NORTH VALLEY EMERGENCY SPECIALISTS, L.L.C. V. SANTANA: THE DEATH KNELL FOR EMPLOYEE ARBITRATION AGREEMENTS IN ARIZONA?

Gregory N. Thomas

I. BACKGROUND

A. Employment Arbitration and State Law under the FAA

The passage of the Federal Arbitration Act ("FAA")[1] in 1925 helped establish arbitration agreements as significant vehicles for alternative dispute resolution by attempting to put arbitration agreements on the same footing as other contracts.[2] In 1983, the United States Supreme Court established a "liberal federal policy favoring arbitration agreements."[3] Despite this federal mandate, arbitration agreements between employers and employees has been a controversial and evolving area of law for several decades. In fact, the Court did not clarify the scope of the FAA's application to employment contracts until 2001.[4]

In *Circuit City Stores, Inc. v. Adams*, one of the most significant cases concerning employee arbitration agreements, the U.S. Supreme Court provided an important clarification of an ambiguous provision of the FAA.[5] Under section 1 of the FAA, employment contracts of "seaman, railroad employees, or any other contracts of workers engaged in foreign or interstate commerce" are exempted from the Act's coverage.[6] The Court established that the exemption applies only to transportation workers—all other employment contracts are covered by the FAA.[7]

The *Circuit City* Court reaffirmed its previous holdings that Congress intended the FAA to apply to both state and federal courts.[8] The Court also

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1. 9 U.S.C. §§ 1–16 (2002).
2. *See* Gilmer v. Interstate/Johnson Lane Corp., 500 U.S. 20, 24 (1991).
3. *See* Moses H. Cone Mem'l Hosp. v. Mercury Constr. Corp., 460 U.S. 1, 24 (1983).
4. *See* Circuit City Stores, Inc. v. Adams, 532 U.S. 105 (2001).
5. *Circuit City*, 532 U.S. at 119.
6. *Id.* at 112.
7. *Id.* at 119.
8. *Id.* at 112.

affirmed the FAA's preemption of state laws that are in conflict with it.[9] However, states are still allowed to establish laws related to arbitration processes and procedures, so long as those laws do not conflict with the national policy favoring arbitration.[10]

B. The Arizona Arbitration Act

In 2003, the Arizona legislature enacted statutes that govern private arbitration agreements and provide guidelines for enforcement and validity of arbitration agreements.[11] Arizona Revised Statutes section 12-1517, precludes arbitration agreements between employees and employers.[12] However, until the recent *North Valley Emergency Specialists v. Santana* decision, a significant question regarding the scope of this provision remained open.[13] The statute specifically states that it has "no application to arbitration agreements between employers and employees or their respective representatives."[14] In *North Valley*, the Arizona Supreme Court decided whether section 12-1517 referred to all employee arbitration agreements or just those involving a collective bargaining agreement.[15] The court held that the scope of the provision includes all employees, rather than only collective bargaining employees.[16] This meant that, under the Arizona Arbitration Act ("AAA"), all employee-employer arbitration agreements were unenforceable because they lacked an enforcement mechanism under Arizona law.[17]

Despite this seemingly clear pronouncement, the *North Valley* court raised, but declined to answer, some significant issues regarding potential enforcement of employee-employer arbitration agreements.[18] This Case Note will analyze the *North Valley* decision in light of existing federal arbitration law and frame the unresolved issues left open by the court.

II. THE ARIZONA SUPREME COURT INTERPRETS ARIZONA REVISED STATUTE SECTION 12-1517

In *North Valley*, a group of physicians and physician assistants, who worked for Team Physicians of Arizona, Inc. ("TPA"), a provider of emergency services for hospitals, left TPA and formed their own competing company, North Valley Emergency Specialists, L.L.C. ("NVES").[19] While at TPA, the former employees signed an employment agreement containing an arbitration clause

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9. *Id.*; *see also* Allied-Bruce Terminix Cos. v. Dobson, 513 U.S. 265, 281 (1994); Southland Corp. v. Keating, 465 U.S. 1, 16 (1983).
10. *See* 9 ARIZ. PRAC. BUSINESS LAW DESKBOOK § 12:19 at 2 (2005).
11. ARIZ. REV. STAT. §§ 12-1501 to 12-1518 (2003).
12. *Id.* at § 12-1517.
13. N. Valley Emergency Specialists v. Santana, 93 P.3d 501 (2004).
14. ARIZ. REV. STAT. § 12-1517.
15. *N. Valley*, 93 P.3d at 502.
16. *Id.* at 506.
17. *See* 9 ARIZ. PRAC. BUSINESS LAW DESKBOOK § 12:19 at 2 (2005).
18. *N. Valley*, 93 P.3d at 506.
19. *Id.* at 502.

requiring that "any and all disputes" arising out of employment were to "be settled by arbitration."[20]

TPA sued NVES and its former employees for damages and injunctive relief, requesting that the cases be submitted to arbitration pursuant to the arbitration agreement.[21] After the defendants refused to arbitrate, TPA responded by submitting a motion to compel arbitration under Arizona Revised Statutes section 12-1502.[22] That section provides that a court will order the parties to arbitrate when there is a valid arbitration agreement in place.[23] NVES contended that the trial court did not have the authority to compel arbitration because section 12-1517 exempts employment contracts from arbitration under the AAA.[24]

Rejecting NVES's argument, the trial court ruled that section 12-1517 applied only to collective bargaining agreements rather than all employment agreements and ordered the parties to arbitrate.[25] NVES then filed a petition for special action review with the court of appeals, which declined jurisdiction.[26] Because there were no appellate decisions dealing with the issue, the Arizona Supreme Court accepted review to resolve the important questions concerning the scope of section 12-1517.[27]

The *North Valley* court, based on the "clear language" of section 12-1517 and the legislative history of the AAA, concluded that the legislature intended to exclude all employee-employer arbitration agreements from the AAA.[28] The court reasoned that statutory language is "the best and most reliable index of a statute's meaning"[29] and that "[i]f the language is clear the court must 'apply it without resorting to other methods of statutory interpretation,' unless the application of the plain meaning would lead to impossible or absurd results."[30] The court reasoned that due to the clarity of the statute's language, the plain meaning analysis appropriately led it to the conclusion that, "an arbitration agreement between an employer and employee is not subject to the provisions of the Act."[31]

The court rejected TPA's arguments that excluding all employer-employee arbitration agreements was contrary to the AAA's purpose, and that, based on statutory interpretation, section 12-1517 actually only referred to collective bargaining employees.[32] The *North Valley* court noted that the Arizona legislative history indicated that the legislature, when adopting the Uniform

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20. *Id.*
21. *Id.*
22. *Id.*
23. *Id.*
24. *Id.*
25. *Id.*
26. *Id.*
27. *Id.*
28. *Id.* at 503.
29. *Id.* (citing State v. Williams, 854 P.2d 131, 133 (1993) (quoting Janson v. Christensen, 808 P.2d 1222, 1223 (1991))).
30. *Id.* at 503 (citing Bilke v. State, 80 P.3d 269, 271 (2003) (quoting Hayes v. Cont'l Ins. Co., 872 P.2d 668, 672 (1994))).
31. *Id.* at 503.
32. *Id.* at 504.

Arbitration Act ("UAA"), specifically rejected the portion of it that made it applicable "to arbitration agreements between employers and employees or between their respective representatives."[33] Instead, the Arizona legislature, unlike the provision found in the UAA, cast the AAA provision in the negative, explicitly providing that the AAA has "*no* application to arbitration agreements between employers and employees or their respective representatives."[34]

The court reasoned that had the legislature wanted to exempt only collective bargaining employee-employer agreements, no statutory change would have been needed.[35] However, since the legislature made the aforementioned textual changes, the court presumed that the legislature intended to change the statute's meaning to exclude all employee-employer arbitration agreements.[36] Finally, the court rejected TPA's statutory construction arguments and vacated the trial court's order compelling arbitration.[37]

III. *NORTH VALLEY*'S CONSISTENCY, OR LACK THEREOF, WITH PRIOR U.S. SUPREME COURT DECISIONS

The *North Valley* decision, although based solely on Arizona law, appears contrary to the U.S. Supreme Court's decisions in *Circuit City* and its predecessors.[38] In *Southland Corp. v. Keating*, the U.S. Supreme Court concluded that the FAA preempts state law and that state courts cannot apply state statutes that invalidate arbitration agreements.[39]

That holding was reaffirmed by the Court in *Allied-Bruce Terminix Cos. v. Dobson*, which declined to reconsider the issues since they were "now well-established law."[40] In *Allied-Bruce Terminix*, the U.S. Supreme Court reversed an Alabama Supreme Court decision affirming a state statute that invalidated predisputed arbitration agreements.[41] The Alabama court interpreted the FAA to apply only when parties to an agreement contemplated substantial interstate activity.[42] Based on that reasoning, that court found that the FAA did not apply because the parties (i.e., the termite prevention company and homeowner) contemplated a primarily local and not substantially interstate transaction.[43] However, the U.S. Supreme Court reversed, interpreting FAA's section 2 phrase "evidencing a transaction involving commerce" broadly, to extend to the limits of Congress's Commerce Clause power.[44] The effect is that states are not free use this

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33. *Id.*
34. *Id.*
35. *Id.*
36. *Id.*
37. *Id.* at 505–06.
38. *See* Circuit City Stores, Inc. v. Adams, 532 U.S. 105, 112 (2001); *see also* Allied-Bruce Terminix v. Dobson, 513 U.S. 265, 281 (1995); Southland Corp. v. Keating, 465 U.S. 1, 15–16 (1983).
39. *Southland,* 465 U.S. at 15–16.
40. 513 U.S. at 272.
41. *Id.* at 282.
42. *Id.* at 269.
43. *Id.*
44. *Id.* at 273–77.

reasoning to carve out exemptions to the FAA's reach and thereby apply their own antiarbitration law or policy.[45]

Lastly, the *Circuit City* Court noted that the FAA preemption holding under *Southland* was not to be "chipped away at by indirection."[46] These cases illustrate the U.S. Supreme Court's expansive view regarding the reach of the FAA and provide a stark contrast with the Arizona Supreme Court's holding in *North Valley* that all employee-employer arbitration agreements are excluded from the AAA.[47]

IV. UNRESOLVED ISSUES IN *NORTH VALLEY*—ENFORCEABILITY UNDER COMMON LAW OR THE FAA

Although the *North Valley* court rejected TPA's argument for enforcement under AAA, it left open two potential enforcement mechanisms for arbitration agreements—common law[48] and the FAA.[49] The court declined to address enforceability under the common law because neither party argued that the arbitration clauses were enforceable as common law contract terms or that employees and employers can agree to arbitration without the benefit of the statute. TPA, in a supplemental brief, raised another potentially dispositive issue—whether the FAA preempts the AAA because "all forms of employment agreements . . . are subject to compulsory arbitration under the [FAA]."[50] Unfortunately, this looming issue was not resolved. The court ruled that because TPA had not raised the issue of federal preemption of the AAA under federal law (i.e., the FAA) at either the trial court or the court of appeals, the issue had been waived.[51]

Given this situation, it seems clear that at some point the Arizona courts will likely need to grapple with both of the following issues: (1) whether an Arizona employment arbitration agreement is enforceable under common law contract principles, and (2) whether an Arizona employment arbitration agreement is enforceable under the FAA, based on its preemption of the AAA. Perhaps the court in *North Valley* was setting the stage to resolve those very issues in the future.

V. CONCLUSION

In *North Valley*, the Arizona Supreme Court resolved the question regarding the scope of Arizona Revised Statute section 12-1517 by holding that its arbitration agreement exclusions applied to all employees, not just collective bargaining employees. The *North Valley* decision seems contrary to recent U.S. Supreme Court decisions that favor the enforcement of employment arbitration agreements and hold that the FAA preempts state laws hostile to arbitration.

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45. *Id.* at 272–73.
46. Circuit City Stores, Inc. v. Adams, 532 U.S. 105, 122 (2001).
47. *N. Valley*, 93 P.3d at 506.
48. *Id.*
49. *Id.* at 503.
50. *Id.*
51. *Id.*

However, the court, in *North Valley*, also declined to address the issues of whether the arbitration agreements would have been enforceable under common law contract principles or federal law through the FAA. It seems likely that Arizona courts will soon need to resolve these issues in order to clarify the enforceability of Arizona employment arbitration agreements.