Employment Arbitration: Evolving from Concept to Practice

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Abstract

The emergence of employment arbitration in nonunion work environments has been applauded by some in the corporate community, while being highly criticized, even reviled, by both employees' rights groups and plaintiffs' attorneys. By requiring, as a condition of employment, that prospective and/or current employees agree to submit work-related disputes to compulsory arbitration, employers are attempting to control the potential costs associated with adverse employment decisions. This paper examines the evolution of employment arbitration in the United States, focusing on the problems employers have encountered in trying to establish a workable system that embodies the necessary elements of due process. The historical context, a discussion of the legal issues surrounding employment arbitration, usage trends, and suggested implementation guidelines are discussed. The author concludes that employment arbitration is experiencing an evolutionary development, with adoption of the process proceeding at a slower pace than originally predicted. Alternative dispute agencies, most notably the American Arbitration Association, have promulgated policies and procedures to address some of the remaining legal concerns surrounding employment arbitration. The author recommends that employers make use of such agencies, or incorporate neutral policies into any employment arbitration system, thus ensuring the protection of employee due process rights.

The emergence of employment arbitration as a management system in nonunion work environments is a development receiving increased attention. There is a growing trend for employers to require as a condition of employment that prospective and/or current employees agree to submit work-related disputes to arbitration. This paper examines how employment arbitration is evolving from concept to practice, and analyzes the forces causing the implementation process to be slower than one might anticipate, given the seeming advantages of the employment arbitration process over civil litigation. Various dimensions of employment arbitration, including the historical context, resolved legal issues, and remaining legal questions concerning the efficacy of employment arbitration will be considered.

Historical Context

The advent and growth of employment arbitration was a reactive strategy by the business community to deal with the increased level of employment litigation in the past three decades. This litigation is a by-product of both increased legislative activity, subjecting business to a heightened expectation of conduct, and the continued erosion of the employment-at-will doctrine at the state level. Since few corporations or industries adopted employment arbitration systems prior to these developments, it is understandable that some assess the promulgation of employment arbitration as an attempt by corporations to mitigate the impact of these developments, while to some extent reestablishing control over the employment relationship.

While viewed by the business community as the lesser of two evils, certain advantages attributed to employment arbitration have created an impression that it is preferable to the litigation alternative. Given arbitration's focus on compensatory damages, and a reluctance to impose obligations appearing to be punitive, it is understandable that employers find employment arbitration a more attractive system than do individual employees and organizations representing the interests of employees, such as the American Civil Liberties Union.

A starting point for gaining the proper historical perspective on employment arbitration is an examination of the labor arbitration provisions found in the collective bargaining agreements between unions and corporations. Labor arbitration has been an accepted practice in unionized work environments for decades. Both parties to the collective bargaining agreement readily accept arbitration as an alternative to adjudication of disputes in the court system, with federal and state governments endorsing this process as well. The inherent advantages of arbitration over litigation are widely accepted, with lower costs, more timely decisions, and the informality of the process being most prominent among those advantages.

Over the years, the labor arbitration system has become refined as the parties have adjusted to one another and to court decisions, particularly at the federal level. The finality doctrine established in 1960 with the landmark Supreme Court Trilogy decisions has endured the test of time, despite the few very limited exceptions carved out by the court in subsequent decisions.[1] Of course, the most notable exception to the finality doctrine occurred with the Supreme Court's 1974 decision in Alexander v. Gardner-Denver Co., in which the Court held that an arbitration clause negotiated into a labor agreement by the union could not waive an individual's right to pursue a statutory employment discrimination claim.[2]

Whereas the "rules of the game" in the labor arbitration arena are clearly enunciated and accepted by all those involved, such is not the case in employment arbitration. However, it is worth noting that the Trilogy decisions were rendered 25 years after the passage of the National Labor Relations Act, and 18 years after the establishment of the War Labor Board and the promulgation of federal policy that mandated the use of arbitration in labor disputes during the World War II period. Since most parties implementing arbitration during this period continued its use after the war, the time lapse between 1945 and 1960 indicates a lengthy process of defining the parameters of labor arbitration.

In essence, it is that same process that we are enduring today with respect to employment arbitration; and, given the volume and complexity of employment legislation during this period, no one should be surprised that the rules of the game are evolving as individual cases presenting new questions come before the courts. Certainly this evolution is complicated by the fact that a large body of employment legislation and case law preceded any significant corporate adoption of employment arbitration. Given the high visibility granted those cases in which employees received extremely large monetary awards, particularly in discrimination cases involving Title VII of the Civil Rights Act, one should not be surprised to find critics who characterize employment arbitration as a step backward for individual employees in the United States.

However, it is noteworthy that labor arbitration did not evolve without similar protests, particularly from unions that preferred using their economic clout by initiating strikes when dissatisfied with management's reaction to grievances. The no-strike clause that accompanied the adoption of a labor arbitration provision in the vast majority of collective bargaining agreements was defied by many unions who engaged in unauthorized work stoppages known as "wildcat strikes." The federal courts enforced the labor agreements, ordering unions back to work in such situations, and finding them in contempt of court when they did not comply. Ultimately, it became clear to all parties that public policy favored the arbitration of employment disputes.

Resolved Legal Issues

The fundamental question confronting courts with respect to employment arbitration was whether such agreements are enforceable, either in total or in part. Employers have asserted that employment arbitration agreements are enforceable under the Federal Arbitration Act (FAA) as contracts deserving the same treatment provided to other private contractual arrangements. The FAA was legislated in 1925 with the intent to alter the hostility of the courts toward arbitration agreements, and is the basis for most court decisions finding employment arbitration provisions enforceable.

Critics, on the other hand, suggest that Section 1 of the FAA, known as the exclusionary clause, provides sufficient justification to find that most employment arbitration clauses are invalid. Section 1 states that "nothing herein contained shall apply to contracts of employment of seamen, railroad employees, or any other class of workers engaged in foreign or interstate commerce."[3] Opponents of employment arbitration argue that the references to "contracts of employment" and "any other class of workers engaged in foreign or interstate commerce" negate employment arbitration agreements for all but a narrow group of employees.

However, the Supreme Court has disagreed with this position, choosing to narrowly apply the exclusionary clause to those workers engaged in transportation, and provide general support for employment arbitration. The Court consistently has stated that Section 2 of the FAA demonstrates a clear Congressional bias toward a liberal application of the Act with respect to employment contracts, and by extension, employment arbitration clauses. To compel arbitration under the FAA, a litigant need only to show four elements: (1) the existence of a dispute between the parties; (2) the dispute is covered by a written arbitration agreement, (3) the

transaction involves interstate commerce, and (4) the other party to the agreement refuses to arbitrate.

In 1991, in Gilmer v. Interstate/Johnson Lane Corp., 500 U.S. 20 (1991), the Supreme Court considered the first of several cases addressing a variety of legal questions regarding employment arbitration. Gilmer's registration with the New York Stock Exchange required arbitration of any employment dispute, including termination. After being terminated at age 62, Gilmer sought redress under the Age Discrimination in Employment Act of 1967 (ADEA), but his employer contended that he was legally bound to submit his claim to arbitration since he had voluntarily agreed to the employment arbitration provision. The Supreme Court agreed with the employer, noting that Congress could have specifically prohibited arbitration of claims under the ADEA, but in failing to do so, rendered the FAA standards controlling in such situations.[4]

In 2001, the Supreme Court was again asked to examine an employment arbitration agreement in Circuit City Stores, Inc. v. Adams, 532 U.S. 105 (2001). The Supreme Court held that the reference to "contracts of employment" in the exclusionary clause of the FAA did not preclude the use of employment arbitration clauses.[5] Therefore, employment arbitration contracts that are carefully constructed to provide fairness and equal protection to employees are valid under the FAA. This decision was consistent with many similar decisions by federal circuit courts, except the Ninth Circuit in San Francisco, which has consistently rejected mandatory arbitration clauses constructed by employers. The Ninth Circuit has a history of animosity toward business, thus the negative rulings toward employment arbitration provisions are not surprising.

In January, 2002, the Supreme Court rendered another decision concerning employment arbitration in Equal Employment Opportunity Commission v. Waffle House, Inc. 2002 WL 46763. In this case, Eric Baker contested his dismissal from a Waffle House restaurant after suffering a seizure just 16 days after his employment. Baker filed a complaint with the EEOC, alleging that his discharge violated the provisions of the Americans With Disabilities Act (ADA). Following an investigation and a finding of probable cause, the EEOC brought action against Waffle House in federal court. The EEOC sought both injunctive relief and specific relief on Baker's behalf, including a request for punitive damages. Waffle House sought to stay the EEOC action, and compel Baker to submit his claim to arbitration, but the district court denied the motion. On appeal, the Fourth Circuit found that Baker's agreement to arbitrate did not preclude the EEOC from fulfilling its statutory duty, since the EEOC was not a party to the agreement to arbitrate. However, the Fourth Circuit did limit the EEOC to injunctive relief, denying specific relief in Baker's interest. The matter was then processed before the Supreme Court.[6]

The Supreme Court decision in this matter enumerated several findings that provide guidance to employers and others in determining the extent to which individual employment arbitration provisions restrict EEOC action on behalf of those individuals. The Court ruled that the EEOC was not restricted by the arbitration clause, since Title VII gives the EEOC control over the choice of forum in such actions. The Court also found that the EEOC could seek both injunctive relief and specific relief, based on the existence of a compelling public interest in this type of action. Since the EEOC was not a party to the arbitration agreement, the Commission

was not prevented from taking whatever action it felt necessary to protect both the interest of the individual in the particular dispute and the interests of the public at large.[7]

However, it is noteworthy that the Court did not challenge the fundamental validity of employment arbitration clauses, but carved out a statutory exception to their use based on the language of Title VII, as amended. This is consistent with the Court's action in regards to labor arbitration, as evidenced by the Court's findings in the Alexander v. Gardner-Denver Co. decision referenced above.

Unresolved Legal Issues After EEOC v. Waffle House

Despite the general finding in support of employment arbitration clauses, additional unresolved legal challenges to employment arbitration remain. In some cases, these issues pose threats to the overall validity of employment arbitration, while others represent structural and process concerns that employers should consider when creating an employment arbitration system to insure its validity should challenges arise.

Concerns about the due process nature of employment arbitration clauses include a structural element related to the selection and control of arbitrators. In Hooters of America, Inc. v. Phillips, 173 F.3d 933 (1999), the Fourth Circuit found the company's attempts to control the process undermined the neutrality of the process, resulting in the court's ruling that the employment arbitration clause was unenforceable. The company retained a unilateral right in selecting the arbitrator and a unilateral right to move for summary judgment.

Furthermore, the company also limited the employee's right to discovery prior to the arbitration hearing.[8] This and other circuit court cases have established that, while supporting employment arbitration as a process, the courts will insist that such procedures must maintain general fairness, and protect both the procedural and substantive due process rights of employees. While recognizing that arbitration can provide an adequate forum in which an employee's rights can be asserted, the courts expect employers to insure this outcome. Should an employee assert that his/her due process rights have been violated, the burden is on the employer to prove that the employee received the same degree of due process as might be expected in court. While the courts accept that the informal nature of arbitration does not directly compromise the due process rights of employees, they also will not allow this informality to be used by an employer as a tool to lessen the due process standards.

Another issue of concern to the courts is a desire that an employee subject to employment arbitration is not denied access to the forum due to excessive costs resulting from "fee-shifting." In labor arbitration, it is customary for the union and the company to split the cost of the arbitration process. Since the union receives dues from its membership, the financial burden of an arbitration proceeding for any one member is actually borne by all members of the union. Individual employees obviously do not have this luxury; therefore, if the employment arbitration process is structured in such a way that the cost to an individual employee is so great as to make it either impossible or extremely difficult for that employee to pay, the court must determine if that employee's due process rights have been violated.

The existence of arbitration as the only forum available to the employee requires that significant care be taken to protect access to that forum. Otherwise, the employer has the best of all worlds since the employee is denied the forum of the courts and cannot afford the forum of arbitration. The lower courts have been very diverse in their opinions on this issue, with some taking a very strong stand against fee-shifting, while others have endorsed the concept. The Tenth, Eleventh, and District of Columbia have opposed fee-shifting, while the Second Circuit and others have upheld fee-shifting clauses. Still others, like the Fourth Circuit, have taken a compromise position in arguing that the equity of fee-shifting must be examined in a case-by-case basis in light of the employee's ability to pay.[9] Given the diversity of opinions among the courts on this issue, it is likely that the Supreme Court will need to render a decision in the near future clarifying the parameters of fee-shifting; and, it would not be surprising to see the Supreme Court utilize its certiorari powers in this situation.

From a practical perspective, many employers have decided to reduce the significance of this issue as a potential challenge to their system by requiring employees to pay only a filing or forum fee, with the employer paying the remaining costs. Given the obvious concern this could lead to the filing of frivolous or capricious claims, other employers stipulate in the employment arbitration clause that the arbitrator can impose additional financial costs on the employee if the arbitrator determines the employee did not file the claim in good faith. Under such provisions, if the employer administers its own employment arbitration system, the question of unilateral control of the proceedings again becomes an issue of concern.

However, utilizing an outside agency like the American Arbitration Association (AAA) will rebut any assertions that the system is biased in favor of the employers. In fact, recent innovations in AAA employment arbitration procedures are designed to lessen concern over both the fee-shifting and control issues. Effective January 1, 1999, the AAA established the Due Process Protocol for Mediation and Arbitration of Statutory Disputes Arising Out of the Employment Relationship. The Due Process Protocol was the result of a joint task force that included representatives from the AAA, the American Civil Liberties Union, the Ameican Bar Association and the National Employment Lawyers Association.[10] Effective November 1, 2002, the AAA implemented new rules to protect employees from paying excessive costs in arbitration proceedings. The employee is required to pay a case filing fee that is now capped at $125.00, with the employer paying all administrative fees unless the arbitrator determines the employee's claim was patently frivolous or filed to harass the employer. If the arbitrator finds the employee guilty of filing a claim in bad faith, the arbitrator can use his discretion to allocate the cost of the proceedings.[11]

As to the issue of management control of the arbitration process, corporate executives point to the professionalism of arbitrators as a sufficient basis for insuring neutrality of the process. Certainly arbitrators concur with this assessment, pointing out that an arbitrator's reputation for integrity as a neutral is the most critical criterion for continuance in the field. For some critics convinced that an employer-administered plan is not acceptable either in appearance or practice, the AAA and other independent agencies, like the National Academy of Arbitrators, provide an acceptable alternative. These agencies are widely respected for their neutrality in such situations; and given the large number of arbitrators on the rosters of such agencies, arbitrators are unlikely to be assigned to the same company with any frequency.

An additional unresolved legal issue is that of class action litigation. An employment arbitration agreement generally has been held by the courts to be an individual contract between the company and employee, which would seem to preclude using this contract as the basis for any class action. For the most part, the U.S. Supreme Court and other federal courts have agreed with this position. In Gilmer, the Supreme Court rejected an argument that arbitration provisions are invalid because they cannot adequately provide for class actions; finding that all individuals adversely affected had an individual right to seek redress of any grievances. Even the Ninth Circuit has found that employees signing an individual contract cannot expect to later combine with other litigants in a class action, even where the agreements were identical.

Recent guidance in this area was provided by the Fourth Circuit in Adkins v. Labor Ready, Inc., involving an employee of a temporary employment agency who brought suit against his employer alleging violations of federal and state wage and hour laws. Mr. Adkins also sought class action status for his complaint. Based on the fact that all employees had signed an arbitration agreement upon employment, and the court's view that each agreement was valid and enforceable individual agreement, the court rejected the plaintiffs' argument. The court instructed that any action must be taken on an individual basis, and within an arbitration forum. Of note in this case is the simplicity of the company's arbitration provision. The provision read:

> I understand that my employment with LABOR READY, INC. is on a day-to-day basis. That is, at the end of the work day, I will be deemed to have quit unless and until I request and receive a work assignment at a later date.
> I agree that any disputes arising out of my employment, including any claims of discrimination, harassment or wrongful termination that I believe I have against Labor Ready and all other employment related issues (excluding only claims arising under the National Labor Relations Act or otherwise within the jurisdiction of the National Labor Relations Board) will be resolved by arbitration as my sole remedy. The arbitration shall be conducted by the American Arbitration Association under its Commercial Arbitration Rules and the decision of the arbitrator shall be final and binding. I understand that Labor Ready also agrees to arbitrate in the same manner any claims which the company believes it has against me.[12]

Unlike some arbitration agreements that may require legal training in order to be understood, the Labor Ready provision is very simple and straightforward. Mr. Adkins sought to have the agreement set aside based on an inequality of bargaining power between himself and Labor Ready, Inc. However, the court rejected this argument, finding nothing about the agreement to be unconscionable. It is also interesting to note that this agreement did not mention the distribution of costs for any proceedings, yet the court made no comment on this issue.

One final legal concern with employment arbitration rests with attacks on the process based on traditional principles of contract law. Where an employer unilaterally imposed arbitration provisions, some courts have determined there was no consideration on the part of the employer to support the employee's obligation to arbitrate. This is particularly true for current employees. While one can argue that individuals signing an arbitration agreement at the initial

hire date received employment as consideration, the same is not true for existing employees. Most courts have found that as long as the employer puts current employees on notice as to the initiation of the employment arbitration system, and they continue to work for the employer, a sufficient contractual "meeting of the minds" exists.

In addition to extensive court activity concerning employment arbitration, it is worth noting that critics of the process have brought pressure on Congress in recent years to legislatively reduce the impact of individual employment arbitration provisions. While such efforts have not yet been successful, continued efforts in this direction are anticipated in the coming years. It should be anticipated that plaintiffs' attorneys will continue to resist any widespread legislative endorsement of employment arbitration, given the reduction in fees such legislation would portend for the legal profession.[13]

Implementing an Employment Arbitration System

Employers should take great care in designing and implementing an employment arbitration system, both for legal and practical reasons. This paper has examined the legal status of employment arbitration, and will combine this perspective with the practicality of the author's experience as a labor arbitrator to provide recommendations in this regard.

The first step taken by corporate executives should be an identification of the desired outcomes of the system. Is the system designed primarily as an attempt to avoid litigation in the courts, or is it intended to provide an impartial arbiter of disputes between the employer and its employees. Both of these alternatives are legitimate, but the decisions concerning significant components of the system can be impacted by the goals of the system. For example, a system designed to avoid litigation will seek to meet the letter of the law in maintaining the system's validity, but may not be as concerned with employee perceptions of the system. This approach is distributive in nature, seeking to maximize the rights of the employer to the greatest extent possible within the parameters of the current legislative environment. A system designed with an integrative view of the employment relationship is more likely to take steps to insure that the system is accepted by the employees of the firm as having face validity. One might anticipate that decisions concerning due process protections, fee-shifting, and process control will be impacted directly by the organization's perspective in determining the system's desired outcomes.

The second step to be taken is to identify the measures to be used in assessing the success of the system. Will success be measured by dollars spent for administering the employment arbitration system versus estimated dollars saved by avoiding litigation, or will measures such as employee satisfaction and turnover provide a more accurate measure of success/failure? In the labor relations arena, arbitration is the final step of an industrial jurisprudence system that tries to solve employer-employee disputes at the lowest level possible. Employment arbitration can be used in this manner, but the vast majority of companies do not place this arbitration as the final step, but the only step. Whereas in unionized environments arbitration is seen as the option of last resort, employment arbitration is often the first and only option. Again, this can affect employee perceptions that the employer is doing only what is in the best interest of the employer.

A third recommendation is to keep the employment arbitration provision as simple as possible. A review of court decisions indicates that this approach reduces the likelihood that an employment arbitration provision will be ruled unenforceable. While your attorney certainly should review any employment arbitration provision prior to distribution, avoid the use of legal jargon that will call into question the employees' ability to understand the provision. Courts have consistently ruled that such employment arbitration provisions will allow successful challenges by employees.

A fourth recommendation is to utilize the AAA or a similar agency to administer your system. Given the remaining legal questions concerning employment arbitration, this provides a measure of protection against charges that arbitrators will be biased toward the party determining neutral selection. The recent procedures enumerated by the AAA protect the rights of all parties, and support the integrity of the employment arbitration process. As indicated above, these guidelines call for the employee to pay only a modest forum fee, with the employer paying the remaining costs.

A final recommendation concerns those employers who act contrary to the previous recommendation to utilize an outside agency. These employers still should require that employees pay only a filing fee, and the employer should assume the remaining financial burden. Since the process is used by most employers only in the event of employee discharge, the costs associated with arbitration are not extensive when compared to a wrongful discharge proceeding. Given the court's divergent views on fee-shifting, the more prudent alternative in this situation is employer payment for the process.

There is a marked trend of increased utilization of employment arbitration provisions by employers, primarily as a tool to gain more control over the employment relationship. However, as the rules of the employment arbitration game continue to evolve, employers should exercise caution in designing and implementing such systems. As is the case with any effective management system, careful internal scrutiny and attention to relevant external developments will increase greatly the probability of success.

Footnotes

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3. 9 U.S.C. S1 et seq.

4. See Gilmer v. Interstate/Johnson Lane Corp., 500 U.S. 20 (1991).

5. See Circuit City Stores, Inc. v. Adams, 120 S.Ct. 200 (2000).

6. See Equal Employment Opportunity Commission v. Waffle House, Inc., 99-1823 U.S. (2002).

7. Id.

8. See Hooters of America, Inc. v. Phillips, 173 F.3d 933 (1999).

9. Starkman, Paul E.: 2002, "Open Issues after Circuit City: Still No Easy Answers on Mandatory Arbitration", Employee Relations Law Journal **27**, 69-99.

10. Fahrbach, Christina, "From Gardner to Circuit City: Mandatory Arbitration of Statutory Employment Disputes Continues", Dispute Resolution Journal **56**, 64-77.

11. See National Rules for the Resolution of Employment Disputes, American Arbitration Association, As Amended and Effective November 1, 2002.

12. See Adkins v. Labor Ready, Inc., Fourth Circuit (2002).

13. Sherwyn, David, "Mandatory Arbitration: Why Alternative Dispute Resolution May Be The Most Equitable Way to Resolve Discrimination Claims," Cornell University: The Center for Hospitality Research, Volume 6, No 9, 2006.