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ARBITRATION

Predispute arbitration clauses are becoming increasingly common, found in everything from the fine print you ignore when installing most new software to credit card agreements, authors R. Scott Oswald and Adam Augustine Carter say in this BNA Insights article. As a consequence, they say, employers are forcing employees to sign predispute arbitration agreements as a condition of employment.

The authors discuss the general framework behind the enforceability of predispute arbitration clauses in employment agreements and recent state and federal legislative responses to employers' attempts to restrict employees' ability to enforce their legal rights.

Forced Arbitration Clauses as Condition of Employment

BY R. SCOTT OSWALD & ADAM AUGUSTINE CARTER

Predispute arbitration clauses are becoming increasingly common, found in everything from the fine print you ignore when installing most new software to credit card agreements, and even the popular online service Instagram.

Employers of all sizes are also hopping on the arbitration bandwagon and forcing employees to sign predispute arbitration agreements as a condition of employment.

This article discusses the general framework behind the enforceability of predispute arbitration clauses in employment agreements and recent state and federal legislative responses to employers' attempts to restrict employees' ability to enforce their legal rights.

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What Is Arbitration?

Employees who believe they have suffered from unlawful discrimination or retaliation traditionally bring their claims in our nation's public court system.[1] There, a judge or jury will hear an employee's claims and administer justice.

Arbitration is a process of resolving disputes outside of the public court system. Not to be confused with mediation, in which the parties work to reach a voluntary resolution, arbitration involves a third party reviewing the parties' claims and defenses and rendering a binding decision to resolve a dispute. The third party is a private citizen, frequently an attorney or retired judge, paid by one or both of the parties.

Arbitration in employment disputes often takes place before one of two organizations, Judicial Arbitration and Mediation Services, Inc. (JAMS) or the American Arbitration Association (AAA).

Proponents of arbitration argue that it provides many benefits. In comparison to the public court system, arbi-

[1] Many laws, such as Title VII of the 1964 Civil Rights, 42 U.S.C. § 2000e et seq., require an employee to first exhaust their administrative remedies by filing a charge of discrimination with a state or federal agency and obtain a right to sue prior to pursuing their claims in court.

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tration may be less costly, provide greater privacy, be less formal and more hospitable to individuals representing themselves, and provide a more timely resolution. Unlike decisions by trial courts, arbitration decisions are also generally not appealable.

Critics of arbitration complain that it deprives employees of a fundamental tenant of the American justice system enumerated in the Seventh Amendment of the U.S. States Constitution—the right to have one's claims decided by a jury. Juries are often sympathetic to individual employees fighting a David and Goliath-style battle and are more likely than an arbitrator to award punitive damages. Arbitration also tends to limit the scope of discovery in a more restrictive fashion than the courts. Limiting discovery can favor employers that usually possess most of the documents and information relating to an employee's claims.

What Is Mandatory or Forced Arbitration?

Mandatory or forced arbitration is a predispute contractual agreement to arbitrate disputes required by one party as a condition of conferring a benefit upon another party.

Mandatory arbitration agreements are frequently the product of inequality in bargaining power in which one party, such as an employer or seller of unique goods, has far more options than the weaker party. The weaker party, forced into a take-it-or-leave-it situation, must accept the terms and agree to arbitration or search for scarce alternatives.

An arbitration agreement will typically identify the manner in which arbitration costs will be paid, the location at which the arbitration shall take place, the rules of the proceedings, and the arbitrator or organization which will administer the proceedings.

The agreements are frequently buried in a stack of other onboarding paperwork, and signed by employees without a second thought. The truth however, is that the arbitration agreement may be one of the most important documents that an employee signs during the employee's orientation.

Federal Arbitration Act

The enforceability of arbitration agreements starts with the Federal Arbitration Act (FAA), 9 U.S.C. § 2. Enacted in 1925, the FAA provides that a signed arbitration agreement ''shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation for any contract.''

The U.S. Supreme Court has said the FAA ''reflects a fundamental principle that arbitration is a matter of contract,'' and evidences a ''liberal federal policy favoring arbitration.'' *Rent-A-Center, W., Inc. v. Jackson*, 561 U.S. 63, 109 FEP Cases 897 (2010) (118 DLR AA-1, 6/22/10); *Moses H. Cone Mem'l Hosp. v. Mercury Const. Corp.*, 460 U.S. 1 (1983).

In accordance with Section 2 of the FAA, an employee may use general contract law principles to invalidate an arbitration agreement. For example, if an employee can show that the agreement was entered into under duress, or that her employer obtained her signature through fraud, the employee may be able to invalidate the agreement.

However, in accordance with FAA Section 2's ''any contract'' language, the state law relied upon by the employee must apply to contracts generally and not have a disproportionate impact on arbitration agreements. *AT&T Mobility LLC v. Concepcion*, 131 S. Ct. 1740 (2011) (81 DLR AA-1, 4/27/11); *Chavarria v. Ralphs Grocery Co.*, 733 F.3d 916, 21 WH Cases 2d 767 (9th Cir. 2013) (210 DLR AA-1, 10/29/13).

In *Brenan v. Bally Total Fitness*, 198 F. Supp. 2d 377, 88 FEP Cases 335 (S.D.N.Y. 2002), a federal judge found that an employer secured employees' consent to arbitration through duress when management failed to provide employees with adequate time to review the arbitration agreement and did not inform employees of their ability to have counsel review the agreement prior to signing. However, the everyday economic distress and pressure associated with employment decisions in general is insufficient to invalidate such an agreement.

Another defense to the enforceability of an arbitration agreement forced on the employee is unconscionability. Whether an agreement is unconscionable is determined using a sliding scale which examines the procedural and substantive aspects.

In *Chavarria v. Ralphs Grocery Co.*, the U.S. Court of Appeals for the Ninth Circuit summarized several decisions providing examples of procedural unconscionability: ''where . . . the employee is facing an employer with overwhelming bargaining power who drafted the contract and presented it to [the employee] on a take-it-or-leave-it basis, the clause is procedurally unconscionable. Likewise . . . we held that a contract is procedurally unconscionable under California law if it is a standardized contract, drafted by the party of superior bargaining strength, that relegates to the subscribing party only the opportunity to adhere to the contract or reject it'' (internal citations and quotations omitted, alteration in original).

The court also observed that ''the degree of procedural unconscionability is enhanced when a written contract binds an individual to later-provided terms'' (citation omitted). The *Chavarria* employment agreement in question required assent to the arbitration agreement, but the terms of the agreement were not presented to employees at the time of signing. Lastly, the court observed the unconscionability of agreements containing a unilateral modification provision.

With regard to procedural unconscionability, the *Chavarria* court further took issue with provisions which virtually guaranteed that the arbitrator would be selected by the employer and required the arbitrator to apportion his or her fees between the employer and employee regardless of the merits of the claim. The court noted that the employee's share of arbitration fees would amount to between $3,500 and $7,000, not including attorneys' fees.

Federal Legislative Responses to Forced Arbitration Agreements

In 2005, two KBR employees, Tracy Barker and Jamie Leigh Jones, reported that they had been sexually assaulted during separate and unrelated incidents in Iraq. Each quickly learned that they were subject to mandatory arbitration agreements with their employer, and their dramatic tales caught the public eye.

On Dec. 19, 2007, the Senate Judiciary Committee heard testimony and reviewed statements from Jones and Barker. In 2009, Jones testified again before the

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Senate Judiciary Committee (193 DLR A-9, 10/8/09) during a hearing discussing the Supreme Court's ruling in *Circuit City v. Adams*, 532 U.S. 105, 85 FEP Cases 266, 17 IER Cases 545 (2001) (56 DLR AA-1, 3/22/01) (holding that the FAA applies to employment contracts).

Following Jones's testimony, the Senate approved amendments to the fiscal year 2010 Department of Defense Appropriations Act in what would become one of the most significant recent legislative attacks on mandatory arbitration (193 DLR A-15, 10/8/09).

The amendments, contained in Section 8116 and proposed by Sen. Al Franken (D-Minn.) (192 DLR A-14, 10/7/09), became law on Dec. 19, 2009. *See* Pub. L. No. 111-118. Section 8116 generally [2] prohibits contractors and subcontractors from requiring employees and independent contractors to arbitrate claims brought under Title VII of the 1964 Civil Rights Act or any tort related to or arising out of sexual assault or harassment, including assault and battery, intentional infliction of emotional distress, false imprisonment, or negligent hiring, supervision, or retention.

Congress again limited employers' ability to enforce predispute arbitration agreements when it passed the Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, in 201. The Dodd-Frank Act contains three separate provisions barring enforcement of predispute arbitration agreements in the employment context. Two of the provisions create new causes of action protecting individuals who make certain disclosures regarding violations of commodities laws or laws administered by the Consumer Financial Protection Bureau, while the third, contained in Section 922(b), amends the anti-retaliation provision of the Sarbanes-Oxley Act of 2002.

Sections 748 and 922(a), codified at 7 U.S.C. § 26 and 18 U.S.C. § 1514A, provide identically:

> (1) Waiver of rights and remedies
>
> The rights and remedies provided for in this section may not be waived by any agreement, policy form, or condition of employment including by a predispute arbitration agreement.
>
> (2) Predispute arbitration agreements
>
> No predispute arbitration agreement shall be valid or enforceable, if the agreement requires arbitration of a dispute arising under this section.

Section 1057, codified at 12 U.S.C. § 6657, provides:

> (1) No waiver of rights and remedies
>
> Except as provided under paragraph (3), and notwithstanding any other provision of law, the rights and remedies provided for in this section may not be waived by any agreement, policy, form, or condition of employment, including by any predispute arbitration agreement.
>
> (2) No predispute arbitration agreements
>
> Except as provided under paragraph (3), and notwithstanding any other provision of law, no predispute arbitration agreement shall be valid or enforceable to the extent that it requires arbitration of a dispute arising under this section.
>
> (3) Exception
>
> Notwithstanding paragraphs (1) and (2), an arbitration provision in a collective bargaining agreement shall be enforceable as to disputes arising under subsection (a)(4), unless the Bureau determines, by rule, that such provision is inconsistent with the purposes of this title.

At first glance, both provisions may appear to ''invalidate all predispute arbitration agreements lacking a Dodd–Frank carve-out, even for plaintiffs who are not pursuing any whistleblower claims.'' *Santoro v. Accenture Fed. Servs., LLC*, 748 F.3d 217, 22 WHCases 2d 781 (4th Cir. 2014) (87 DLR AA-1, 5/6/14). However, courts disagree. The Fifth Circuit even labeled such an interpretation as ''unreasonable.'' *See Holmes v. Air Liquide USA, L.L.C.*, 498 F. App'x 405, 122 FEP Cases 1208 (5th Cir. 2012).

The result is that plaintiffs bringing multiple claims may have to bifurcate their case and proceed separately in court[3] and arbitration simultaneously, though at least one trial court has allowed a plaintiff to proceed with arbitrable claims to avoid re-litigating common facts in arbitration. *See Stewart v. Doral Fin. Corp., CIV*, 997 F. Supp. 2d 129 (D.P.R. 2014).

Courts are split regarding the retroactive application of the Dodd-Frank Act's anti-arbitration provisions. *Compare Wong v. CKX, Inc.*, 890 F. Supp. 2d 411, 34 IER Cases 608 (S.D.N.Y. 2012) (finding that the Dodd-Frank Act's anti-arbitration provision did not take away any substantive rights and therefore could have a retroactive effect); *and Pezza v. Investors Capital Corp.*, 767 F. Supp. 2d 225, 31 IER Cases 1694 (D. Mass. 2011) (43 DLR A-1, 3/4/11) (finding no prejudicial consequences to the retroactive application of the Dodd-Frank Act's anti-arbitration provision); *with Henderson v. Masco Framing Corp.*, 32 IER Cases 1008, 2011 BL 191929 (D. Nev. 2011) (rejecting retroactivity because it ''would not merely affect the jurisdictional location in which such claims could be brought; it would fundamentally interfere with the parties' contractual rights and would impair the 'predictability and stability' of their earlier agreement''); *and Taylor v. Fannie Mae*, 839 F. Supp. 2d 259, 33 IER Cases 983 (D.D.C. 2012) (finding that the Dodd-Frank Act's anti-arbitration provision affected the substantive rights of the parties and could not have a retroactive effect).

State Legislative Response to Predispute Arbitration Agreements

States, including California and Massachusetts, have also enacted laws to limit mandatory arbitration. However, such attempts have limited effect due to the Supremacy Clause.

In *Preston v. Ferrer*, 552 U.S. 346, 27 IER Cases 257 (2008) (34 DLR AA-5, 2/21/08), the Supreme Court examined the effect and reach of the California Talent Agencies Act (TAA). The TAA, at the time in question, required parties in cases arising under the relevant provisions of state law to submit their disputes to the state Labor Commissioner or arbitration.

The court observed that the TAA conflicted with the FAA in two respects: ''First, the TAA . . . grants the La-

[2] The law contains dollar amount thresholds for contracts and contains a waiver for national security interests.

[3] Section 806 of the Sarbanes-Oxley Act, 18 U.S.C. § 1514A, requires plaintiffs to first exhaust their administrative remedies by filing with the Department of Labor, thus plaintiffs may find themselves before the DOL instead of court.

bor Commissioner exclusive jurisdiction to decide an issue that the parties agreed to arbitrate; second, the TAA . . . imposes prerequisites to enforcement of an arbitration agreement that are not applicable to contracts generally'' (citations omitted). The court held that the FAA preempts the TAA and ruled that federal policy ''foreclose[s] state legislative attempts to undercut the enforceability of arbitration agreements'' (alteration in original, quotations and citations omitted).

Late last year, the Ninth Circuit further examined the issue of preemption in the *Chavarria* case mentioned previously. The Ninth Circuit held that while the FAA preempts state laws that have a disproportionate impact on arbitration agreements, it does not preempt all of California's procedural unconscionability rules for contracts, leaving room for state laws which reflect a general policy against abuses of bargaining power.

Executive Order—Fair Pay and Safe Workplaces

On July 31, 2014, President Obama also took a swing at pre-dispute arbitration agreements when he issued the Fair Pay and Safe Workplaces, Executive Order 13,673 (147 DLR AA-1, 7/31/14) The order contains provisions similar to the FY 2010 Defense Appropriations Act and restricts the ability of federal contractors to enforce certain pre-dispute arbitration agreements:

> Sec. 6. Complaint and Dispute Transparency. (a) Agencies shall ensure that for all contracts where the estimated value of the supplies acquired and services required exceeds $1 million, provisions in solicitations and clauses in contracts shall provide that contractors agree that the decision to arbitrate claims arising under title VII of the Civil Rights Act of 1964 or any tort related to or arising out of sexual assault or harassment may only be made with the voluntary consent of employees or independent contractors after such disputes arise. Agencies shall also require that contractors incorporate this same requirement into subcontracts where the estimated value of the supplies acquired and services required exceeds $1 million.

Of course, there are several exclusions, including for contracts for the acquisition of off-the-shelf items and collective bargaining agreements. A full copy of the executive order is available at: http://www.whitehouse.gov/the-press-office/2014/07/31/executive-order-fair-pay-and-safe-workplaces.

Conclusion.

In recent years, there have been numerous efforts from nearly all levels of government to eliminate predispute arbitration provisions in employment agreements or to limit their enforceability. There are no signs that these efforts will slow anytime soon. Employers should take care to have their counsel frequently review the enforceability of their employment agreements, and employees should take the time to read and understand the paperwork they sign when coming on to a new employer.

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