4:11-CV-8830A (N.D. Texas 2013).
4. Mr. Wall's purported diminutions were: (1) demotion from the position of project leader on a project constituting only 20 percent of his annual performance objectives and (2) being precluded from publishing an article, when publication was not listed as part of his job description or included in his evaluations.
5. *Wall v. Alcon Labs., Inc.* No. 13-10117, at 8 (5th Cir. 2014) (*citing Schexnayder v. Hartford Life & Accident Insurance Co.*, 600 F.3d 465,468 (5th Cir. 2010)).
6. *Wall v. Alcon Labs., Inc.* No. 13-10117, at 8 (5th Cir. 2014) (*citing Holland v. Int'l Paper Co. Ret. Plan*, 576 F.3d 240, 247 (5th Cir. 2009)).

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