Arbitration of Employment Claims - An overview

Jonathan Ben-Asher
Beranbaum Menken Ben-Asher & Fishel LLP
Three New York Plaza
New York, N.Y. 10004
Telephone: 212 509-1616
Facsimile: 212 509-8088
E-mail: jb-a@bmbf.com

Basic Employment Rights and Responsibilities
American Bar Association 2002 Convention
Section of Labor and Employment Law
August 10, 2002
Washington, D.C.

© 2002 by Jonathan Ben-Asher
Arbitration of Employment Claims - An overview

Jonathan Ben-Asher
Beranbaum Menken Ben-Asher & Fishel LLP

I. What is arbitration and why don’t plaintiffs’ lawyers usually like it?

“Arbitration” encompasses a wide range of methods of alternative dispute resolution, which are being used in an increasing variety of contexts. ¹ In arbitration, there is no jury, formal rules of evidence are unlikely to apply, discovery is quite limited, and there is an extremely narrow scope of judicial review. Depending on the particular forum, the available remedies may also be limited.

For these reasons alone, mandatory arbitration has been favored by the management bar, and feverishly resisted by most lawyers for employees—at least in cases based on statutory employment claims, where wide-ranging discovery can be crucial and access to a jury is prized.

Attorneys for plaintiffs do not necessarily object to arbitration itself, but rather to its imposition. For plaintiffs, there may be many occasions on which arbitration is preferable to litigation, such as limited disputes over employment contracts. There may be an advantage in the parties being able to choose the presiding neutral, and in some cases arbitration may be less expensive than litigation. However plaintiffs’ lawyers, of course, would like to have their clients choose those occasions, rather than have them imposed before a dispute arises.

¹ This paper does not address issues arising in traditional labor arbitrations arising under collective bargaining agreements.
II. Arbitration procedures

Arbitration is a creature of contract, which means it requires an agreement to arbitrate. As discussed below, the courts have usually been generous in finding an “agreement.”

An agreement to arbitrate will usually describe the disputes covered by the agreement and the forum selected for the arbitration, and either set out the procedures that govern the arbitration or refer to the chosen forum’s arbitration rules. Those rules should normally describe what a party must do to invoke arbitration, how fees and costs will be allocated between the parties, rules for pleadings, how the arbitrator is picked (by either designating a specific individual, or picking an arbitrator from a roster of an ADR provider), what procedures apply regarding discovery and motions, hearing procedures, the applicable law and standards of proof, the form of the arbitrator’s award, and the extent to which a party can seek review.

One of the most frequently used arbitration forums is the American Arbitration Association (AAA).

The AAA’s rules:

The American Arbitration Association has promulgated a set of detailed rules for the arbitration of employment disputes. These rules can be found at www adr.org.

These rules were developed after a panel of representatives of management, labor, employment, civil rights organizations and the AAA published a Due Process Protocol for Mediation and Arbitration of Statutory Disputes Arising out of the Employment Relationship. The Due Process Protocols reflected concerns over the fairness of arbitration procedures, as applied to statutory discrimination claims.

The panel was unable to agree about the propriety of mandatory arbitration agreements arising before or at the inception of the employment relationship. However, it did recommend a number of procedures to better protect the rights of claimants, including that employees should have the right to be represented by someone of their own choosing;

although fees for such representation should be based on an arrangement between the claimant and his representative,
employer procedures to reimburse at least part of those fees
should be encouraged;

there be “adequate but limited” pre-trial discovery, and
“necessary pre-hearing depositions consistent with the
expedited nature of arbitration;”

Parties be provided with contact information for
representatives who have recently appeared before the
arbitrator.

The arbitrator should be empowered to award “whatever
relief would be available in a court of law.”

The result was the AAA’s National Rules for the Resolution of
Employment Disputes. The National Rules provide that:

The party seeking arbitration shall file and serve a demand
within the time limit established by the applicable statute of
limitations if the dispute involves statutory rights. If statutory
rights are not involved, the filing period is set by the
arbitration agreement the parties signed.

The respondent files an answer and counterclaims within ten
days, and the claimant files an answer to the counterclaims
within ten days. Either party may request, or the AAA may
schedule, a pre-arbitration conference, which may include
consideration of mediation.

The arbitrator has authority to order discovery as he considers
“necessary to a full and fair exploration of the issues in
dispute, consistent with the expedited nature of arbitration.”
This may include depositions, interrogatories, document
production and other methods.

The arbitrator shall conduct an Arbitration Management
Conference with the parties to consider procedural and
substantive issues in the case.

The location of the arbitration, if not agreed upon by the
parties, is determined by the AAA; the parties may object to
that choice, but the AAA makes the final decision.

Selection of the arbitrator:
Arbitrators of employment disputes shall meet specified standards, including experience in employment law and neutrality.

The arbitrator is selected by the parties, from a limited choice provided by the AAA. If the parties cannot agree, the AAA selects.

Prior to accepting the appointment, the arbitrator must disclose all information that might be relevant to his neutrality.

Parties may seek to challenge the arbitrator based on failure to “meet standards of excellence and neutrality.”

Any party may be represented by counsel.

A stenographic record, if made, is paid for by the party arranging for it.

Fees and costs:

The AAA’s rules provide for filing fees, hearing fees, and the arbitrator’s compensation. The AAA can require the parties to deposit all fees in advance, and the arbitration can be suspended for non-payment. The arbitrator can apportion these costs in favor of either party. The arbitrator can also award attorney’s fees in accordance with applicable law.

Burdens of proof: “The parties shall have the same burden of proof and burdens of producing evidence as would apply if their claims and counterclaims had been brought in court.”

Evidence: The arbitrator has authority to set the rules for conduct of the proceeding. “The arbitrator shall be the judge of the relevance and materiality of the evidence offered, and conformity to legal rules of evidence shall not be necessary.” The arbitrator may also receive and consider evidence in the form of affidavits, subject to giving it the weight he deems proper.
The arbitrator may subpoena witnesses or documents.

Interim relief: The arbitrator may take whatever interim measures he deems necessary, including measure for the conservation of property.

Arbitrator’s award: shall be made no less than 30 days from the close of the hearing, and shall be publicly available. It shall provide the reasons for the award, unless the parties agree otherwise. The arbitrator can grant any remedy or relief that he deems just and equitable, including any which would have been available in court.

III. The Federal Arbitration Act

The Federal Arbitration Act, 9 U.S.C. Sec. 1 et seq., is the basis for the enforcement of most arbitration provisions. The FAA, which was originally enacted in 1925 and amended in 1947, provides:

Validity, irrevocability, and enforcement of agreements to arbitrate

A written provision in any maritime transaction or a contract evidencing a transaction involving commerce to settle by arbitration a controversy thereafter arising out of such contract or transaction, or the refusal to perform the whole or any part thereof, or an agreement in writing to submit to arbitration an existing controversy arising out of such a contract, transaction, or refusal, 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. Sec. 2.

A. Motions to compel arbitration under the FAA

The FAA permits a party seeking to compel arbitration to bring a proceeding in federal court to stay a proceeding, and for an order
compelling arbitration when a party has not complied with an arbitration agreement. The party resisting arbitration can demand a trial by jury of the arbitrability issue. (However, most cases are decided by the court using summary judgment standards). If the court or jury finds there is a written arbitration agreement and that a party has defaulted in proceeding under it, the court may direct the parties to proceed with the arbitration. FAA, 9 U.S.C. Secs. 3 and 4.

B. Arbitration procedures under the FAA

1. Appointment of the arbitrator:

Normally the arbitration agreement provides for a method for picking the arbitrator. In the rare case where it does not, or if a party “shall fail to avail himself of such method,” a party can apply to the federal district court to appoint an arbitrator. 9 U.S.C. Sec. 5.

2. Witnesses

The FAA authorizes the arbitrator to order the attendance of witnesses and order those witnesses to bring documents to the hearing. If a witness disobeys the summons, the district court can compel attendance or punish the witness for contempt. 9 U.S.C. Sec. 8.

3. Arbitration award

If the parties’ arbitration agreement provides that an arbitration award may be the basis of a judgment in court, any party to the arbitration can request judicial confirmation of the award. The application should be made to the court specified in the agreement, or if the parties did not name a court, to the district court where the award was made. The court must confirm the award, unless the ward is vacated, modified or corrected. 9 U.S.C. Sec. 9.

4. Judicial review

Courts are normally extremely reluctant to vacate arbitrators’ awards, and usually defer to the arbitrator, unless there is proof of clear error, the abuse of discretion, fraud, corruption, misconduct, or where the arbitrator exceeded his power.
a) Vacating the award

The FAA, 9 U.S.C. Sec. 10a, permits awards to be vacated on a few narrow grounds. These are:

Where the award was “procured by corruption, fraud, or undue means.”

Where there was “evident partiality or corruption” by an arbitrator.

Where the arbitrator committed misconduct by refusing to postpone the hearing, hear pertinent and material evidence, or was guilty “of any other misbehavior by which the rights of any party have been prejudiced.”

Where the arbitrator exceeded his powers, or “so imperfectly executed them that a mutual, final and definite award upon the subject matter submitted was not made”

Another permissible ground, though not mentioned in the FAA, is an arbitrator’s “manifest disregard” of the law. However, even this is applied extremely narrowly. Exxon Shipping Co. v. Exxon Seamen’s Union, 993 F.2d 357 (3rd Cir. 1993). For example, see Merrill Lynch Pierce Fenner & Smith v. Bobker, 808 F. 2d 930, 933-4 (2nd Cir. 1986) (arbitrator shows “manifest disregard” when he understands a clearly governing legal standard but decides to ignore it); DiRussa v. Dean Witter Reynolds Inc., 121 F.3d 818 (2nd Cir. 1997), cert. denied, 522 U.S. 1049 (denying plaintiff’s motion to vacate or modify award where arbitrator was unaware that the ADEA provided for an award of attorneys fees to the prevailing party, but the plaintiff did not adequately inform the arbitrator of the governing law.)

b) Modifying the award

The FAA permits a court to modify or correct an award if:
There was an evident material miscalculation of figures

The arbitrator made an award on a matter not submitted to arbitration which affects the merits of the decision on the matter which was submitted

The award has a defect in form not affecting the merits.

IV. Challenges to Mandatory Arbitration

Mandatory arbitration has grown with the development of case law approving it over the challenges of employees. Millions of employees are now covered by such provisions. Employees have largely been unsuccessful in challenging the application of mandatory arbitration clauses, but there are still many challenges left.

A. The Supreme Court’s decision in *Gilmer*

In *Gilmer v. Interstate/Johnson Lane Corp.*, 500 U.S. 201 (1991) the Supreme Court, endorsing arbitration, ruled that in general claims arising under statute may be made subject to mandatory arbitration.

The plaintiff in *Gilmer* argued that an arbitration agreement contained in his New York Stock Exchange registration application (the “U-4” form) could not be enforced to require him to arbitrate his claims under the ADEA. The court ruled that a mandatory pre-dispute arbitration agreement was enforceable to require arbitration of a statutory claim unless Congress “intended to preclude a waiver of a judicial forum” for the statutory claim in issue. 500 U.S. at 14.

The court emphatically rejected the plaintiff’s argument that mandatory arbitration deprived him of rights under the ADEA. It wrote that by agreeing to arbitrate a statutory claim, “a party does not forgo the substantive rights afforded by the statute; it only submits to their resolution in an arbitral, rather than a judicial, forum.” 500 U.S. at 13.

The court also rejected the “host” of plaintiff’s challenges to the
fairness of arbitration as “far out of step with our current strong endorsement of the federal statutes favoring this method of resolving disputes.” The court did not consider any of the grounds on which arbitration might be most suspect — with respect to bias, limited discovery, the lack of detailed written opinions and limited appellate review — to be significant. 500 U.S. at 30.

B. Challenges to mandatory arbitration of statutory claims after Gilmer

Since the decision in Gilmer, the federal courts have repeatedly upheld mandatory arbitration of various statutory claims, including claims under Title VII, the FMLA, the ADA, ERISA, and the Equal Pay Act. 2 See, e.g., Rosenberg v. Merrill, Lynch, Pierce, Fenner & Smith, Inc. 170 F.3d 1 (1ST Cir 1999) (rejecting challenge to mandatory National Association of Securities Dealers arbitration of Title VII claims based on language in the Civil Rights Act of 1991 [amending Title VII in which Congress appeared to encourage arbitration and other ADR procedures]; Desiderio v. National Association of Securities Dealers, Inc., 191 F.3d 198 (2nd Cir. 1999) (same); Seus v. John Nuveen & Co., 146 F. 3d 175 (3d Cir. 1998), cert. denied, 525 U.S. 1139 (same); Patterson v. Tenet Healthcare, Inc., 113 F.3d 832 (8th Cir. 1997) (Title VII claims arbitrable in general). 3

A very lonely exception is the Ninth Circuit’s ruling in Duffield v. Robertson Stephens & Co., 144 F.3d 1182 (9th Cir. 1998); cert. denied, 525 U.S. 982 (1998) (rejecting mandatory arbitration of Title VII claims)

C. The Supreme Court’s Decision in Circuit City v. Adams


3 One segment of the securities industry has taken a step back from mandatory arbitration. The National Association of Securities Dealers (NASD) adopted a rule, approved by the SEC and effective January 1, 1999, requiring its member employers to exempt from mandatory arbitration any claims of employment discrimination or sexual harassment. 63 Fed. Reg 35299 (1998).
The Federal Arbitration Act specifically exempts from its coverage “contracts of employment of seamen, railroad employees, or any other class of workers engaged in foreign or interstate commerce.” 9 U.S.C. Sec. 1.

In Gilmer, the Supreme Court explicitly declined to interpret this language, and refused to address the issue of whether the Federal Arbitration Act bars the enforcement of a mandatory arbitration clause contained in an individual employment contract. The Court was able to sidestep this question, because the Gilmer’s arbitration agreement was not part of an employment contract, but was contained in his registration statement with the New York Stock Exchange.

After Gilmer, virtually all the Courts of Appeals which addressed the issue rejected employees’ claims that the Federal Arbitration Act precludes the enforcement of mandatory arbitration agreements contained in employment contracts. Instead, these courts found that the FAA only excludes from coverage employment contracts of workers actually engaged in the movement of goods in interstate commerce.

See e.g., Cole v. Burns International Security Services, 105 F. 3d 1465 (D.C. Cir. 1997); Great Western Mortgage Corp. v. Peacock, 110 F. 3d 222, 227 (3d Cir.), cert. denied, 522 U.S. 915 (1997); O’Neil v. Hilton Head Hospital, 115 F.3d 272, 274 (4th Cir. 1997); Rojas v. TK Communications, Inc., 87 F.3d 745, 748 (5th Cir. 1996); Asplundh Tree Expert Co. v. Bates, 71 F.3d 592, 600-01 (6th Cir. 1995); Miller Brewing Co. v. Brewery Workers Local Union No. 9, 739 F.2d 1159, 1162 (7th Cir. 1984); Dickstein v. duPont, 443 F.2d 783, 785 (1st Cir. 1971); Erving v. Virginia Squires Basketball Club, 468 F.2d 1064, 1069 (2d Cir. 1972).

The sole exception was, again, the Ninth Circuit. In Circuit City Stores v. Adams, 194 F.3d 1070 (9th Cir. 1999), it held that the Federal Arbitration Act exception clause (Sec. 1) is very broad, and that the FAA therefore does not apply to individual employment contracts.

Last year, the Supreme Court firmly decided this issue, ruling that the FAA covers all contracts of employment except those of workers actually engaged in the movement of goods interstate. Circuit City Stores v. Adams, 532 U.S. 105 (2001).

The employee in Circuit City, Adams, had signed a mandatory arbitration agreement — Circuit City’s Dispute Resolution
Agreement — as part of his job application. After he brought a discrimination action in state court under California’s Fair Employment and Housing Act, Circuit City brought an action in federal court to compel arbitration under the FAA. The District Court ordered the case to arbitration.

The Ninth Circuit, reversing, ruled that the FAA was inapplicable to the case because Circuit City’s Dispute Resolution Agreement was an employment contract (in spite of the agreement’s disclaimer of exactly that). The court based its decision on its prior decision in *Craft v. Campbell Soup, Co.*, 177 F.3d 1083 (9th Cir. 1999), in which it had held that Congress did not intend the FAA to apply to “labor or employment contracts;” the *Craft* court thus held that an arbitration agreement contained in a collective bargaining agreement could not bar the plaintiff’s race discrimination claim.

The Supreme Court reversed the Court of Appeals in a 5-4 decision which again endorsed the use of mandatory arbitration in employment disputes. The Court ruled that Sec. 1 of the FAA, excluding from the statute’s coverage “contracts of employment of seamen, railroad employees, or any other class of workers engaged in foreign or interstate commerce,” concerns only employees actually engaged in the movement of goods in interstate commerce. The Court thus rejected Adams’ argument, and the Ninth Circuit’s holding, that employment contracts in general are not covered by the FAA. The Court’s reasoning was simple, based on the application of that old maxim of statutory interpretation, ejusdem generis: by specifically naming seamen and railroad employees, Congress showed its intent to only exempt similar classes of workers.

The Court also rejected Adams’ argument that Section 2 of the FAA, which makes the statute applicable to contracts “evidencing a transaction involving interstate commerce,” does not just apply to contracts between commercial parties, because in enacting the FAA, Congress intended to use the full reach of the commerce clause.

The Court strongly rejected the other arguments raised by Adams, many amici, and the four dissenting Justices.

It rejected Adams’ argument that the FAA’s legislative history showed that the exception in Sec. 1 was actually placed in the statute in response to concerns that the FAA might inappropriately require arbitration in labor disputes, and that the language was actually intended to shield employees from mandatory arbitration. (To the dissenters, the court was
“playing ostrich” with the “substantial” legislative history.

It dismissed the claim that broadly applying the FAA to employment disputes would wrongly preempt the states’ traditional role in regulating employment relationships, and would interfere with states’ ability to legislatively prohibit mandatory arbitration of state-law discrimination claims. The Court noted that in *Southland Corp. v. Keating*, 465 U.S. 1 (1984), it had ruled that Congress intended the FAA to preempt state anti-arbitration laws, and for the FAA to apply in state courts. To the dissenters, the Court simply “ignored the interest of the unrepresented employee.”

The Court again spoke of the “real benefits to the enforcement of arbitration provisions,” which it said included avoidance of the costs of litigation “and the accompanying burdens to the Courts.” “We have been clear in rejecting the supposition that the advantages of the arbitration process somehow disappear when transferred to the employment context.” The Court appeared to view employment cases as particularly suitable to arbitration, because they involve smaller sums of money than commercial disputes, and present “difficult choice-of-law questions.” It noted that Adams’ view of the FAA “would call into doubt the efficacy of alternative dispute resolution procedures adopted by many of the Nation’s employers” — as if those procedures were above examination and were in themselves a compelling basis for enforcing mandatory arbitration.

To the dissenters, the Court’s statutory analysis was “deliberately uninformed,” producing a “sad result” which was only “consistent with a court’s own views of how things should be.”

V. Arbitration issues and challenges to arbitration after *Circuit City*

While the decision in *Circuit City* produced much discussion and press coverage, it is important to recognize that, for all the fanfare, it did not change the state of the law governing arbitration of employment disputes in most areas of the country. Outside of the Ninth Circuit, courts had largely viewed the FAA as covering all employees except those who actually move goods in interstate commerce. So, for the other Circuits, *Circuit City* affirmed the status quo.
The fact that most employees are subject to the FAA is only the starting point in the potential battles over employment arbitration. *Circuit City* did not address many of the crucial questions about employment arbitration which are now likely to occupy the courts, as employees resist mandatory arbitration. Likely areas of litigation include:

The extent to which the FAA preempts state law

What constitutes a “written agreement” sufficient to form an arbitration agreement under the FAA

What state-law contract defenses will void an arbitration agreement

What procedural and substantive protections are required in employment arbitration, including

- The extent of discovery
- Arbitral neutrality
- Availability of remedies
- Apportionment of fees and costs

Whether an arbitration agreement can also preclude the EEOC or state Fair Employment Practice agencies from pursuing claims on behalf of employees

The effect of potential remedial legislation

These questions are discussed below.

**A. The FAA and State law**

Prior to *Circuit City*, the Supreme Court had ruled that the FAA preempts all state laws which “undercut the enforceability of arbitration agreements.” *Southland Corp. v. Keating*, 465 U.S. 1, 16 (1984). This means that States cannot exempt transactions or parties from arbitration. In addition, under *Southland*, a party can move to compel arbitration in either federal or state court. If the FAA applied only to federal court proceedings, the Court reasoned, plaintiffs would be rewarded for forum shopping. (“Since the overwhelming proportion of all civil litigation in this country is in state courts...we cannot believe Congress intended to limit the Arbitration Act to disputes subject only to federal-court jurisdiction.”)

The FAA also apparently precludes a state from enacting legislation requiring arbitration agreements to meet more stringent standards
than those of the FAA — for example, requiring an arbitration agreement to be signed by the employee after a mandated review period. The Supreme Court has ruled that the FAA preempted a state statute which made arbitration agreements unenforceable unless a notice that the contract was subject to arbitration was “typed in underlined capital letters on the first page of the contract.” The FAA precludes States from “singling out arbitration provisions for suspect status, requiring instead that such provisions be placed ‘upon the same footing as other contracts.’” Doctor’s Associates, Inc. v. Casarotto, 517 U.S. 681, 687 (1996). So, while a state may pass legislation requiring all contracts to meet certain requirements, it cannot direct such a law at arbitration agreements in particular.

It is unclear whether Southland and Doctor’s Associates would also prevent States from mandating basic procedural protections such as document production and depositions, or prohibiting arbitration forums from charging employees fees and expenses.
B. What defenses are available to a party resisting arbitration under the FAA?

1. Is there a written agreement to arbitrate?

The FAA requires an “agreement in writing” to submit a controversy to arbitration. 29 U.S.C. Sec. 2. When a party seeks to compel arbitration, the initial question for the court is whether such an agreement exists. Employees seeking to avoid arbitration have had limited success in arguing that the arbitration agreement relied on by the employer is not, actually, an agreement.

a) Consideration

Employees have often argued that a mandated arbitration agreement is no agreement at all, because the employee was given no consideration for entering into it. These arguments have usually failed, because most courts view an at-will employee’s continued employment as sufficient consideration for the employee’s promise to arbitrate.

See, e.g., Metzler v. Harris Corporation, 2001 U.S. Dist. LEXIS 1903 (S.D.N.Y. February 23, 2001) (arbitration clause in compensation agreement requires no additional consideration); Ahing v. Lehman Brothers, Inc., 2000 U.S. Dist. LEXIS 5175 (S.D.N.Y. 2000) (employee who signed arbitration agreement after she became employed was given sufficient consideration for promise to arbitrate, because her at-will employment was continued.)

However, in Gibson v. Neighborhood Health Clinics, 121 F.3d 1126 (7th Cir. 1997), the court held that continued employment was not adequate consideration for an agreement to arbitrate because there was no evidence that the employer’s decision to continue the plaintiff’s employment was actually based on the employee signing the arbitration clause. The moral here is that employees resisting arbitration should seek discovery on this issue, as well as on the question of what happened to employees who refused to sign an arbitration agreement.
b) Employee handbooks and policy statements

Employees have had some greater success in attacking the validity of arbitration provisions contained in employee handbooks. See Nelson v. Cyrus Bagdad Copper Corp., 119 F.3d 756 (9th Cir. 1997) (finding no agreement where employee only agreed to “read and understand” handbook containing arbitration clause, and rejecting continued employment as consideration). Many employee handbooks contain an explicit disclaimer that they constitute a “contract,” and are therefore vulnerable to attack as not creating an arbitration “agreement.” See Ramirez-de-Arellano v. American Airlines, 133 F.3d 89 (1st Cir. 1997) (finding no agreement where handbook provided it was not a contract and was subject to unilateral amendments by the employer); Snow v. BE&K Construction, 126 F. Supp. 2d 5 (D. Maine 2001) (same).

Employers who have such disclaimers in their handbooks should probably use separate arbitration agreements, or create a separate identity for an arbitration agreement contained in a handbook. See, e.g., Patterson v. Tenet Healthcare, Inc., 113 F.3d 832 (8th Cir. 1997) (arbitration agreement in handbook was a valid contract, since it was highlighted with an introduction, was removed from the handbook after signing and separately stored, and contained strong contractual language contrasting with the tone of the handbook.)

Note that courts have also sustained handbook arbitration provisions based on the consideration furnished by the employee’s continued employment. Lang v. Burlington Northern Railroad Company, 835 F. Supp. 1104 (D. Minn. 1993)

which was not “buried” in an employment handbook, and finding sufficient consideration in plaintiff’s continued employment.)

c) **Mutuality**

Employers risk having their arbitration agreements invalidated if they reach too far, and reserve to themselves, or to a third-party ADR provider, the right to alter the rules which govern the arbitration of a dispute. In *Floss v. Ryan’s Family Steak Houses, Inc.*, 211 F.3d 306 (6th Cir. 2000), the court voided an arbitration agreement which gave the arbitral forum complete discretion in altering the arbitral rules, without having to obtain an employee’s consent or even notify the employee of the change. As a result, the agreement lacked mutuality of obligation, and therefore lacked consideration. See also *Brennan v. Bally Total Fitness*, 198 F. Supp. 2d 377 (S.D.N.Y. 2002) (agreement invalid because it permitted employer to modify the terms at any time.)

2. **Assuming there is a written agreement, is it valid?**

The FAA makes arbitration agreements enforceable “save upon such grounds as exist at law or in equity for the revocation of any contract.” FAA, 9 U.S.C. Sec. 2. The “grounds” are those set out in the relevant state common law governing the formation of contracts. “[G]enerally applicable contract defenses, such as fraud, duress, or unconscionability, may be applied to invalidate arbitration agreements” without raising preemption issues. *Doctor’s Associates v. Casarotto*, 517 U.S. 681, 687 (1996). However, as that case made clear, such defenses must be ones which apply to contracts in general; courts cannot invalidate arbitration clauses under state laws directed only at arbitration agreements.

The courts have not been friendly to arguments based on fraud, duress, or unconscionability. They have been mindful of the Supreme Court’s emphatic rejection in *Gilmer* of the argument that the unequal bargaining power of employers and employees made arbitration agreements suspect. “Mere inequality of bargaining power...is not a sufficient reason to
hold that arbitration agreements are never enforceable in the employment context.” 500 U.S. at 32.

See, e.g., Desiderio v. National Association of Securities Dealers, 191 F.3d 198 (2nd Cir. 1999) (rejecting unconscionability claim and holding that an unconscionable contract is one where one party does not have a meaningful choice and where contract terms are unreasonably favorable to the other party); Rosenberg v. Merrill Lynch, Pierce, Fenner & Smith Inc., 170 F.3d 1, 17 (1st Cir. 1999) (rejecting claim, using same standard); Berger v. Cantor Fitzgerald Securities, 967 F. Supp. 91 (S.D.N.Y. 1997) (alleged misrepresentations by employer about the terms of plaintiff’s securities registration statement cannot be basis of fraud claim, since “plaintiff cannot avoid his legal obligation to read a document carefully before signing it”; time pressure placed on plaintiff to sign the agreement did not rise to level of duress.)

As usual, a notable exception comes from California. In Armendariz v. Foundation Health Psychcare Services, 6 P.3d 669, 2000 Cal. LEXIS 6120 (2000), the California Supreme Court found an arbitration agreement unconscionable because, among other things, the employer had imposed the agreement without giving the employee the opportunity to negotiate its terms, and because only the employee was required to arbitrate. Another is the Ninth Circuit’s decision in Circuit City on remand from the Supreme Court, where the court invalidated Circuit City’s arbitration agreement because, in part, only the employee was had to arbitrate claims. Circuit City Stores, Inc. v. Adams, 279 F.3d 889 (9th Cir. 2002). See also Brennan v. Bally Total Fitness, 198 F. Supp. 2d 377 (S.D.N.Y. 2002) (arbitration agreement invalid where plaintiff had only fifteen minutes to review the sixteen-page, single spaced document, and the employer threatened employees who wouldn’t sign and said that only the signers would be promoted.)

Plaintiffs seeking to invalidate arbitration agreements based on fraud face a difficult procedural hurdle as well. Claims of “fraud in the inducement” are based on misrepresentations by one party about the promises being made to the other. If the
plaintiff is claiming the he was fraudulently induced to sign the arbitration agreement itself, a court can rule on that claim. However, if the arbitration agreement is part of a larger agreement, and the plaintiff is claiming that the fraud goes to the making of the entire agreement, that claim must be heard by the arbitrator. Prima Paint Corp. v. Flood & Conklin Mfg. Co., 388 U.S. 395 (1967); Wright v. SFX Entertainment, 2001 U.S. Dist. LEXIS 1000 (S.D.N.Y. 2001).

3. Challenges based on procedural unfairness

Employees have been most successful in avoiding (or modifying) arbitration agreements when the arbitral procedures are simply too lopsided and set up too many hurdles to an employee asserting claims — particularly statutory ones. The courts have required a strong showing by plaintiffs that the arbitral forum is an unfair one, whether in terms of limits on discovery, lack of neutrality, limiting an employees’ statutory remedies, or imposing unaffordable arbitration fees.

In Cole v. Burns International Security Services, 105 F.3d 1465 (D.C. Cir. 1996), the Court of Appeals, in a searching opinion by Judge Harry Edwards, approved an employer’s pre-dispute arbitration program, administered by the AAA. The Court reviewed the protections which were necessary so that an employee, as the Supreme Court wrote in Gilmer, could effectively vindicate his statutory rights in arbitration. As described by the Court, these include:

Neutral arbitrators

“More than minimal” discovery

A written arbitration award

The availability of all relief which could be awarded had the claim been brought in court

No requirement that the employee pay either “unreasonable costs” or any arbitrators’ fees or expenses as a condition of access to arbitration.

105 F.3d at 1482. The Court’s decision in Cole has provoked a
great deal of controversy, and is frequently cited by courts in cases condemning and upholding arbitration procedures.

In Armendariz v. Foundation Health Psychcare, 6 P.3d 669, 2000 Cal. LEXIS 6120 (2000), the California Supreme Court echoed the D.C. Circuit’s concerns. The Court endorsed Cole’s procedural protections for employees in mandatory arbitration of statutory claims, on each of the points raised above.

With these two cases setting the context of the debate, the courts have been forced to confront the thorny question of how far they are willing to go to heed — or disregard — questions of essential fairness in the mandatory arbitration of employment claims, and particularly statutory claims.

For example, in Hooters of America v. Phillips, 173 F.3d 933 (4th Cir. 1999), the Court of Appeals denied the employer’s motion to compel based on a host of procedures which, charitably described, were unfairly stacked in the employer’s favor. As the Court explained, “The Hooters rules when taken as a whole...are so one-sided that their only possible purpose is to undermine the neutrality of the proceeding.”

The employee was required to file a notice of claim specifying the acts underlying the claim, but Hooters did not have to file any response or notice of defenses. Only the employee was required to provide a list of witnesses. Two of the three arbitrators were selected from a list created by the employer, which was not prohibited from placing its own managers on the list of “neutrals.” Hooters could raise any matter in the arbitration, but the employee could only raise matters noted in his notice of claim. Only Hooters could move for summary judgment, and only Hooters could seek to vacate the arbitration award. Hooters could also modify any of the rules at any time.

Faced with such brazen overreaching, the Court rescinded the agreement, holding that Hooters’ promulgation of so many biased rules breached the arbitration agreement itself.
Limitations on remedies

Courts have largely rejected employers’ attempts to prevent an arbitrator from awarding relief which the employee could have sought in court, at least for statutory claims.

Preclusion of particular types of damages:

In *Paladino v. Avnet Computer Technologies*, 134 F.3d 1054 (11th Cir. 1998), the arbitration agreement permitted an award of damages for breach of contract only, although the employee had claims for pain and suffering and reinstatement under Title VII. The Court of Appeals, using a creative approach, construed the agreement to cover only the breach of contract claims—thus permitting the employee’s statutory claims to be litigated. It rejected the employer’s request to strike the limit on remedies and send all the claims to arbitration, ruling that “the presence of an unlawful provision...may serve to taint the entire arbitration agreement.”

Similarly, in the litigation of *Circuit City* on remand from the Supreme Court, one of the grounds cited by the Ninth Circuit for voiding the company’s arbitration agreement was that it limited the remedies the employee would otherwise have under California’s employment discrimination statute, the Fair Employment and Housing Act. The agreement limited a prevailing employee to obtaining injunctive relief, one year of back pay, two years of front pay, compensatory damages, and capped punitive damages. *Circuit City Stores, Inc. v. Adams*, 279 F.3d 889 (9th Cir. 2002).

Preclusion of attorney’s fees:

Where the arbitration agreement precludes an arbitrator from awarding attorneys fees and
costs, the agreement should be rescinded. *Perez v. Globe Airport Security Services*, 253 F.3d 1280 (11th Cir. 2001), *vacated on other grounds*, 2002 U.S. App. LEXIS 12334 (11th Cir. 2002). In *Perez*, the Court of Appeals refused to reform the arbitration agreement, ruling that doing so would only encourage employers to include unlawful provisions in agreements, force employees to seek unnecessary court intervention, and deter employees from enforcing statutory rights.

See also *Mastrobuono v. Shearson Lehman Hutton*, 514 U.S. 52 (1995) (New York decisional law which prohibits an arbitrator from awarding punitive damages is preempted under the FAA).

Allocation of arbitration costs:

The costs and fees for arbitration can be substantial. The AAA rules (set out above) require the payment of filing fees, administrative fees and arbitrator fees which are usually billed at a very healthy hourly rate. The expenses can be many thousands of dollars, particularly if the issues are complex and the arbitration proceedings protracted. The AAA requires a deposit for the costs before the arbitration, and can stop the arbitration if the fees are not paid. Employees have recently been successful in having courts reject employers’ efforts to have these costs borne, in part, by employees.

In *Cole v. Burns*, above, the Court of Appeals created a per se rule that an employee could never be required to pay arbitrators’ fees or expenses, or unreasonable arbitration costs, as a condition of access to arbitration. Other cases following a per se approach are *Shankle v. B-G Maintenance Management*, 163 F.3d 1230 (10th Cir. 1999); *Paladino v. Avnet*, above; and *Armendariz v. Foundation Health Psychcare Services*, above.

Other courts adopt a case-specific approach, analyzing the employee’s financial situation to determine whether payment of arbitration costs would deter him from asserting his claims. These cases largely rely on
the Supreme Court’s recent decision in a non-employment case, where the Court noted that “It may well be that the existence of large arbitration costs could preclude a litigant...from effectively vindicating her federal statutory rights in the arbitral forum.” 

Green Tree Financial Corp. v. Randolph, 531 U.S. 79 (2000). There, the Court ruled that the record did not contain sufficient evidence of the particular costs involved or of the plaintiff’s financial condition.

See, for example, Bradford v. Rockwell Semiconductor Systems, 238 F.3d 549 (4th Cir. 2001) (court should consider whether the employee can pay arbitration fees, and how those costs differ from those of litigation); Giordano v. Pep Boys, 2001 U.S. Dist. LEXIS 5433 (E.D. Pa. 2001) (considering plaintiff’s resources); Livingston v. Associates Finance, Inc., 2001 U.S. Dist. LEXIS 8678 (N.D. Ill. June 25, 2001) (permitting limited discovery by plaintiff regarding the costs of arbitration); Boyd v. Town of Hayneville, Alabama, 144 F. Supp. 2d 1272 (M.D. Ala. 2001) (where evidence of burdensome costs was speculative, plaintiff would be allowed to seek post-arbitration judicial intervention, on a showing that arbitration costs exceeded those of litigation.); Ball v. SFX Broadcasting, Inc., 165 F. Supp. 2d 230 (N.D.N.Y. 2001) (plaintiff’s showing that she could not afford to pay arbitration fees sufficient).

Employers can expect that the costs issue will be raised by plaintiffs in opposing motions to compel, and that the litigation of that issue will slow down and complicate the referral of cases to arbitration.

4. Arbitration and the EEOC

If an employee is required to arbitrate discrimination claims, does that preclude the EEOC or a state Fair Employment Practices agency from bringing a claim on behalf of the employee?

In EEOC v. Kidder, Peabody & Co., 156 F.3d 298 (2nd Cir. 1998), the EEOC sued the employer under the ADEA on behalf of a group of the defendant’s former employees. The employees had signed U-4 arbitration agreements, and while the EEOC’s court action was pending, some of them
arbitrated their age discrimination claims. The EEOC continued its action, seeking purely monetary relief. The Court of Appeals affirmed the district court’s order dismissing the EEOC’s action, ruling that the EEOC may not seek monetary relief in the name of an employee who has waived, settled or previously litigated the claim.

In Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Nixon, 210 F.3d 814 (8th Cir. 2000), a terminated stockbroker arbitrated his state and federal discrimination claims and lost. He then filed an administrative charge with the Missouri Commission on Human Rights, which filed an action against Merrill Lynch. The district court enjoined the MCHR from seeking monetary relief on the employee’s behalf, but permitted it to seek injunctive relief. The Court of Appeals ruled that the employee’s discrimination claims were precluded by res judicata and collateral estoppel, and that the MCHR, while barred from seeking damages, could seek injunctive relief.

This year the Supreme Court finally settled the issue, at least as it concerns the EEOC. It ruled that the EEOC can pursue its own action to enforce federal anti-discrimination statutes on behalf of an employee, even if the employee has agreed to arbitrate all statutory discrimination claims. In such an action, the EEOC is not limited to seeking injunctive relief. EEOC v. Waffle House, 534 U.S. 279 (2002).

In Waffle House, the terminated employee had signed an arbitration agreement but filed an EEOC charge under the ADA. The EEOC filed its own action in District Court, and Waffle House moved to compel arbitration. That motion was denied by the district court. The Court of Appeals then ruled that the EEOC was not bound by the employee’s arbitration agreement, particularly because of its role in protecting the public interest. The Court of Appeals found that the public interest in any individual’s claim is weaker than the public interest in large-scale EEOC actions seeking injunctive relief. The court therefore ruled that the EEOC could seek injunctive relief for employees who had signed arbitration agreements, but could not pursue relief in court which was specific to those employees.

The Supreme Court, reversing, emphasized that it was the EEOC and not the employee which was “the master of its
own case,” and in control of a statutory discrimination charge. Since the EEOC was not a party to the arbitration agreement, it could not be bound by it. The Court emphatically rejected the Court of Appeals’ “compromise solution,” under which the EEOC could seek injunctive relief but not damages. That decision, the Court wrote, “turns what is effectively a forum selection clause into a waiver of a nonparty’s statutory remedies.” The EEOC’s statutory authority to seek both monetary and injunctive relief could not be trumped by the forum chosen by the employer and employee.

We are likely to see much litigation in the future over whether the logic of Waffle House applies to state Fair Employment Practices agencies.

VI. Legislation to overrule Circuit City

A bill to overrule the decision in Circuit City was introduced in the House of Representatives last year by a group of 35 sponsors. The bill, the “Preservation of Civil Rights Protections Act of 2001” would amend the FAA to clarify that employment contracts are exempt from its coverage. The bill also provides that “any clause of any agreement between an employer and an employee that requires arbitration of a claim arising under the Constitution or laws of the United States shall not be enforceable,” except for agreements made after a claim arises.

Conclusion

We can expect that arbitration will continue to be a forum of choice for employers. Employees forced into arbitration are likely to continue to resist the imposition of an unwanted and inadequate forum, with spiraling litigation on all these questions.