THE FATE OF MANDATORY ARBITRATION AGREEMENTS IN EMPLOYMENT DISPUTES

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With the continued backlog of cases on the Court's docket and the increase of wrongful termination lawsuit filings during these recessionary times, employers turn to arbitration as a form of alternative dispute resolution. For many employers, arbitration is the preferred method to resolve employee disputes. Proponents of this process argue that the parties avoid lengthy trial delays, the excessive expense of protracted discovery, negative publicity, and inconsistent jury verdicts. Employers argue that arbitrators are less sympathetic and more predictable than juries, especially in California.

Employers typically have arbitration provisions contained within employer-employee contracts, employee handbooks, and even in employment acceptance letters and applications for employment. For the most part, employees typically sign and agree to such arbitration provisions when hired; however, when a dispute arises, more often than not, the employee wants his or her day in court with a jury.

An employee who seeks to have his or her dispute litigated often raises the following legal objections to an employer's efforts to enforce arbitration[1]:

- Arbitration denies an employee due process because it is a more expensive process. The administrative and hearing fees for the process exceed the nominal amount required by an employee to file a lawsuit in state or federal court. Forcing an employee to pay to arbitrate may prevent that employee from pursuing his/her statutory protected rights if he/she is unable to afford the costs associated with arbitration.
- Arbitration may limit an employee's ability to conduct discovery necessary to establish his/her prima facie case in the case of Title VII and other antidiscrimination statutes as well as limit that employee's legal remedies under those statutes.
- Arbitration provisions sometimes contain language that require the employee to arbitrate claims but do not equally require that the employer arbitrate any and all employment-related disputes.
- The employer unilaterally decides not only the forum location to arbitrate but also adds choice of law provisions designed to favor it and increase the potential outcome of a good result for the employer.

While the arbitration clause contained in an agreement may be enforceable initially, the employee can claim that the employer has legally waived its right to seek enforcement

of the provision (to arbitrate) when the employer does not immediately assert the application of that provision and, instead, engages in discovery and deposition taking.

Current federal legislation favors resolution of disputes between employees and employers through the utilization of the arbitration process. The Federal Arbitration Act ("FAA") creates a strong national policy in favor of enforcing arbitration clauses.[2] The Act states that arbitration clauses will be enforced in all cases where there is a maritime transaction, or where a contract involves a transaction crossing state lines. Otherwise, State law determines whether the arbitration clause is enforceable. Encouragement of the use of the arbitration process is contained in the Americans with Disabilities Act ("ADA") and in the text of the Civil Rights Act of 1991.

The U.S. Supreme Court has supported the notion of arbitrating all contractual and statutory employment claims[3] and it has even held that in specific instances arbitration is a legitimate means of resolving employment disputes where collective bargaining agreement provisions require its union members to arbitrate age discrimination claims.[4]

While many states' laws mirror the FAA, California is a state which allows arbitration clauses to be disregarded under some of the following circumstances:

- Courts scrutinize arbitration agreements for provisions that favor the employer to the disadvantage of the employee. For example, language in such provisions which appears to limit the scope of arbitration or unilaterally restrict judicial access has been deemed to be unconscionable or otherwise unenforceable;[5]
- Where the employee claims that his/her ability to vindicate a statutory right is unreasonably impaired by the arbitration process, as was the case in the California Supreme Court case of *Armendariz v Foundation Health Psychcare Svcs., Inc.;*[6]
- The contract itself, which contains the arbitration clause, is found to be invalid as a contract of adhesion;[7] or
- The party in the arbitration agreement is joined by a third party in a pending court action which arose out of the same transaction or series of related transactions.[8]

The effect of the Armendariz standard in California has extended into circumstances where a California Appellate court invalidated an arbitration provision in an employment contract that required the employee to pay an equal share of the expenses of arbitration.[9] Another Appellate court ruled against an employer dispute resolution policy because it found that the applicable arbitration clause contained provisions which in the mind of the court demonstrated a systematic effort to impose arbitration on an employee "not….as an alternative to litigation, but as an inferior forum that works to the employer's advantage."[10]

It is clear that at least in California some state courts apply a heightened scrutiny to employee-employer arbitration agreements Courts following the Armendariz standard continue to poke at such arbitration provisions scouring for even modest indicia of substantive unconscionability provisions to find reason to defeat enforcement of an arbitration agreement. A state court judge may well refuse enforcement of a particular arbitration provision if the terms appear designed to tilt the outcome in favor of an employer or contains provisions which may be perceived as unfair to a party who is perceived to be weaker (usually deemed to be the employee who has unequal bargaining power).

LEGISLATION INTENDED TO LIMIT OR EXTINGUISH MANDATORY ARBITRATION

During fiscal year 2010, Congress passed and President Obama signed into law the Department of Defense Appropriations Act (H.R. 3326). The original bill was introduced by Senator Al Franken. The Franken Amendment (S. Amendment 2588) was amended by Congress and signed into law on December 19, 2009. The Act applies to defense contracts over one million dollars. It provides that defense contractors may not require any employee to agree to mandatory arbitration of any claim under Title VII or any tort related to or arising out of sexual assault or harassment as a condition of employment or to take any action to enforce any provisions of an existing agreement with an employee or independent contractor, but only on defense contracts. Subcontractors are still free to require arbitration of their employees for the types of claims referenced on non-defense contracts.

The Act only applies to defense contracts awarded after February 17, 2010. Defense contractors must provide a certification that establishes that they have required each of their covered subcontractors to agree to the same limitations on arbitration agreements. Those certifications were required to be submitted by June 17, 2010.

The good news for defense contractors is that the Act does not prohibit mandatory arbitration of claims of age discrimination under the Age Discrimination in Employment Act, claims under the Family and Medical Leave Act, the Fair Labor Standards Act, the Americans with Disabilities Act, or state labor and fair employment statutes. Additionally, the arbitration limitations do not apply to contractor’s or subcontractor’s agreements with employees or independent contractors that cannot otherwise be enforced in the United States.

The Arbitration Fairness Act

There is also far broader legislation afoot which impacts mandatory arbitration provisions. The Arbitration Fairness Act (“AFA,” H.R. 1020, S. 931) was introduced in the House of Representatives in February of 2009. The proposed AFA limits the scope

of the U.S. Arbitration Act which has been in place since 1925. The AFA proposes to exclude from mandatory arbitration: 1) disputes between an employer and employee arising out of their employment relationship; 2) consumer disputes between an individual and the seller or provider of real or personal property, services, money, or credit for personal, family, or household purposes; and 3) disputes between a franchisor and a franchisee. In fact, passage of the AFA would mean that an arbitrator would no longer have the authority to determine the validity and enforceability of arbitration agreements.

Proponents of the AFA argue that mandatory arbitration provisions hidden away in the fine print of consumer transactions such as credit card accounts and bank accounts are one sided and unfair to the consumer who has unequal bargaining power and fails to routinely read the fine print language.

Those against the passage of the AFA, most recently Shirley M. Hufstedler, Secretary of Education, and former FBI and CIA Director William H. Webster, are critical of the AFA and see the Act as an effective "abolishment of arbitration as a viable alternative for such disputes."[11]

The AFA may have taken a blow recently with the defeat of Senator Russ Feingold of Wisconsin who had been a sponsor of the AFA for years. It is unclear whether his replacement, Senator Ron Johnson, will pick up where Mr. Feingold left off. The AFA remains stalled in Congress.

The recently enacted Economic Stimulus Bill, H.R. 1(Section 1533 of the American Recovery and Reinvestment Act), among other things, contains new protections for whistleblowers who work for state and local governments and private contractors who received some of the billions of taxpayer dollars under this bill. With regard to the enforcement of arbitration clauses, under this enacted bill pre-dispute mandatory arbitration clauses are made unenforceable, with the exception of disputes arising under a collective bargaining agreement.

The Dodd-Frank Wall Street Reform and Consumer Protection Act

The financial services industry will be impacted by recently passed legislation that seeks to reform, curtail or possibly eliminate all pre-dispute arbitration of consumer complaints in stockbroker and other financial service disputes. The Dodd-Frank Wall Street Reform and Consumer Protection Act, H.R 4173, authorizes and directs the U.S. Securities and Exchange Commission to conduct a study to determine whether it finds that mandatory pre-dispute arbitration runs against the public interest or in some way is detrimental to the protection of financial investors such that these agreements should be severely limited or prohibited. The Act also bans pre-dispute arbitration agreements in residential mortgages and home equity lines of credit.[12]

It allows the SEC to ban or limit pre-dispute arbitration agreements in securities law disputes involving broker-dealer or investment advisers and their customers. Today, most cases against broker or brokerage firms are decided in an arbitration forum run by the Financial Industry Regulatory Authority ("FINRA"). The FINRA supports pre-dispute arbitration agreements as a less costly, faster and fair venue for investors to handle their grievances against their brokers. However, it remains to be seen whether arbitration of such disputes will be a thing of the past for the financial services industry. The SEC has set up a website for those interested in commenting on what actions, if any, the SEC should take on limiting, if not prohibiting, pre-dispute mandatory arbitration agreements in security industry disputes. You can access this website and comment at **www.sec.gov/comments/df-title-is/pre-dispute-arbitration/pre-dispute-arbitration.shtml.**

Within Title X of the Dodd-Frank Reform Act, the CFPB (Consumer Financial Protection Bureau) has been established and this agency has been directed to conduct a study of such pre-dispute mandatory arbitration agreements involving disputes between the consumer and those offering or providing consumer financial products or services. The CFPB will take over the enforcement of federal consumer protection and fair lending laws, including the Equal Credit Opportunity Act, the Real Estate Settlement Protection Act (RESPA) and the Truth-in-Lending Act.[13]

Class Actions

The movement toward banning arbitration agreements extends to class action lawsuits as the U.S. Supreme Court is preparing to rule whether an arbitration agreement containing a class action waiver which is unconscionable and unenforceable under state law, in the context of a class action lawsuit, is preempted by the FAA (Federal Arbitration Act).[14] The U.S. Court of Appeals, Ninth Circuit, ruled that the arbitration clause was unconscionable and unenforceable in view of the California Supreme Court case of *Discover Bank v. Superior Court.*[15]

Counsel representing AT & T Mobility suggests that it is the responsibility of the Court to determine whether the California State Court applied its unconscionability analysis in a manner that in fact directly discriminates against arbitration; if the California State Supreme Court has devised a rule and labeled it "Unconscionably" but it clearly discriminates, then the U.S. Supreme Court is permitted under the FAA to review the State Court 's imposition of the unconscionability analysis in the context of class action waivers in an arbitration agreement.

A ruling by the Court is expected sometime in 2011.

[1] *Armendariz v. Foundation Health Psychare Svcs.,* 24 Cal. 4th 83 (2000).

[2] *Federal Arbitration Act,* 9 U.S.C.S. § 1 *et seq*.

[3] *Gilmer v. Interstate/Johnson Lane Corp.,* 500 U.S. 20, 111 S. Ct. 1647; 114 L. Ed. 2d 26 (1991).

[4] *14 Penn Plaza LLC et al. v. Pyett et al.,* 129 S. Ct. 1456, 173 L. Ed. 2d 398 (2009).

[5] *Independent Assn. of Mailbox Center Owners, Inc. v. Sup. Ct.,* 133 Cal. App. 4th 396, 412-413 (2006).

[6] *Armendariz*, *supra*, 24 Cal. 4th 83 (2000).

[7] Cal. Code. Civ. Pro. § 1281; *Higgins v. Sup. Ct.,* 140 Cal. App. 4th 1238, 1251 (2006).

[8] Cal. Code. Civ. Pro. § 1282.2(c); *Best Interiors, Inc. v. Millie & Severson, Inc.,* 161 Cal. App. 4th 1320, 1330 (2008).

[9] *O'Hare v. Municipal Resource Consultants,* 107 Cal. App. 4th 267 (2003).

[10] *Fitz v. NCR Corporation* 118 Cal. App. 4th 702, 727 (2004).

[11] Shirley M. Hufstedler and William H. Webster, *Arbitration Under Siege,* National Law Journal, Sept. 20, 2010.

[12] Dodd-Frank Act, Section 921.

[13] The Truth-in-Lending Act is now amended to include a prohibition against enforcing mandatory pre-dispute arbitration agreements in residential mortgage contracts. (See Section 1414 of the TILA).

[14] See *AT & T Mobility v. Concepcion*, 130 S. Ct. 3322, 176 L. Ed. 2d 1218 (May 24, 2010) ….does the FAA preempt a state from conditioning the enforcement of an arbitration agreement on the availability of a class wide arbitration when such a procedure is not necessary to ensure that the parties to the arbitration agreement are able to vindicate their claims.)

[15] 36 Cal. 4th 148 (2005) (…the court found the clause forced consumers to arbitrate small dollar claims on an individual basis.)