

*LAYING OFF LITIGATION:
ARBITRATION CLAUSES IN EMPLOYMENT AGREEMENTS*
By: Aaron Ginandes*

Arbitration is rapidly becoming the preferred method of dispute resolution between employers and employees.¹ Since Congress enacted the Federal Arbitration Act (“FAA”)² in 1925, covenants to arbitrate disputes have made their way into collective bargaining agreements, as well as employer-employee employment contracts.³ Advocates of arbitration as a true alternative to litigation cite the informality, procedural simplicity, speed, reduced costs, privacy, and individualized attention to each dispute as among the forum’s greatest assets. Opponents, on the other hand, express concerns about claimants being stripped of their substantive and procedural rights afforded through litigation, unequal bargaining power existing between employer and employee when entering into an employment contract, bias within the arbitral system, and abridged or diluted remedies for statutory claims.⁴

Despite arbitration’s readily appreciable benefits, it is abundantly clear that for arbitration to be considered a viable, and a possibly beneficial alternative to litigation, employees and employers must both be assured that they will have the same procedural rights and remedies afforded by traditional court proceedings. Such rights include: commensurate levels of access, statutory protection, judicial impartiality, and official oversight.

While the courts have long been aware of these concerns, they have been slow to address them head on, often taking passive stances and relying on the arbitral institution to police itself.⁵ Within recent years, however, the courts have begun to address claimants’ concerns and have set forth a number of substantive and procedural safeguards of claimants’ rights. While private

* J.D. Candidate 2007, Rutgers School of Law-Newark

arbitration should not (and probably could not) wholly supersede litigation, recent court decisions have allowed arbitration to mature into a practical, if not even preferable, alternative means of dispute resolution between employers and employees.⁶

Arbitration was not new to the American courts in 1925, when Congress enacted the FAA; however, in the 1920's the courts found arbitration awards generally unenforceable and, under the common law doctrine of Revocability, parties often breached pre-dispute arbitration agreements.⁷ The FAA, modeled after earlier New York laws, sought to preempt state laws that prohibited arbitration agreements and give them a level of protection comparable to that afforded to any other legally enforceable contract.⁸ As such, Section 2 of the FAA specifically provides that any arbitration agreement found in contracts involving maritime transactions or interstate commerce is "valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract."⁹ The FAA's fortification of contractual arbitration agreements, however, was not unqualified. Section 1 of the FAA does not apply to "contracts of employment of seamen, railroad employees, or any other class of workers engaged in foreign or interstate commerce."¹⁰

Since Congress passed the FAA, the Supreme Court has had numerous occasions to identify the FAA's breadth in a commercial context and has upheld the validity of arbitration agreements for claims brought under a number of federal statutes, including: the Sherman Antitrust Act,¹¹ the Securities Act of 1933,¹² and the Equal Credit Opportunity Act.¹³ In 1974, the United States Supreme Court ruled in *Alexander v. Gardner - Denver Co.* that an employee was permitted to bring a Title VII claim against his employer despite the fact that the parties had already arbitrated the claim.¹⁴ The Court noted that the employee's union (not the actual employee) entered into the arbitration agreement with the employer as part of a collective

bargaining agreement.¹⁵ Consequently, the Court found that “an individual does not forfeit his private cause of action if he first pursues his grievance to final arbitration under the nondiscrimination clause of a collective-bargaining agreement.”¹⁶ Furthermore, the Court observed that, in this matter, the arbitrator was asked to rule on a contractual issue, not a Title VII claim.¹⁷ Though not directly addressing questions of employer-employee arbitration agreements, the Court in *Alexander* recognized a potential conflict between the rights an employee waives through an arbitration agreement and those to which an employee is entitled under statutory law.¹⁸ In fact, the Court noted that “presumably an employee may waive his cause of action under Title VII as part of a voluntary settlement”¹⁹ Moreover, the Court added that “[i]n no event can the submission to arbitration of a claim under the nondiscrimination clause of a *collective-bargaining* agreement constitute a binding waiver with respect to an employee's rights under Title VII.”²⁰

In 1991, the Supreme Court issued its first ruling on an FAA claim based on an employer-employee contract in *Gilmer v. Interstate/Johnson Lane Corp.*²¹ There, the Court affirmed an appeals court decision holding that federal statutory claims of an employee against his employer could be precluded by an existing arbitration agreement barring a showing of contrary congressional intent.²² In *Gilmer*, the plaintiff sued his former employer claiming a violation of the Age Discrimination in Employment Act (“ADEA”).²³ The employer responded to the claim by asking the court to compel arbitration pursuant to an arbitration agreement found in Robert Gilmer’s (“Gilmer”) registration with the New York Stock Exchange (“NYSE”). Having held in *Alexander* that statutory claims can be subject to arbitration, the Court placed the burden squarely on Gilmer to demonstrate Congress intended to preclude arbitration of statutory claims in an employer-employee contract.²⁴ The Court, finding no such congressional intent

within the ADEA, ruled that “having made the bargain to arbitrate, the party should be held to it unless Congress itself has evinced an intention to preclude a waiver of judicial remedies for the statutory rights at issue.”²⁵ Additionally, the Court dismissed Gilmer’s concerns regarding the adequacy of the arbitration process. The Court found that the arbitration process adequately protected Gilmer’s substantive rights, because the arbitration agreement did not require him to forfeit his rights, rather “[he] only submits to [the claim’s] resolution in an arbitral, rather than a judicial, forum.”²⁶ The Court concluded that arbitration agreements should be upheld as long as they meet the standards applicable to any other contract.²⁷

While the Court in *Gilmer* seems to have conclusively ruled that federal statutory claims can be made subject to employer-employee arbitration agreements, the Court declined to address the issue of whether the FAA applies to employer-employee pre-dispute contracts – a question raised not by *Gilmer*, but through *amici curiae*. Contrary to the strong dissenting opinion in *Gilmer*, the majority side-stepped the question of FAA applicability because Gilmer’s arbitration agreement was contained within his NYSE registration, not his employment contract.²⁸ Though the majority of Circuit Courts had agreed that the FAA did not cover employer-employee pre-dispute agreements, the courts had not resolved whether Section 1 of the FAA exempted from arbitration all pre-dispute agreements for workers having any relation to interstate commerce or just those that govern employees actively involved in the movement of goods through interstate commerce (i.e., transportation employees). In 1998, in *Craft v. Campbell Soup Co.*, the United States District Court for the Ninth Circuit dismissed an interlocutory appeal from a district court ruling that the plaintiff’s Title VII claim could not be constrained to arbitration under the FAA.²⁹ There, the court concluded that because “Congress never intended for the FAA to apply to employment contracts of any sort” it lacked jurisdiction to consider the appeal.³⁰

Contemporaneous with the *Craft* ruling was a separate decision by the Ninth Circuit that employers could not, through employment contracts, compel individuals to waive their Title VII right to litigation.³¹ In *Duffield v. Robertson Stephens & Co.*, the court concluded that the text of Title VII and its legislative history were indications of Congress's intent to preclude compulsory arbitration of claims brought under Title VII of the Civil Rights Act of 1964.³²

By 2001, the Ninth Circuit was the only jurisdiction following the *Craft* and *Duffield* decisions,³³ and *Craft* would not last throughout the year. In *Circuit City Stores, Inc. v. Adams*,³⁴ the Supreme Court, in a five to four decision, explicitly overruled *Craft* and adopted a narrow reading of the FAA Section 1 exemption for “seamen, railroad employees, or any other class of workers engaged in foreign or interstate commerce.”³⁵ The Court found that the FAA applies to the pre-dispute contracts of the majority of employees, excluding only seamen, railroad employees, and other transportation workers (i.e., those directly engaged in the act of interstate commerce).³⁶ The majority opinion concluded that had the architects of the FAA intended for all employment contracts to be exempt, seamen and railroad employees would not have been specifically identified.³⁷ The Court regarded the identification of such professions as evidencing Congress’s intent that only those professions, and others immediately related, be exempt.³⁸ Shortly after the *Circuit City* decision, the Ninth Circuit ruled that Title VII claims can be subject to compulsory arbitration as a condition of employment, and that *Duffield* was now to be regarded “as within the category of ‘fruitful error.’”³⁹

The Supreme Court’s rulings in *Gilmer* and *Circuit City* appear to have decisively resolved the issues foreshadowed in *Alexander*: employee-employer arbitration agreements are valid under the FAA and are enforceable even when encompassing federal statutory claims. The FAA, however, does not provide any safeguards for claimants entering arbitration and questions

still remain as to whether compulsory arbitration through employment contracts provides an adequate, if not equal, forum in which employees may have their grievances adjudicated. In *Cole v. Burns International Security Services*, the United States Court of Appeals for the District of Columbia identified and addressed a variety of concerns regarding the arbitral forum.⁴⁰ These included: the arbitrator's assumption of the role of "private judge" who is "neither publicly chosen nor publicly accountable"; the arbitrator's competence to adequately decide purely legal issues connected to statutory claims; the employer's possible benefit in choosing an arbitrator as a result of the employer being a "repeat player in cases involving individual statutory claims"; the employers' requirement, in an attempt to discourage claims from being brought, that employees pay arbitration fees; the employer's potential advantage over employees due to lack of public disclosure of arbitration decisions; and questions regarding the abridged procedural processes of arbitration as they relate to discovery, testimonial, and evidentiary issues.⁴¹

Drawing on *Gilmer*, the *Cole* Court identified five factors by which the validity of an employer-employee arbitration agreement could be measured: (1) access to a neutral arbitrator; (2) provisions for more than minimal discovery; (3) a written award; (4) provisions for all types of relief that would otherwise be available through the courts; and (5) assurance that the arbitration agreement does not require employees to pay either "unreasonable costs or any arbitrators' fees or expenses as a condition of access to the arbitration forum."⁴² While the court in *Cole* does not go as far as to suggest that each of these factors be specifically addressed in an arbitration agreement, it appears that such agreements will be found enforceable as long as the employer does not draft the agreement to impede or exclude fulfillment of these provisions. As such, the court ruled that "at a minimum, statutory rights include both substantive protection and access to a neutral forum in which to enforce those protections."⁴³

Since *Cole*, both state and federal courts have required the presence of the safeguards enumerated by the D.C. Circuit before finding arbitration agreements enforceable. In *Hooters of America, Inc. v. Phillips*, the Court of Appeals for the Fourth Circuit refused to enforce an employee's arbitration agreement when it found the employer's control of the identity of the non-party appointed arbitrator fundamentally undermined the arbitral process.⁴⁴ Similarly, the California Supreme Court in *Armendariz v. Health Psychcare Service, Inc.* ruled that inherent in an arbitration agreement is an understanding that adequate discovery is essential to the successful arbitration of a claim.⁴⁵ In *Brennan v. King*, the Court of Appeals for the First Circuit found a university faculty member's claim was not subject to the university's arbitration requirement as the arbitrator did not have the authority to fully vindicate the rights conferred to the claimant under state and federal law.⁴⁶ Additionally, the Court of Appeals for the Eleventh Circuit in *Paladino v. Avent Computer Technologies, Inc.* refused to uphold an arbitration agreement, finding that the agreement contained provisions that were "fundamentally at odds with the purposes of Title VII."⁴⁷ Furthermore, in *Shankl v. B-G Maintenance Management of Colorado, Inc.*, the Court of Appeals for the Tenth Circuit denied a motion to compel arbitration of the claimant's discrimination claim due to the pre-dispute agreement's fee-splitting condition, holding that the claimant's access to a forum to vindicate his statutory rights was prohibited.⁴⁸

Not all courts, however, have unconditionally applied the safeguards identified in *Cole*. In both *Gilmer* and *Cole*, the court's examination centered on whether arbitration agreements diluted claimants' rights to bring federal statutory claims and were congruent with congressional intent. As evidenced in *Brown v. Wheat First Securities, Inc.*, however, the protections outlined in *Cole* do not necessarily apply when determining whether state law claims survive arbitration agreements.⁴⁹ Here, the D.C. Circuit Court of Appeals declined to extend its holding in *Cole* to

non-statutory state law claims based on public policy.⁵⁰ In *Brown*, the court dismissed with prejudice an employee’s claim filed against his former employer and ordered the employee to pay a fee for the arbitration proceedings. The court in *Brown* found no basis for an extension of *Cole*’s “central rationale – respecting congressional intent – as it does not extend beyond the statutory context.”⁵¹ The court further added that to extend the holding in *Cole* to the facts in *Brown* would “significantly alter the terms of the Federal Arbitration Act, imposing a serious procedural limit on a wide (but unpredictable) range of arbitration claims, all without the slightest signal from Congress.”⁵² It should be noted, however, that the California Supreme Court adopted the safeguards enumerated in *Cole* in *Armendariz*. There, the Court found that a pre-dispute arbitration agreement would be enforceable under the California Arbitration Act (“CAA”) for a claim brought under the state antidiscrimination statute, if the CAA provided the same five protections enumerated in *Cole*.⁵³ Unlike *Brown*, in which the D.C. Circuit considered the blending of protections afforded to federal statutory claims with state law, *Armendariz* only required consideration of protections found within state statutory law and their relation to the state arbitration act.

A further province of state law is the criteria for assessing the validity of an arbitration agreement as a contract. FAA Section 2 provides that arbitration agreements are “valid, irrevocable, and enforceable, *save upon such grounds as exist at law or in equity for the revocation of any contract.*”⁵⁴ In *Parilla v. IAP World Wide Services, VI, Inc.*, the Virgin Islands court looked to the Restatement (Second) of Contracts when determining that a pre-dispute agreement’s provisions (providing a thirty day window for employees to present claims and bear their own costs, expenses, and fees) were unconscionable and unenforceable.⁵⁵ In New Jersey, an appeals court applying the “general rules of contract interpretation,” found the language too

ambiguous to enforce, and held that the agreement did not preclude the claimant from bringing a discrimination claim against his employer in state court.⁵⁶ It should also be noted that on remand, the Ninth Circuit refused to enforce the arbitration agreement in *Circuit City*, finding it unconscionable under general California state law contract principles.⁵⁷

A successful arbitral system for employee-employer disputes is in the public interest. It relieves congestion in the courts while providing a less expensive, faster, more informal and personal method of dispute resolution. As the cases mentioned above reveal, pre-dispute agreements to arbitrate are not without flaws or pitfalls. As demonstrated in *Gilmer* and *Cole*, however, the courts are cognizant of the hazards of arbitration and set out to secure claimants' statutory rights. Nonetheless, for arbitration to truly succeed as a method of employee-employer dispute resolution, the burden must fall not just on the courts as overseers, but on employers as willing participants in a balanced and neutral forum. While the court in *Cole* takes the lead in identifying factors to assess the validity of a pre-dispute agreement, much of the criticism of compulsory arbitration may be allayed through the inclusion of provisions within the agreement itself. Such provisions may include: a just and joint means for selecting a impartial arbitrator; a requirement that employer claims (not just employee claims) be arbitrated; a setting of procedural standards akin to the court system; an equitable and realistic fee structure; and a guarantee of written awards. Furthermore, employee claims should be subject to the same limitations that would be enforced had the claim been brought in court (e.g. statute of limitations). Given the financial and procedural benefits of the arbitral process, and the ability to remedy many of its failings, courts should promote, rather than preclude, agreements to arbitrate in a balanced and neutral forum that furnishes both parties all of the substantive rights afforded under the law.

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- ¹ Senator Russell D. Feingold, *Mandatory Arbitration: What Process is Due?*, 39 HARV. J. ON LEGIS. 281, 290-91 (2002).
- ² 9 U.S.C. §§ 1 *et. seq.*
- ³ STEPHEN J. WARE, ALTERNATIVE DISPUTE RESOLUTION: HORNBOOK SERIES 104 (West 2001).
- ⁴ CARRIE J. MENKEL-MEADOW ET AL., DISPUTE RESOLUTION BEYOND THE ADVERSARIAL MODEL 450-451 (Aspen 2005); *See also* Sarah Rudolph Cole, *Incentives and Arbitration: The Case Against Enforcement of Executory Arbitration Agreements Between Employers and Employees*, 64 UMKC L. REV. 449, 450 (1996).
- ⁵ Sarah Rudolph Cole, *Uniform Arbitration: "One Size Fits All" Does Not Fit*, 16 OHIO ST. J. ON DISP. RESOL. 759, 763-65 (2001).
- ⁶ *See Id.*
- ⁷ William H. Webster, Partner, Milbank, Tweed, Hadley & McCloy LLP; former Judge, U.S. Court of Appeals (8th Cir.); and former Director, Federal Bureau of Investigation and Central Intelligence Agency, Keynote Address at the Federal Arbitration Act at 80: A Tribute Anniversary Lecture Series (Feb. 10, 2005), available at http://www.adr.org/_si.asp?id=1891.
- ⁸ *Id.*; Cole, *supra* note 4 at, 465-66.
- ⁹ 9 U.S.C. § 2 (1925).
- ¹⁰ *Id.* at § 1.
- ¹¹ *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth*, 473 U.S. 614 (1985).
- ¹² *Rodriguez de Quijas v. Shearson/American Express, Inc.*, 490 U.S. 477 (1989)
- ¹³ *Green Tree Fin. Corp. -Alabama v. Randolph*, 531 U.S. 79 (2000).
- ¹⁴ *Alexander v. Gardner-Denver Co.*, 415 U.S. 36 (1974).
- ¹⁵ *Id.* at 39-42.
- ¹⁶ *Id.* at 49.
- ¹⁷ *Id.* at 52.
- ¹⁸ *Id.* at 54.
- ¹⁹ *Id.* at 52.
- ²⁰ *Id.* at 52 n.15 (emphasis added).
- ²¹ *Gilmer v. Interstate/Johnson Lane Corp.*, 500 U.S. 20 (1991)
- ²² *Id.* at 26
- ²³ *Id.* at 25.
- ²⁴ *Id.* at 25-27
- ²⁵ *Id.*
- ²⁶ *Id.*
- ²⁷ *Id.* at 33.
- ²⁸ *Id.* at 25 n2, 40 (Stevens, J, dissenting, with whom Justice Marshall joined).
- ²⁹ *Craft v. Campbell Soup Co.*, 177 F.3d 1083 (9th Cir. 1998).
- ³⁰ *Id.* at 1090.
- ³¹ *Duffield v. Robertson Stephens & Co.*, 144 F.3d 1182, 1199 (9th Cir. 1998).
- ³² *Id.* at 1199-1200.
- ³³ Jacqueline F. Drucker, *Selected US Court of Appeals Decisions Dealing With Arbitration of Statutory Employment Claims*, available at http://www.ilr.cornell.edu/alliance/resources/Legal/court_of_appeals_decisions_stat_emp_claims.html (1999).
- ³⁴ *Circuit City Stores, Inc. v. Adams*, 532 U.S. 105 (2001)
- ³⁵ 9 U.S.C § 1.
- ³⁶ *Id.* at 129
- ³⁷ *Id.* at 114-15.
- ³⁸ *Id.*
- ³⁹ *EEOC v. Luce, et al.*, 303 F.3d 994, 1003-4 (9th Cir. 2002).
- ⁴⁰ *Cole v. Burns International Sec. Servs.*, 105 F.3d 1465 (D.C. Cir. 1997)
- ⁴¹ *Id.* at 1476-1478
- ⁴² *Id.* at 1482.
- ⁴³ *Id.*
- ⁴⁴ *Hooters of Am., Inc. v. Phillips*, 173 F.3d 933, 940 (4th Cir. 1999)
- ⁴⁵ *Armendariz v. Foundation Health Psychcare Servs., Inc.*, 6 P.3d 669, 683 (Cal. 2000)

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- ⁴⁶ *Brennan v. King*, 139 F.3d 258, 269 (1st Cir.1998)
- ⁴⁷ *Paladino v. Avnet Computer Technologies, Inc.*, 134 F.3d 1054, 1060 (11th Cir. 1998)
- ⁴⁸ *Shankle v. B-G Maintenance Mgmt. of Colo, Inc.*, 163 F.3d 1230, 1235 (10th Cir. 1999)
- ⁴⁹ *Brown v. Wheat First Securities, Inc.*, 257 F.3d 821 (D.C. Cir. 2001)
- ⁵⁰ *Id.* at 825.
- ⁵¹ *Id.*
- ⁵² *Id.* at 826
- ⁵³ *6 P.3d 669 at 682.*
- ⁵⁴ 9 U.S.C. § 2 (emphasis added).
- ⁵⁵ *Parilla v. IAP World Wide Servs. VI, Inc.*, 368 F.3d 269, 276 (3d Cir., 2004)
- ⁵⁶ *Quigley v. KPMG Peat Marwick, LLP*, 330 N.J. Super. 252 (App. Div. 2000).
- ⁵⁷ *Circuit City Stores v. Adams*, 279 F.3d 889 (9th Cir. 2002).