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Is a State Statute Allowing an Employee to Sue in State Court Preempted by Federal Law?

by Jay E. Grenig

Barclay Perry and James Johnston
v.
Kenneth Morgan Thomas
(Docket No. 86-566)
Argued April 28, 1987

A California statute gives employees the right to sue in state court to collect unpaid wages, regardless of any existing private agreement to arbitrate (other than an arbitration agreement in a collective bargaining agreement). The United States Arbitration Act provides that written agreements to settle controversies by arbitration are enforceable.

ISSUES

This case presents the question of whether the United States Arbitration Act precludes an employee from suing in state court to collect wages if the employee's wage claim is referable to arbitration under an agreement between the parties.

FACTS

In May, 1984, a dispute arose between Kenneth Thomas and Barclay Perry and James Johnston concerning certain commissions allegedly owed Thomas but which were instead paid to Johnston. All three were employees of Kidder, Peabody & Co., a securities dealer. When Thomas applied for employment with Kidder Peabody, he signed a statement which provided:

"I agree to arbitrate any dispute, claim or controversy that may arise between me and my firm, or a customer, or any other person, that is required to be arbitrated under the rules, constitutions, or by-laws of the organizations with which I register..."

Among the organizations with which Thomas registered was the New York Stock Exchange. Rule 347 of the NYSE provides that "any controversy between a registered representative and any member or member organization arising out of the employment or termination of employment of such registered representative by and with such member or member organization shall be settled by arbitration, at the insistence of any such party, in accordance with the arbitration procedure prescribed elsewhere in these rules."

Thomas sued Perry and Johnston in state court, seeking nearly $200,000 in damages for unpaid commissions and for several tort claims. When Thomas refused to submit the dispute to arbitration, Perry and Johnston petitioned the court to stay the proceedings and to require Thomas to submit the dispute to arbitration. Denying the petition, the court held that Thomas' claims were for wages and were exempt from arbitration under California Labor Code section 229. After appeals to California appellate courts, the United States Supreme Court agreed to hear Thomas' appeal.

BACKGROUND AND SIGNIFICANCE

In *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Ware* (414 U.S. 117 (1973)), the Supreme Court unanimously held that the Securities and Exchange Act did not require that NYSE Rule 347 be given supremacy over Labor Code section 229. In *Ware*, Merrill Lynch relied on the state arbitration act rather than the United States Arbitration Act. Reviewing the legislative history of section 229, the Supreme Court observed that the legislature apparently desired "to protect the worker from the exploitative employer who would demand that a prospective employee sign away in advance his right to resort to the judicial system for redress of any employment grievance."

Ten years later, the Supreme Court held that the provisions of the California Franchise Investment Law, which required judicial consideration of claims brought under the law, conflicted with the United States Arbitration Act (*Southland Corp. v. Keating*, 104 S.Ct. 852 (1984); *Preview*, 1983-84 term, pp. 161-63). According to the Court, Congress expressed in the Arbitration Act a national policy favoring arbitration and withdrew the states' power to require a judicial forum for the resolution of claims that the contracting parties agreed to resolve by arbitration. Justice O'Connor and now Chief Justice Rehnquist dissented in that case, arguing that the Arbitration Act is a procedural statute applicable only in federal courts.

One year later, the Supreme Court ruled that by compelling arbitration of state law claims, a federal district court successfully protects the parties' contractual rights and their rights under the Arbitration Act (*Dean*

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Witter Reynolds, Inc. v. Byrd, 105 S.Ct. 1238 (1985); *Preview*, 1984-85 term, pp. 167-69). The Court explained that the purpose behind passing the Act was to ensure judicial enforcement of privately made agreements to arbitrate.

This case requires the Supreme Court to determine whether the state's concern with protecting workers from exploitative employers recognized in *Ware* is limited by the United States Arbitration Act's policy that arbitration agreements cannot be avoided by allowing one party to ignore the agreement and resort to the courts.

ARGUMENTS

***For Barclay Perry and James Johnston** (Counsel of Record, Peter Brown Dolan, 550 S. Flower Street, 6th Floor, Los Angeles, CA 90071; telephone (202) 683-1100)*

1. California Labor Code section 229 has been preempted by the United States Arbitration Act and the Securities and Exchange Act of 1934.
2. The United States Arbitration Act creates a body of federal substantive law of arbitrability that favors arbitration agreements.
3. Amendments to the Securities and Exchange Act of 1934 indicate a clear expression of congressional intent to preempt any state law, such as Labor Code section 229, which might interfere with Rule 347.
4. Even if Thomas has a non-arbitrable claim for wages against Perry and Johnston, the remaining tort claims must be submitted to arbitration.

***For Kenneth Morgan Thomas** (Counsel of Record, Bruce Gelber, 700 S. Flower Street, Suite 2200, Los Angeles, CA 90017; telephone (213) 488-0660)*

4. The agreement for compulsory arbitration constitutes an unenforceable contract of adhesion since the selection of arbitrators under Rule 347 is presumptively biased in favor of management and there is no opportunity for meaningful discovery under arbitration rules.
3. Because Perry and Johnston were not parties to Thomas' contract of employment which contained the arbitration clause, they lack standing to seek an order compelling arbitration.
4. The agreement for compulsory arbitration constitutes an unenforceable contract of adhesion since the selection of arbitrators under Rule 347 is presumptively biased in favor of management and there is no opportunity for meaningful discovery under arbitration rules.