ARBITRATION: WHAT ROLE SHOULD IT PLAY FOR RESOLVING DISPUTES

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SHOULD WE ARBITRATE?

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II. Conclusion

I. Should We Arbitrate or Not?

In recent years, arbitration has gained popularity as a means to resolving disputes "quickly," “efficiently” and "privately" among businesses, employers, and employees. Companies representing every facet of industry from credit-card issuers, health care providers, franchisors to cell phone companies rely on arbitration as a "cost-effective" and "expeditious" means to resolving their disputes. A number of companies use it for their employment disputes.

However, is arbitration always the best choice for companies and employers? Is there a place for arbitration within your companies scheme for resolving internal disputes with employees, external disputes with customers or both? Is arbitration really the fast, efficient, and economical procedure for which it has been touted? And if arbitration is the right choice, what are the considerations in making sure an arbitration agreement is legally enforceable?

A. What Do The Statistics Say?

Empirical analysis of the arbitration process is imprecise at best. Arbitrations are private and often confidential, and therefore, there is limited availability of reporting and information. However, there have been studies in varying areas, and though the statistics differ in precision, they all suggest that arbitration is faster, less disruptive, preferred, and typically more favorable to employers.[1] A survey of general counsel and high ranking in-house counsel found:

- 78% find arbitration faster than lawsuits.[2]

[1] In 2004, the National Arbitration Forum produced an article, "The Case for Pre-Dispute Arbitration Agreements: Effective and Affordable Access to Justice for Consumers Empirical Studies & Survey Results (2004)," which referenced most of the statistics and studies cited herein to illustrate the benefits of pre-dispute arbitration.

[2] *Survey on Arbitration, ABA Section of Litigation Task Force on ADR Effectiveness*, ABA, 2003.

- 59% find arbitration costs are equal to or less expensive than lawsuits.

- 83% find arbitration to be equally or more fair than lawsuits.[3]

- 84% found arbitration preferable for insurance issues.

Other Legal Surveys Have Shown:

- Outcome differences between arbitration and litigation are essentially the same, with median awards in arbitration at $100,000 and for litigation at $95,554.

- 78% of business attorneys find that arbitration provides faster recovery than lawsuits.[4]

- Individuals obtain some recovery at least slightly more often in arbitration than through lawsuits with claimants prevailing 46% of the time in arbitration compared to 34% in federal court.[5]

- The average duration of an arbitrated claim was 8.6 months, compared to 2.5 years in litigation.[6]

- 93% percent of consumers using arbitration find it to be fair.[7]

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[3]*Id*.

[4]Burr, Michael T., "The Truth About ADR: Do Arbitration and Mediation Really Work?", *Corporate Legal Times*, (February, 2004).

[5]Delikat, Michael and Morris M. Kleiner, *Comparing Litigation and Arbitration of Employment Disputes: Do Plaintiffs Vindicate Their Rights in Litigation,* 2003.

[6]Maltby, *infra* n. 14.

- In securities actions, consumers prevail in arbitration 16% more than they do in court.[8]

- 64% of American consumers would choose arbitration over a lawsuit for monetary damages.[9]

- 93.8% - - the percentage of company wins in California consumer arbitrations between 2003 and 2007 and including 34,000 arbitrations.[10]

- Two Democratic Senators introduced legislation in 2007 to ban mandatory pre-dispute arbitration in consumer, securities, employment and franchise cases.

B. Why Choose Arbitration?

1. How Widespread is the Use of Arbitration?

The American Arbitration Association, one of many arbitration providers, shows new arbitration filings averaging about 25,000 a year.

Historically, in 1979, only 1% of employers used arbitration for employment disputes.[11]

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[7]Perino, Michael, "Report To The Securities And Exchange Commission Regarding Arbitrator Conflict Disclosure In NASD and NYSE Securities Arbitrations.

[8]United States General Account Office, Rep. No. GAO GGD-92-74 (5/11/92), "Securities Arbitration: How Investors Fare."

[9]"Legal Dispute Study: Roper ASW: Survey for the Institute for Advanced Dispute Resolution" (April, 2003).

[10]Trial, December 2007.

[11]Bureau of National Affairs, “Policies for Unorganized Employees” (PPF Survey No. 125) (1979).

By 1998, 62% of Fortune 1000 corporations surveyed had used employment arbitration at least once between 1995 and 1998.[12]

By 2002, 37% of the employments contracts made with key employees in a sample of more than 2,800 publically-held companies included pre-dispute mandatory arbitration clauses. Of the 13 types of contracts studied, employment contracts were the most prevalent.[13]

As of 2007, it was estimated that 30 million non-union workers out of 121 million are covered by binding mandatory arbitration.[14]

2. Speedy Resolution

There are multiple reasons why arbitration is considered faster than traditional litigation. First, the deadlines are shorter, because the case is typically on a fast track. Arbitrations, depending on the difficulty of the case, can take place even within a few months of the initial contact with the arbitrator. Secondly, as discussed below, there is typically no right of appeal, and therefore, the matter is concluded once a judgment is rendered without the additional time of appeal.

However, arbitration does not always resolve in a few months. The arbitration itself can be delayed for a significant period of time during a court battle over the validity of the arbitration agreement. Once the parties actually get to arbitration, the better the arbitrator, the

[12]Lipsky & Seeber, "Patterns of ADR Use in Corporate Disputes," 5 Dispute Resolution Journal 66 (Feb. 1999).

[13]Miller Eisenberg, "The Flight from Arbitration: An Empirical Study of Arbitration Clauses in Publically-Held Companies' Contracts," NYU Law and Economics (2006).

[14]"Increasing Prevalence of Mandatory Arbitration Systems Imposed on Employees," NELA, October 2007.

more likely the arbitrator will have few open dates to hear the case.

Although arbitration awards are final and binding on the parties with no general right of appeal, the losing party does have a very limited right to seek to have the award vacated, which can also extend the time it takes to conclude the matter. Despite these issues, statistics have shown that arbitration is typically a speedier process that court litigation, even if only by a matter of months in some cases.

Employment claims take 650 to 720 days to be resolved in state court, according to the National Center for State Courts.[15]

Claims in federal courts have a median time length of 22.2 months.[16]

Median time to resolve consumer disputes by arbitration is 104 days.[17]

3. Cost Efficient

Arbitration is typically considered to be more cost efficient for companies and employers, because of the traditionally "speedier" process with the assumption being, less time is less money.

However, in a complex litigation, where the discovery to prepare the matter for hearing is comprehensive, the fees can be comparable to the costs involved in a traditional court case despite saving a few months of time.

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[15]Examining work of State Courts (1999 - 2000), National Center for State Courts.

[16]Federal Judicial Case and Statistics, March 31, 2006, Table C-5.

[17]Consumer and Employment Arbitration in California, August 2004.

Arbitrators have to be paid as well, where judges are publicly subsidized. Consequently, this is an additional expense.

Finally, as discussed herein, arbitrators are very unlikely to grant summary judgments, having a tendency in arbitrations to try and "split the baby". Therefore, especially in the case of employment disputes, an employer will sometimes fare better in a federal court, where it will get better consideration of the merits of a summary judgment motion. If the court grants the summary judgment motion, then the matter concludes without expense of a trial and the preparation necessary to get it to trial.

There is a balance here to consider between fewer summary judgments versus private resolution and much lower likelihood of extreme verdicts.

4. Convenience

In arbitration, the parties are not at the mercy of the court's calendar. An arbitration hearing can be set at a time and location that is most convenient for all the parties. The person creating the arbitration framework also has latitude to specify what rules will apply is the arbitration. If those rules are reasonable, even if somewhat more restrictive that court's, the agreement will typically be enforced.

5. Finality

Arbitration is intended to be a substitute for both the trial and appeal of a case. In order to submit to arbitration, each party waives their right to almost all appeals. If you choose to arbitrate a dispute, federal law supports the notion that the arbitrator's decision should be respected.

Typically, an arbitrator's award and opinion is final, binding and not reviewable by a court. If however, a party can show the arbitrator's decision was arbitrary and capricious, a very high legal standard of proof, the decision can be vacated by a court of law. Under the Federal Arbitration Act, opportunities to appeal are limited to fraud or that the arbitrator was so biased, it was tantamount to fraud. The standard to get a decision reviewable is very hard to reach.

6. Expanded Review in Court, Post-Arbitration: A Contract Right?

One disadvantage with arbitration is little or no review of an award. This is especially true where one side believes the arbitrator made fundamental legal errors.

One effort around this problem has been to specify in the arbitration documents that errors of law may be reviewed by the courts following an award. In essence, the parties agree by contract to the expanded scope of review allowed following the arbitrators ruling. These provisions made sense in light of the notion that arbitration is a creature of contract and that the Federal Arbitration Act seeks to enforce the agreements entered into by the parties.

NOT SO FAST, AS THEY SAY . . .
HALL RULING

In ***Hall Street Associates v. Mattel***, the Court said it would not enforce a contract to expand judicial review after arbitration to review general legal errors. The Justices said expanded judicial review was at odds with the Federal Arbitration Act. 552 U.S. _____ (March 25, 2008).

Hall involved a factory site in Oregon and the efforts to make tenant Mattel pay to clean up the property after it was polluted with industrial solvents.

In deciding to arbitrate the dispute, the parties agreed to a provision that the arbitrator's award could be appealed in court if it contained errors of law. The District Court retained the case while sending the payment for clean-up issue to the arbitrator pursuant to the parties agreement.

The arbitrator first found that Mattel was not responsible for the clean up. The District Court disagreed with the arbitrator's legal analysis, vacating the decision. It said the arbitrator gave an "impossible" reading of the lease. On remand, the arbitrator sided with the building owner and the District Court upheld the award.

The U.S. Court of Appeals for the Ninth Circuit reversed saying the parties agreement for judicial review of errors of law was unenforceable under the FAA.

The Supreme Court agreed. It found that the virtue of "resolving disputes straightaway" was compromised by expanded FAA review. The court left for remand whether there were state statutory or common law means to enforce the parties agreement.

The ruling preserves arbitration's overall delivery of a speedy, economical and final decision as reflected in the language and policies of the FAA. It does so at the cost of expanded review of legal errors under the FAA.

However, careful drafters of arbitration agreements still seeking expanded review may look to support from other sources, such as state arbitration laws and statutes. The Supreme Court raised the issue, but did not address, whether the Alternate Dispute Resolution Act of 1998, 28 U.S.C. 651 *et seq*., might allow for an expanded review of legal errors.

The Court left for remand whether the District Court's authority to manage cases under Fed. R. Civ. P.

16 might provide an independent basis of support for the expanded review in this case. The parties would have to overcome the issue of waiver as all assumed that the issue in the case only arose through the FAA and not through some other means.

One Post - Hall lesson, for those still looking for expanded review of legal errors, appears to be to look for authority outside the FAA to support that claim. Clearly, Post Hall, management lawyers need to analyze their arbitration post-award review clauses. Many will need modification as expanded post-award review had been the law in the First, Third, Fourth, Fifth, Sixth and Eight Circuits covering most of the United States. Those still using expanded scope of review clauses should include a severability language in the clause in case state courts also decide these clauses are unenforceable.

7. Privacy

An arbitration hearing is not open to the public or anyone who is not involved in the matter, whereas, traditional lawsuits are open to the public and the media. Thus, arbitrations have a reputation for being "private". However, proceeding with arbitration is no guarantee of privacy.

Although the media and witnesses are not allowed in the hearing, there can be leaks of information to such sources. Even if there are no leaks, the process still opens the door to future disclosure.

Specifically, an arbitration award is not a judgment. It is considered a contract between the parties. The prevailing party, therefore, may request a court to enter judgment consistent with the award through a petition. Once the judgment is obtained, the prevailing party may need to enforce the award against the losing party through contempt proceedings, debtor examinations, property seizure, and other enforcement procedures against debtors. Additionally, under limited circumstances, the

losing party can seek to vacate the arbitration ruling. The unanticipated product of these post-arbitration proceedings is to make public what was desired to be private when the parties agreed to arbitrate.
Although a party can seek to have court records of a post-arbitration matter sealed, it is a difficult burden to overcome the presumption of public access to court records. Thus, the Court has to determine which competing public policy is most important - open access to court records or the privacy expectation in arbitrating disputes.

In an effort to maintain privacy, therefore, it is a good idea to consider tailoring the arbitration provision to include a confidentiality provision, and getting the parties to stipulate to seal all records exchanged during arbitration.

8. Expert Decision Maker

Parties in arbitration are gaining more and more control over the arbitrator selection process as a whole. To the contrary, however, parties who choose to litigate their dispute in court have less say in who decides their dispute.

Thus, the parties participating in arbitration have the ability to choose an arbitrator who has extensive experience and expertise in the particular area of the law that is at issue in the case. In the traditional court setting, parties are assigned a Judge that may or may not have any experience in dealing with the issues in particular dispute, or must rely on a jury that lacks the expertise of the arbitrator. Keep in mind, however, that there are good and bad experts, just as there are good and bad Judges.

9. Less Disruptive

Arbitration can be considered less disruptive to businesses and employers in the sense that the "speedier" resolution limits the time and toll on the

business and its current employees. However, this "pro" is wholly dependent on whether of not the arbitration is actually "speedier".

10. Simplicity

An arbitration is more informal than a trial, because the formalities of the court room procedure are not as restrictive. An arbitrator can seek out information that is important. Evidentiary rules are relaxed. Dispositive motions and motions in limine are not typically utilized to limit evidence and streamline the case. Therefore, more evidence and testimony is elicited, even by the arbitrator at the hearing.

11. Avoid Run-a-way Jury Verdicts

Where a dispute involves inflammatory facts, it is not uncommon for a jury to award high damages to punish the offending party. In arbitration, the award comes from the arbitrator himself. While the same range of remedies must also be available to the arbitrator, the extreme cases usually don't occur in arbitrations. This is not to say, however, that the quantum utilized by the arbitration does not result in an extensive damage award. See statistics herein which show claimants fare well in arbitration. However, the extraordinary run-a-way jury verdicts can be avoided in arbitration.

Carrington v. Southwest Airlines, (Tx. State Court 4/06) - **Jury Verdict of $27,500,000 against airline for emotional distress.** A female of Iranian descent suffered emotional distress from malicious prosecution, false arrest, and race discrimination when the defendant airline accused her of assaulting a flight attendant on a flight. The plaintiff contended that she was racially profiled, and the attendant was lying and said plaintiff reminded her of terrorists.)

Olivari v. City Pub. Serv. Bd. Of San Antonio (Tx. 45th JDC, Bexar County 9/23/05) - **Jury Verdict of $5,000,000 million in pain and suffering for sexual harassment, assault, hostile work environment, and constructive discharge.** A meter reader alleged that she was subjected to unwelcome sexual advances, comments and touching from her supervisor. She repeatedly asked him to stop and reported him, but nothing was done. Constant harassment led to major depression and a medical leave.

Williams v. Waffle House, 2005 W.L. 1309225 (Tx. State Court 4/05) - **Jury awards $3,500,000 for pain and suffering in sexual harassment case.** The plaintiff waitress was subjected to inappropriate and unwelcome comments and physical touching by a male cook and the four managers she complained to did nothing to stop it

Reber v. Bell Helicopter (Tx. State Court 2/06) - **Jury Verdict of $2,500,000 in pain and suffering for state law age discrimination claim**. Two male former employees, age 54 and 66 sued the defendant company alleging they were terminated by the defendant and replaced by younger, less qualified men at a lower salary. The defendant claimed the plaintiffs were terminated as part of a reduction in force.

E.E.O.C. v. City of Moss Point (S.D.Miss. 9/05) Case No. 1:05-cv-00427-LG-RHW- **Jury Verdict of over $2,000,000 on behalf of 61 year male applicant claiming age discrimination**. Plaintiff alleged that the defendant failed to hire him as Human Resources Director despite his education and experience. Instead, the defendant hired a 20 year old with no human resources experience and a non-related degree.

Zubulake v. UBS, 229 F.R.D. 422 (S.D.N.Y. 2004) **29.3 million jury verdict for two plaintiffs in employment discrimination case in New York.** Award from jury included 20.2 million in punitive damages.

Stevens v. Safeway, Inc., 2:2005cv03863 (M.D. Ca. 2006) **18.4 million jury verdict for one plaintiff, an inventory clerk, in a sexual harassment and retaliation lawsuit.**

Lane v. Hughes Aircraft Co., California Superior Court No. BC075517. (October 1994). **89.5 million jury award to two plaintiffs by Los Angeles superior court jury in a failure to promote discrimination case.** 80 million of the award was for punitive damages, though plaintiffs offered evidence at trial that Hughes was worth more than 1.6 billion.

C. Why Not Choose Arbitration?

As discussed above, some of the "pros" of arbitrating can be "cons" depending on the facts and circumstance of dispute. Likewise, some of the traditional "cons" of arbitrating can be "pros" depending on the facts and circumstances of the dispute.

1. Risk of Loss of Highly Qualified Applicants

Arbitration agreements can be a turn off for highly qualified applicants, so employer's run the risk of losing some of the best qualified candidates for the job. However, employers must balance their need for low-profile, quick resolutions of disputes that arise when high level managers, partners, or board members must leave against any potential turn-off of highly qualified candidates. This can easily be a matter of negotiation for contract employees.

2. Not Always Cost Efficient

Although the reduced time it takes to get to Judgment may reduce some of the costs of the litigation, arbitration does not always turn out to be significantly less costly for an employer than the court system. Lengthy court battles

over whether the arbitration agreement is enforceable can drive up costs. And, assuming the matter proceeds to arbitration, then the parties must incur the costs and expense of finding a suitable arbitrator. Employers are typically saddled with the expense of the arbitrator, as well, which is typically sever hundred dollars an hour. Further, once the parties go to arbitration both sides must still engage in discovery and prepare the case for trial, and in a complex litigation, this will likely be an extensive and costly process.

3. Denial of Summary Judgment More Likely

Arbitrators are much less likely to grant summary judgment than courts. Multiple factors likely come into play in this finding. Arbitrators do not have the resources that courts have in handling the summary judgment process. Arbitrators have to be concerned that their award is final and binding. A Trial Judge in making a close call can rely on the fact the losing party has a right to appeal, but that is just not the situation in an arbitration setting.

As a result, this can be a big concern in the employment litigation context, where employers typically have a significant success rate at the summary judgment stage in federal courts. It can also drive up costs where the arbitrator is unwilling to streamline the case and dismiss merit-less claims.

Additionally, this will prevent or limit the streamlining of the case for trial, resulting in the preparation for all claims and defenses, thereby increasing the costs and time for the preparation and the arbitration hearing.

4. Splitting The Baby

Arbitrators have the tendency to split-the-baby, trying to give some relief to both parties to appease both sides. If the arbitrator finds for the employee on a small matter and

awards *de minimis* damages, the claimant may still be able to recover a significant portion of his or her attorney fees.

5. Informality

While some consider the simplicity of the arbitration proceeding to be a benefit, this informality can also amount to a con when determining whether or not to proceed via arbitration. For instance, due to relaxed procedure and evidentiary rules, the arbitrator may let in hearsay or similar evidence that would typically be excluded in a courtroom.

6. Limited Discovery

Because arbitration is intended to be faster, less expensive, and more efficient than court litigation, the deadlines are shorter, and the parties, therefore, have less time to engage in discovery. Also, an arbitrator has limited subpoena power. Thus, a party may have to hold an arbitration hearing in another jurisdiction solely for purposes of obtaining documents if they are deemed highly relevant and necessary to the litigation.

The limited discovery, however, in certain disputes may be considered a benefit by a party and another reason that he or she may want to choose arbitration.

7. Lack of Arbitrator Accountability

Where a trial judge is accountable to the appellate courts, the arbitrator's decisions are binding and not review-able. Therefore, one may deem it a "con," that the arbitrator can do whatever he or she wants and not be held accountable. However, without appellate review, arbitrators are still accountable to their clients. If the clients are unsatisfied, the arbitrator will not be called upon in the future to arbitrate future disputes. Further, the Federal Arbitration Act includes the safeguard feature of

the ability to vacate an award if the arbitrator unfairly exceeds his powers in issuing the award.

8. Public Relations Concerns

Despite the favorable statistics toward arbitration by claimants, consumer and public rights groups consider arbitration with great disdain, as taking away a person's right to a jury trial, and frequently speak out against arbitration agreements with great fervor.

D. Federal Arbitration Act Overview

1. Federal Arbitration Act, 9 U.S.C. § 1, et seq. ("FAA"). "Congress enacted the FAA in 1925 in response to the traditional judicial hostility to the enforcement of arbitration agreements. The FAA provides that such agreements are enforceable to the same extent as other contracts. The enactment establishes a strong federal policy in favor of the resolution of disputes through arbitration. Accordingly, federal law presumptively favors the enforcement of arbitration agreements." *Alexander v. Anthony Intern., L.P.*, 341 F.3d 256, 263 (3d Cir. 2003).

    a. Coverage

        I. Agreement to arbitrate is enforceable in court if it is "a contract evidencing a transaction involving commerce." 9 U.S.C. § 2.

        ii. The agreement must be in writing if it is to be enforced. *Id.*

        iii. Term "involving commerce" has been interpreted broadly as reaching any transaction "affecting" commerce.

Allied-Bruce Terminix Cos. v. Dobson, 513 U.S. 265, 276 (1995).

iv. Exclusion. FAA does not apply to "contracts of employment of seamen, railroad employees, or any other class of workers engaged in foreign or interstate commerce." 9 U.S.C. § 1. This exclusion has been read narrowly to exclude from the FAA's coverage only contracts of "transportation workers" and not employment contracts in general. *Circuit City Stores, Inc. v. Adams*, 532 U.S. 105, 119 (2001).

b. *Jurisdiction* FAA is not an independent source of federal jurisdiction. Federal court can compel arbitration or enforce or vacate award only if it would have jurisdiction over a suit based on the underlying dispute. *Moses H. Cone Mem. Hosp. v. Mercury Constr. Corp.*, 460 U.S. 1 (1983).

c. *Motion to Compel* Pursuant to 9 U.S.C. §§ 3-4, a federal court is authorized to compel arbitration if a party to an arbitration agreement institutes an action that involves an arbitrable issue and one party to the agreement has failed to enter arbitration. When determining whether a given claim falls within the scope of an arbitration agreement, a court must focus on the factual allegations in the complaint rather than the legal causes of action asserted. If these factual allegations touch matters covered by the parties' contract, then those claims must be arbitrated, whatever the legal labels attached to them. "[A}ny doubts concerning the scope of arbitrable issues should be resolved in favor of arbitration, whether the problem at hand is

the construction of the contract language itself or an allegation of waiver, delay, or a like defense to arbitrability." *Moses H. Cone Memorial Hospital v. Mercury Constr. Corp.*, 460 U.S. 1, 24-25 (1983).

d. *Appeal of Orders Granting/Denying Motion to Compel Arbitration* Unlike most interlocutory orders, an order denying a motion to compel arbitration is immediately appealable as of right. 9 U.S.C. § 16. An order granting a motion for a stay pending arbitration is not an appealable order.

e. *Stay of Proceedings*. Where an issue in a case is referable to arbitration, court should stay proceedings until arbitration is completed. 9 U.S.C. § 3.

f. *Arbitrability Determination* The question of whether the parties have submitted a particular dispute to arbitration is an issue for the court, unless the parties clearly and unmistakably provide otherwise. "A gateway dispute about whether the parties are bound by a given arbitration clause raises a 'question of arbitrability' for a court to decide. Similarly, a disagreement about whether an arbitration clause in a conceededly binding contract applies to a particular type of controversy is for the court." *Howsam v. Dean Witter Reynolds, Inc.*, 537 U.S. 79, 84-85 (2002). However, "procedural" questions growing out of the dispute and bearing on its final disposition are presumptively for an arbitrator to decide. In particular, the presumption is that the arbitrator should decide issues of waiver, delay, or similar defenses to arbitrability. *Id.*

g. *Judicial Enforcement of Award*

I. A party has one year within which to move to have an arbitration award confirmed by a court. 9 U.S.C. § 9.

ii. The motion may be filed in the district in which the award was made or in any district specified by the parties in their agreement. *Id.*

iii. A court may vacate an arbitration award only if: (1) the award was procured by corruption, fraud, or undue means; (2) where there was "evident partiality or corruption" on the part of the arbitrators, or either or them; (3) where the arbitrators were guilty of misconduct in refusing to postpone the hearing, upon sufficient cause shown, or in refusing to hear evidence pertinent and material to the controversy, or of any other misbehavior by which the rights of any party have been prejudiced; or (4) where the arbitrators exceeded their powers, or so imperfectly executed them that a mutual, final, and definite award upon the subject matter submitted was not made. 9 U.S.C. § 10.

2. **Federal Arbitration: Historically**

a. *Historical Skepticism Toward Arbitration From The Supreme Court*

i. *Wilko v. Swan*, 346 U.S. 429 (1953) (declining to compel arbitration of claims under the Securities Act involving an arbitration agreement; "the protective provisions of the Securities Act require

the exercise of judicial direction to fairly assure their effectiveness").

1. *Wilko* was not over-ruled until 1989. *Rodriguez de Quijas v. Sherson*, 490 U.S. 477 (1989) ("*Wilko*" was incorrectly decided and inconsistent with federal arbitration statutes).

ii. *Alexander v. Gardner-Denver Co.*, 415 U.S. 36 (1974) (refusing to give preclusive effect to an arbitration decision under a collective bargaining agreement in an employment discrimination claim brought under Title VII; grievance arbitration was a "comparatively inappropriate forum for the final resolution of rights created by Title VII").

b. *The Supreme Court's Favored Recognition of Arbitration*

I. *Moses H. Cone v. Mercury Constr. Corp.*, 460 U.S. 1 (1983). ("The Arbitration Act establishes that, as a matter of federal law, any doubts concerning the scope of arbitrable issues should be resolved in favor of arbitration, whether the problem at hand is the construction of the contract language itself or an allegation of waiver, delay or a like defense to arbitrability").

ii. *Southland Corp. v. Keating*, 465 U.S. 1 (1984) (the FAA blocks the "power of the states to require a judicial forum for the resolution of claims which the

contracting parties agreed to resolve by arbitration").

iii. *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*, 473 U.S. 614, 628 (1985) (approving arbitration of federal antitrust claims; "By agreeing to arbitrate a statutory claim, a party does not forgo the substantive rights afforded by the statute; it only submits their resolution in an arbitral, rather than a judicial, forum"; rejecting the argument that the FAA does not require arbitration of statutory claims; "we are well past the time when judicial suspicion of the desirability of arbitration and of the competence of arbitral tribunals inhibited the development of arbitration as an alternative means of dispute resolution").

iv. *Shearson/Am. Express, Inc. v. McMahon*, 482 U.S. 220 (1987) (affirming that "[t]he burden is on the party opposing arbitration ... to show that Congress intended to preclude a waiver of judicial remedies for the statutory rights at issue").

v. *Mastrobuono v. Shearson Lehman*, 514 U.S. 52 (1995) (the FAA preempts state law restrictions on arbitrators' authority to award punitive damages; holding that an arbitration held pursuant to an agreement that incorporated New York law—but that said nothing explicitly about punitive damages—could result in the award of punitive damages, despite New York state case law barring arbitrators from granting such relief).

vi. *Green Tree Fin. Corp. v. Randolf*, 531 U.S. 79 (2000) (where party seeks to invalidate arbitration agreement based on expense, that party bears burden of showing likelihood of incurring those costs).

vii. *Circuit City Stores, Inc. v. Adams*, 532 U.S. 105 (2001) (FAA applies to employment arbitration provisions and employees subject to pre-dispute arbitration clauses must arbitrate their employment related claims).

vii. *E.E.O.C. v. Waffle House, Inc.*, 534 U.S. 27 (2002). That an employee is required to arbitrate his or her claims against an employer does not preclude the EEOC from filing a lawsuit against an employer based upon the same conduct complained-of in the arbitration and from seeking employee-specific damages. The Court in *Waffle House* did not reach the question of the effect of a settlement by or judgment in favor of employee on the Commission's right-to-sue.

viii. *Hall Street Assoc. v. Matel Inc.* - U.S. - (March 25, 2008) (Under FAA, parties contract, expanding judicial review to include errors of law, is not enforceable as FAA's listed grounds for appellate review are exclusive and not expandable by contract.)

E. Arbitration of Statutory Employment Law Claims

1. **Civil Rights Act of 1991**: "Where appropriate and to the extent authorized by law, the use of alternative means of dispute resolutions including, ... arbitration, is encouraged to resolve disputes arising under the Acts or provisions of Federal law amended by this title." § 118 of Pub.L. 102-166, set forth in the notes following 42 U.S.C. § 1981 (Supp. 1994).

2. **Age Discrimination in Employment Act ("ADEA"):** *Gilmer v. Interstate/Johnson Lane Corp.*, 500 U.S. 20 (1991) (an employee could be compelled to arbitrate his age discrimination claims under ADEA; concluding that "[h]aving made the bargain to arbitrate, the parties 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"; rejecting plaintiff's arguments that 1) the arbitration panel would be biased; 2) that the limited discovery allowed in arbitration would make it more difficult to prove discrimination; and 3) that arbitration agreements should not be enforced because of the inequality of bargaining power between employers and employees).

F. What Provisions/Limitations in an Arbitration Agreement May Invalidate the Agreement?

Because arbitration is a creature of contract, the company or employer designs the arbitration process through the crafting of the arbitration agreement. To be valid, companies and employers must avoid provisions that would make the agreement unfair or oppressive, and therefore, unconscionable.

Examples of problem areas include: (1) financial burden on individual too great; (2) too much confidentiality; (3)

arbitration is not equally binding on parties; (4) discovery rights unequal or too small; (5) statute of limitations too short; (6) available remedies not the same; and (7) waiver of right to participate in class actions.

1. It's Unconscionable!

The unconscionability analysis focuses on both procedural unconscionability and substantive unconscionability. Procedural unconscionability concerns how an agreement was negotiated, and relates to "unfair surprise". If a court determines that one party exercised undue coercive power it may invalidate the document. Substantive unconscionability refers to the actual terms of the agreement and related to "oppression".

Thus, in determining the enforceability of an arbitration agreement, courts will typically consider the following:

1. Was there an absence of meaningful choice for one party? In other words, was the agreement offered on a take it or leave it basis?

2. Were the contractual terms unreasonably favorable to one party?

3. Was there unequal bargaining power between the parties?

4. Were there oppressive, one-sided or unfair terms in the contract?

Interestingly, in California, pre-dispute agreements to arbitrate in the context of statutory employment matters are unenforceable unless the agreement includes each of the following:

1. An agreement by the employer to bear the costs of the arbitration;

2. An agreement by both the employer and the employee to arbitrate all claims;

3. An agreement that the arbitrator be neutral;

4. Provisions for adequate discovery; and

5. The arbitrator will render a written decision that permits judicial review.

Armendariz v. Foundation Health Psychare, Inc., (2000) 24 Cal. 4th 83, 99 Cal. Rptr. 2d 745, 6 p.3d 669. This decision still remains subject to any post-*Circuit City* decision that may decide whether the requirements of *Armendariz* are precluded by the FAA.

2. Recent Cases

a. Procedurally Unconscionable: Look to Your Particular State's Rules for Contract Formulation

I. Adhesion - "Take it or Leave it" Contracts

Arbitration provision was unconscionable, because it was adhesive, buried in paragraph under heading of "General Provisions," and defendant did not make rules of arbitration available to customers. *Bragg v. Linden Research, Inc.*, 487 F. Supp.2d 593 (E.D.Pa. 2007).

Arbitration provision with three month opt-out provision for employees was procedurally unconscionable, because it was still a "take it or leave it" contract. *Davis v. O'Melveny & Myers*, 485 F.3d 1066 (9th Cir. 2007).

Provision was procedurally unconscionable, because "the employer's explanation of benefits of arbitration was 'markedly one-sided," and "employees may have felt

pressure not to opt out of arbitration because the employer made its preference clear." *Gentry v. Superior Court*, 2007 42 Cal. 4th 443, 165 P.3d 556.

Car dealership's arbitration agreement with purchaser was unconscionable where is was "take it or leave it", purchaser did not possess business sophistication, it was hastily presented for signature, purchaser had no opportunity to seek representation, and the clause was inconspicuous. *Simpson v. MSA of Myrtle Beach, Inc.,* 644 S.E.2d 663 (S.C. 2007).

ii. Unfair Arbitration Provisions

Held procedurally unconscionable where arbitration language is at the end of a long agreement, in single-spaced lines and small font, despite large heading of "RESOLVING DISPUTES," and customer received agreement after purchasing product and services. *Bess v. DirecTV, Inc.*, 2007 WL 2013613 (Ill. App. 5 Dist. 2007). See *Zuver*, *infra*, agreement is unenforceable when included in a "maze of print."

See the following decisions for other practices that courts have found by employers to be procedurally unconscionable: *Campbell v. General Dynamis Gov't Sys. Corp.*, 321 F. Supp.2d 142, 149 (D. Mass. 2004) (arbitration agreement was disseminated in mass e-mail message); *Zuver v. Airtouch Communs, Inc.*, 103 P.3d 753, 760-761 (Wash. 2004) (terms of the arbitration agreement were "set forth in such a way that an average person could not understand them," and employer failed to give employee reasonable time to consider agreement before signing it); *Buckley v. Nabors Drilling USA, Inc.,* 190 F. Supp.2d 958, 965 (S.D. Tex. 2002) (arbitration agreement was included in paycheck envelope); *Acher v. Fujitsu Network Communications, Inc.*, 354 F. Supp.2d 26, 37 (D. Mass. 2005) (arbitration agreement was simply posted on website); *Prevot v. Phillips Petroleum Co.*, 133 F. Supp.2d 937, 939-941 (S.D.Tex. 2001) (arbitration

agreement was in English even for Spanish speaking employees); and *Hooters of America, Inc. v. Phillips*, 173 F.3d 733 (4th Cir. 1999) (arbitration rules were contained in a separate agreement to which employees were not given any access).

b. Substantively Unconscionable

I. Class Action Waivers

Many companies preclude arbitration for class actions from their arbitration clauses. Many believe this preserves this speedy, fair and inexpensive method for resolving disputes. Most are probably also worried about having one person decide such a potentially costly issue with no judicial review.

California's Supreme Court invalidated a class action waiver in an arbitration clause in the employment context. *Gentry v. Superior Court*, 42 Cal. 4th 443 (2007) (even through employee could opt-out of arbitration and choose not to do so, Court found Circuit City's class action arbitration waiver may still have been procedurally unconscionable, and, hence, unenforceable (trial court must determine whether class arbitration more effective in indicating employee rights).

Consumer cases with smaller amounts of money at issue may get closer scrutiny on this issue. *Coady v. Cross Country Bank*, 729 N.W.2d 732 (Wis. Ct. App. 2007) (Class action ban in contract unconscionable in abusive debt collection case); *Cooper v. QC Financial Services, Inc.*, 503 F. Supp. 2d 1266 (D.Ariz. 3/30/07) (Class action ban in payday lender's arbitration clause was unconscionable, because it may deny relief to a group of customers, which would be impractical for any of them to obtain alone) ; *Dale v. Comcast Corp.*, 498 F.3d 1216 (11th Cir. 2007) (Enforceability of particular class action waiver in arbitration agreement must be determined on case by case basis); *Ford v. Verisign, Inc.*, 2007 WL

3194743 (9th Cir. 2007); *Scott v. Cingular Wireless*, 161 P.3d 1000 (Wash. 2007) (Class action waiver in consumer agreement arbitration provision unconscionable because it denies relief under state consumer protection statute); *S.D.S. Autos, Inc. v. Chrzanowski*, 2007 WL 4145222 (Fla. Dist. Ct. App. 11/26/07) (Unconscionable because it denies relief under state unfair trade practices statute); *Skirchak v. Dynamics Research Corp*., 2007 WL 4098832 (1st Cir. 11/19/07) (Class action ban in employment contract unconscionable in overtime wage payment case).

ii. Retroactive Clauses

Retroactive clause in arbitration agreement held unconscionable as it related to a presently active lawsuit that would be dismissed if the clause were given effect. *Bilbrey v. Cingular Wireless, L.L.C.*, 164 P.3d 131 (Okla. 2007).

iii. Unilateral Rights

Arbitration agreement unconscionable substantively, because it provided the seller with one sided remedies for resolving disputes and a unilateral right to modify the arbitration clause, imposed costs on consumers above those of going to court, required the arbitration to take place in San Francisco, and imposed a gag order on the proceedings. *Bragg v. Linden Research, Inc.*, 487 F. Supp. 2d 593 (E.D.Pa. 2007).

iv. Limitations of Statute of Limitations

Arbitration agreement was considered substantively unconscionable on the following grounds: one-year limitations provision prohibited "ongoing violation" claims, confidentiality provision prohibited even mentioning the existence of a dispute thereby stifling discovery, its bar on administrative actions would preclude EEOC claims, and non-mutual provision allowing company to sue employees

for injunctive relief for violations of attorney-client privilege, work product doctrine, or other disclosures of confidential information, because of broad category "of confidential information." *Davis v. O'Melveny & Myers*, 485 F.3d 1066 (9th Cir. 2007).

v. Cost Distribution Clauses

Court held arbitration provision unconscionable where it imposed total cost of arbitration on plaintiff (client of law firm) and bound only the plaintiff to arbitration but permitted the defendant attorneys to pursue any and all procedural and substantive remedies with our without a jury. *Lafleur v. Law Offices of Anthony G. Buzbee, P.C.*, (Cir. /07), 960 So.2d 105. See also *Vasquez-Lopez v. Beneficial Or., Inc.*, 210 Or.App. 553 (1/31/07) (oppressive circumstances of formation, ban on class actions, *and cost-sharing provisions* rendered agreement unenforceable).

vi. Limitations on Statutory Actions or Remedies

Car dealership's arbitration provision found substantively unconscionable, because it limited statutorily available remedies by providing that arbitrator could not award punitive, exemplary, double or treble damages. *Simpson v. MSA of Myrtle Beach, Inc.*, 644 S.E.2d 663 (S.C. 2007). Further violative was agreement excepting from arbitration claims pursued by company against customer. *Id*. Interestingly, the court struck entire arbitration agreement, refusing to sever violative provisions due to cumulative effect of multiple oppressive and one-sided provisions. *Id*. See also *Alterra Healthcare Corp. v. Bryant*, 937 So.2d 263, 266 (Fla.Dist.Ct.App. 2006) (elimination of punitive damages and cap of non-economic damages).

c. *Arbitration agreements are only enforceable by signatories.*

In *Peters v. Columbus Steel Castings Co.*, 115 Ohio St. 134, 873 N.E.2d 1258 (Ohio 2007), the Ohio Supreme Court held a wrongful death claim was not bound to arbitration. The Court reasoned that only signatories to an arbitration agreement are bound by its terms, and a wrongful death action belongs to a decedent's beneficiaries, not the estate. See also, *West v. Household Life Ins. Co.*, 170 Ohio App. 3d 463, 867 N.E.2d 868 (Ohio Ct. App. 2007) (Life insurance company could not enforce arbitration agreement against plaintiff, because agreement indicated it was between borrower (plaintiff) and lender (bank)).

But see *Wash. Mut. Fin. Group, L.L.C. v. Bailey*, 364 F.3d 260, 267 (5th Cir. 2004) (nonsignatory plaintiff bound by arbitration provision contained in contract suing under); *Blinco v. Green Tree Servicing, L.L.C.*, 400 F.3d 1308, 1312 (11th Cir. 2005) (compelled non-signatory plaintiff to arbitration under equitable estoppel theory); and *In re Kellogg Brown & Root, Inc.*, 166 S.W.3d 732, 741 (Tex. 2005) (a non-signatory should only be compelled to arbitrate if it seeks to derive a direct benefit from the contract containing the provision).

d. *Agreement to arbitrate must be by a voluntary and knowing waiver.*

In *Robertston v. J.C. Penny Co., Inc.*, 484 F. Supp. 2d 561 (S.D.Miss. 2007), a department store bill stuffer agreement to arbitrate was held unenforceable. The court found there was no evidence that plaintiffs' had received the agreement and use of a credit card was insufficient to demonstrate a "voluntary and knowing" waiver of the right to sue.

e. *Right to Arbitrate Can Be Waived When Party Acts Inconsistent With Right to Arbitrate.*

Lender waived its right to arbitrate by filing a foreclosure action. The lender knew of its arbitration provision, and acted inconsistent with it by filing action in court. *Blackburn v. Citifinancial, Inc.*, 2007 WL 927222 (Ohio Ct. App. 2007).

Contractor waived right to arbitrate by filing a breach of contract action against a home owner in court. *Elite Home Remodeling, Inc. v. Lewis*, 2007 WL 730072 (Ohio App. 3 Dist. 2007).

Lender's delay of 11 months before asserting right to arbitrate resulted in waiver where it would have required have forced plaintiff to incur duplicative expenses, and in participating in the litigation process during this time, the lender acted inconsistently with its right to arbitrate. *Lewallen v. Green Tree Servicing, L.L.C.*, 487 F.3d 1085 (8th Cir. 2007).

3. Considerations in Drafting Arbitration Agreements

a. *The contract should specifically state what types of disputes are to be resolved by arbitration.* All too often, the drafter of the agreement will just indicate, "any disputes will be resolved by arbitration." Such open ended and general references may lead a court to decide a certain claim was not to be included unless specifically stated.

b. *The company or employer should agree to bear the costs of the arbitration or have a waiver of costs provision.* Courts often will consider the undue burden on the contracting

underdog as a means to reject the arbitration agreement.

c. *Include a severability provision in the arbitration agreement.* This is a precautionary measure toward enforcement should a provision be included in the agreement that a court later determines to be violative. Some jurisdictions have upheld arbitration agreement when severing the offending portion. *Ingle v. Circuit City Stores,* 328 F.3d 1165 (9th Cir. 2003); *Hadnot v. Bay, Ltd.*, 344 F.3d 474 (5th Cir. 2003).

d. *Be careful with provisions in the agreement that give the company or employer unilateral rights toward arbitration.* Courts will consider any such inequities in determining if the agreement is adhesive, and therefore, unenforceable as unconscionable.

e. *Think long and hard before making an agreement including any limitations of statutory rights or remedies.* This would include statutory claims, the statute of limitations for any clams, and any damages that may be awarded as a matter law, such as exemplary or punitive damages. Such limitations have sometimes been deemed unconscionable and a means to find the agreement unenforceable. See also *Walker v. Ryan's Family Steak Houses, Inc.*, 400 F.3d 370, 387 (agreement unenforceable due to limited discovery provision).

f. *Review the 2007 California cases on class a*ction waiver *and the factors there which may undermine these important clauses in other parts of the country.*

g. *Require written awards to confirm reasons for decisions.* Not only has this been found as a basis in some jurisdictions to invalidate an arbitration agreement, but it also provides protection from any post-hearing disputes on what the arbitrator actually intended.

II. Conclusion

After considering all the "pros and cons" of arbitration in connection with your specific type of dispute and the facts and circumstances surrounding the dispute, you should evaluate whether your case would better be resolved by arbitration. For instance, if you have a set of facts that are favorable to summary judgment, you may not want to exercise your right to arbitration. If you are infrequently sued, you may have no need for arbitration. If however, you are in a position of being frequently sued, it may be a good choice. If you chose arbitration, you must be prepared to spend the time and money necessary to craft an enforceable arbitration agreement taking into consideration the issues most pertinent to your needs.

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