Seventh Circuit Joins Sister Circuits in Holding That Courts, not Arbitrators, Should Decide the Availability of Class Arbitration

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In a matter of first impression before the Seventh Circuit Court of Appeals involving an issue left open by the Supreme Court of the United States, a Seventh Circuit panel issued an opinion on a key threshold question of class arbitrability. The question was who decides—a court or an arbitrator—whether arbitration can proceed on a class or collective basis. In an opinion authored by Judge Amy Coney Barrett, the Seventh Circuit joined the Third, Fourth, Sixth, Eighth, and Eleventh Circuits in holding that courts should answer this gateway question of arbitrability.

The case is Herrington v. Waterstone Mortgage Corporation, No. 17-3609 (October 22, 2018). The appeal arose out of an arbitration award of more than $10 million in damages, fees, and costs issued against Waterstone Mortgage Corporation after a collective Fair Labor Standards Act arbitration. The arbitration only proceeded on a collective basis after a district court ruling in 2011 invalidating a class and collective action waiver in the plaintiff’s arbitration agreement. Ultimately, in 2017, the arbitrator issued a finding of liability on a collective basis, which led to the award.

Waterstone retained Ogletree Deakins to challenge the liability award. The U.S. District Court for the Western District of Wisconsin confirmed the award in large part, prompting the appeal.

The Seventh Circuit heard oral argument on May 29, 2018, just days after the Supreme Court issued its ruling upholding class action waivers in Epic Systems Corporation v. Lewis. On October 22, 2018, the Seventh Circuit issued an opinion. The court first found that, in light of Epic Systems, the district court erred in invalidating the class action waiver in the plaintiff’s arbitration agreement. As a result, it vacated the district court’s order confirming the arbitration award.

The Seventh Circuit then wrote, “The lawfulness of the waiver is the easy part of this appeal. The hard part is a question Epic Systems does not address: what happens next?” The plaintiff argued, notwithstanding the class waiver and her prior position that the waiver was unenforceable, the agreement nevertheless allowed for collective arbitration. The court characterized this argument as “implausible.” But the key question facing the court was whether an arbitrator or a court should determine if the plaintiff’s agreement authorized class or collective arbitration.

The Seventh Circuit ruled that the issue of class arbitrability is a “gateway” question for courts and not arbitrators to decide. The court reasoned: “The availability of class or collective arbitration involves a foundational question of arbitrability,” which resolves the “question of with whom Waterstone chose to arbitrate.” The court further reasoned that “[d]eciding whether a contract permits class or collective arbitration...
arbitration involves a second...question of arbitrabili...whether the agreement to arbitrate covers a particular controversy; namely, a class or collective dispute. Finally, the court identified the “most important” reason for its decision. The court explained that class arbitration constitutes a “fundamental” change from bilateral arbitration. It ruled that such fundamental gateway questions should be resolved by the courts. If an arbitrator allowed for class arbitration and issued a class award, there would be “no effective means of review” of these orders. That is exactly what happened in the Herrington arbitration.

Significantly, the Seventh Circuit distinguished its prior precedent, which held that the issue of consolidated proceedings in arbitration was a procedural dispute for an arbitrator to resolve. The court found even those cases “expressly recognize[d] the difference between consolidating bilateral arbitrations and authorizing class arbitration.” The court ultimately concluded “the availability of class or collective arbitration is a threshold question of arbitrabili...On remand, the district court, rather than the arbitrator, must evaluate Herrington’s contract with Waterstone to determine whether it permits class or collective arbitration.”

The opinion is significant for two reasons. First, it upheld the lawfulness of class action waivers established in Epic Systems and vacated an arbitration award of more than $10 million. Second, the Seventh Circuit resolved a key open question in determining courts and not arbitrators should decide the availability of class arbitration. The majority of appellate circuits (including the Third, Fourth, Sixth, Eighth, and Eleventh Circuits) have now held that class arbitrabili...is a threshold question for courts to resolve. On the other hand, the Supreme Court of California has indicated that disputes over class arbitration are presumptively for arbitrators to decide unless delegated to courts.

The who decides issue is a critical one. As noted by the Seventh Circuit, whether an arbitration is limited to individual claims or instead allowed to proceed as a putative class action can fundamentally change the nature of arbitration. It can lead to far more complex, expensive, and time-consuming arbitrations, with far greater potential exposure. Moreover, the rulings of arbitrators and the rulings of courts are subject to vastly different standards of review. Court rulings regarding arbitration are often subject to de novo review and to immediate appeal if the court denies a motion to compel arbitration. On the other hand, an arbitrator’s interpretation of an arbitration provision is subject to far more limited review under the Federal Arbitration Act (FAA). Under the FAA, courts cannot reverse an arbitrator’s ruling solely due to legal error. The result is that an arbitrator has more flexibility in interpreting arbitration provisions, and given the standard of review, an employer may have a far more difficult time challenging an arbitrator’s ruling on class or collective arbitration. That is why many employers want this issue to be decided by the courts.

We will continue to monitor and report on developments in this area of law. While the ruling helps clarify the law in the Seventh Circuit, the case is also a good reminder for employers to consider reviewing their arbitration agreements. Employers that would like arbitration to proceed on an individual basis should consider whether their agreements contain clear and enforceable class and collective action waivers. Until the Supreme Court conclusively weighs in on this issue, employers that would also like courts to resolve the threshold question of class arbitrabili...may want to consider including language in arbitration agreements that explicitly delegate this responsibility to the courts.

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