Putting the Reins on Employment Arbitration: Courts Safeguard Employee Rights - By Ethan A. Brecher

The law governing the arbitration of employment discrimination has undergone a remarkable evolution during the past nine years. At the beginning of the 1990's the U.S. Supreme Court, in Gilmer v. Interstate/Johnson Lane Corp.,[1] endorsed arbitration as an acceptable forum in which employers could compel employees to resolve their statutory age discrimination claims.

In doing so, the Court rejected challenges to the adequacy of arbitration and its procedures as the byproduct of an antiquated and out-of-favor hostility towards arbitration as a means to resolve statutory claims.

Federal courts are now recognizing, however, that arbitration sometimes favors employers unfairly, despite Gilmer's pronouncements to the contrary. Accordingly, they have started to issue rulings intended to ensure that arbitration is in fact the neutral forum originally contemplated by the Supreme Court.

Employers have also started to reconsider whether to compel arbitration of discrimination claims in the first place. Arbitration is not necessarily a faster and less expensive alternative to litigation. Employers practices regarding mandatory arbitration have also come under scrutiny by the United States Congress and federal courts. Indeed, the securities industry, one of the original proponents of compulsory arbitration, has within the past year abandoned its mandatory arbitration requirement for these claims altogether.

Three cases decided by federal appellate courts during the past year reflect the judiciary's effort to temper the excesses of employment discrimination arbitration, and how the securities industry has revised its arbitration requirement.

In 1991, the Supreme Court in Gilmer decided that an employee could be held to a pre-employment, pre-dispute agreement to arbitrate any claims arising under the Age Discrimination in Employment Act of 1967, as amended (ADEA),[2] against his securities industry employer at the New York Stock Exchange

(NYSE). The court held that the ADEA does not preclude a waiver of judicial remedies, and that by submitting such a claim to arbitration an employee does not forgo substantive statutory rights, but merely agrees to resolve them in a different forum.[3] Except for the U.S. Court of Appeals for the Ninth Circuit, every other federal appellate court addressing the issue has extended Gilmer's holding to discrimination claims arising under Title VII of the civil Rights Act of 1964.[4]

In Gilmer, the Supreme Court also rejected an employee's contention that his arbitration agreement was an unenforceable contract of adhesion because arbitration was imposed as a condition of employment. Similarly, the Court held that the arbitration agreement was valid even though arbitration did not provide the same advantages as federal court litigation, such as broad discovery, reasoned opinions by judges and extensive appellate review.

The Court dismissed generalized attacks on the adequacy of arbitration procedures, such as the limited scope of discovery as compared to what would be available in federal court, the potential for arbitrator bias, the lack of written opinions from arbitrators, and reduced judicial review as "rest[ing] on suspicion of arbitration as a method of weakening the protections afforded in the substantive law to would be complainants, and as such, they are far out of step with our current strong endorsement of the federal statutes favoring this method of resolving disputes."[5]

In making these assertions, the Court noted that "[by agreeing to arbitrate, a party] trades the procedures and opportunities for review of the courtroom for the simplicity, informality, and expedition of arbitration."[6] The Court also held that "although judicial scrutiny of arbitration awards necessarily is limited, such review is sufficient to ensure that arbitrators comply with the requirement of the statute at issue."[7]

Despite the trust the Supreme Court placed in arbitration, it has not been immune from abuse. Since Gilmer was decided, and particularly during the past year, courts have had to correct some egregious results that stemmed from employers who have used arbitration to increase their chances of winning. In doing so,

courts have issued a warning that arbitration must be better policed and administered if it is to remain a viable substitute for civil litigation.

One-Sided Arbitration

In April 1999, the Fourth Circuit in Hooters of America, Inc. v. Phillips [8] refused to compel a former Hooters' bartender in Myrtle Beach, S.C., to arbitrate her sexual harassment claim under Hooters' own arbitration procedures. The woman claimed that a Hooters' official sexually harassed her by "grabbing and slapping her buttock."[9] She quit after complaining to her boss about the incident, who told her to "let it go.[10]

Hooters brought an action in federal court to compel the woman to arbitrate her claims under its arbitration policy. The court acknowledged that although discrimination claims must be arbitrated under a valid arbitration agreement, the question before it was whether Hooters' arbitration clause was enforceable. The court held that it was not, because "Hooters materially breached the arbitration agreement by promulgating rules so egregiously unfair as to constitute a complete default of its contractual obligation to draft arbitration rules and to do so in good faith."[11]

The court reviewed Hooters' arbitration rules and determined that they were so one-sided that "their only possible purpose is to undermine the neutrality of the proceeding.[12] Indeed, no plaintiff could receive a fair hearing under Hooters' rules. The plaintiff was required to particularize her claim in advance, while Hooters did not have to file a responsive pleading or notice its defenses. When first filing her claims, the employee was required to list all fact witnesses and provide a summary of their testimony. Hooters had no reciprocal obligation.

The rule governing the selection of arbitrators was even more favorable to Hooters. The employee and Hooters each selected an arbitrator, who in turn selected a third. Hooters, however, created the list of all acceptable arbitrators, and the court noted that because Hooters was free to devise a list of particular arbitrators, "the selection of an impartial decision-maker would

be a surprising result.[13]

While Hooters was entitled to enlarge the scope of the arbitration to any matter regardless of whether it related to the plaintiff's claim, the employee was limited to only those claims in her original notice of claim. Hooters was permitted to make a motion for summary judgment before the hearing, while the employee was not permitted at all to seek summary judgment. Only Hooters was allowed to transcribe the arbitration hearing. Hooters' arbitration rules also allowed it to seek vacature of the award where it could show by a preponderance of the evidence that the arbitrators had exceeded their authority. The employee had no such right. Hooters, but not the employee, could cancel the arbitration agreement on 30 days notice. Finally, Hooters was allowed to change the arbitration rules whenever it wanted, without notice, even in the middle of the arbitration hearing.

The court concluded that Hooters' performance under the arbitration agreement was "so egregious that the result was hardly recognizable as arbitration at all.[14] The Fourth Circuit explained, however, that by striking the arbitration clause, it was in fact advancing the federal policy of favoring alternative dispute resolution: "By promulgating this system of warped rules, Hooters so skewed the proceeding its favor that [the employee] has been denied arbitration in any meaningful sense of the word. To uphold the promulgation of this aberrational scheme under the heading of arbitration would undermine, not advance, the federal policy favoring alternative dispute resolution."[15]

Judicial Review

In July 1998, the Second Circuit in Halligan v. Piper Jaffray[16] vacated an arbitration award denying a plaintiff's ADEA claim on grounds that it was in "manifest disregard of the law." This standard is a judicially created grounds for vacating arbitration awards on the merits, but one which had never been used in the Second Circuit to overturn an arbitration decision.[17] The court's reliance on the "manifest disregard" standard was an obvious signal that something had gone severely awry in the arbitrators' deliberative process.

After a detailed review of the underlying dispute, the court concluded that the arbitrators "ignored the law or the evidence or both."[18] The court's emphasis that the arbitrators had manifestly disregarded the facts was a significant addition to the law governing judicial review of arbitration awards, as previously the standard had been limited to manifest disregard of the law.

In vacating the award, the court was influenced by lack of a written opinion, something that the Supreme Court in Gilmer had already said was not a requirement for arbitration. Although the court acknowledged that written opinions are generally note required from arbitrators, it also explained that "where a reviewing court is included to find that arbitrators manifestly disregarded the law or the evidence and that an explanation, if given, would have strained credulity, the absence of explanation may reinforce the reviewing court's confidence that the arbitrators engaged in manifest disregard."[19]

The court's decision is also noteworthy because it expressly recognized the public controversy over whether arbitration has proved as fair to employees as the Supreme Court envisioned in Gilmer. "In the aftermath of Gilmer . . . mandatory binding arbitration of employment discrimination disputes has caused increased controversy. Attention has focused on, among other things, whether additional procedural requirements are necessary to ensure that employees will be able, in the words of Gilmer, to `effectively … vindicate their rights in arbitration.'"[20] The court surveyed some of the notable judicial and legislative initiatives concerning the arbitration of discrimination claims, including the bill introduced in Congress in 1997 to prevent pre-dispute waiver of a judicial forum.[21] While the court declined to address directly the adequacy of arbitration for the resolution of discrimination claims, its enhancements the "manifest disregard" standard signal that obviously wrong arbitration decisions, while perhaps previously immune from judicial review, will no longer be tolerated.

Limits on Fees

Courts have also started to take a dim view about arbitrations in which plaintiffs are assessed arbitrators' fees as high as

$55,000.[22] In January 1999, in Shankle v. B-G Maintenance Management of Colorado,[23] the Tenth Circuit declared an arbitration agreement unenforceable because it required the employee to pay one-half of the arbitrators' fees on his Title VII claim, which in the case at bar could have reached $5,000. The court explained that: "[t]he [Arbitration] Agreement thus placed Mr. Shankle between the proverbial rock and a hard place- it prohibited use of the judicial forum, where a litigant is not required to pay for a judge's services, and the prohibitive cost substantially limited use of the arbitral forum."[24]

The court held that the plaintiff "could not afford such a fee, and it is unlikely that other similarly situated employees could either."[25] In striking the arbitration clause altogether, the court noted that "[the employer] required [the plaintiff] to agree to mandatory arbitration as a term of continued employment, yet failed to provide an accessible forum in which he could resolve his statutory rights. Such a result clearly undermines the remedial and deterrent functions of the federal anti-discrimination laws."[26]

The employer argued in defense of the arbitration agreement that the arbitrators' fees should be divided evenly in order to ensure arbitrator neutrality. The court rejected this premise, explaining that arbitrators are presumptively impartial regardless of who pays their bill.[27] The court also indicated that even if fee splitting encourages neutrality, "that benefit is substantially outweighed by the impediment such a provision places on access to the arbitral forum."[28]

Securities Industry

In April 1997, the National Association of Securities Dealers Inc. (NASD) initiated a self-examination of its requirement that all individuals agree in advance, as a condition of employment in the securities industry , to resolve statutory employment discrimination claims in arbitration. The NASD consulted with civil rights organizations, the EEOC,[29] general counsels of its member firms, management and plaintiff's attorneys and other interested groups. In light of the "public perception that civil rights claims may present important legal issues dealt within a judicial

setting," the NASD rewrote its rules, effective Jan. 1, 1999, to remove its arbitration requirement for its such claims.[30] Even before these changes were approved, brokerage firms such as Merrill Lynch decided to abandon the system of forced arbitration of discrimination claims for its employees.[31] The NYSE, the Boston Stock Exchange, the Chicago Board of Options and the Pacific Stock Exchange also have all implemented similar rules.[32]

Conclusion

If arbitration of employment discrimination claims is to survive as a legitimate substitute for court, arbitrators must act more diligently, fairly and judiciously in hearing and deciding cases. Employers must implement arbitration provisions that are tailored towards creating a dispute resolution mechanism that protects employees' due process rights. For their part, employees should stay vigilant and challenge unfair and inappropriate arbitration procedures and rulings; so that when arbitration tilts out of balance, courts will have the opportunity to take appropriate remedial action.

[1] 500 U.S. 20 (1991)
[2] 29 U.S.C § 621, et seq.
[3] 500 U.S. at 26
[4] See e.g. Rosenberg v. Merrill Lynch, Pierce, Fenner & Smith, 170 F3d 1, 10 (1999) (citing cases); but see Duffield v. Robertson Stephens & Co., 144 F3d 1182 (9th Cir.), cert. denied, 119 S. Ct. 445 (1998).
[5] 500 U.S. at 31.
[6] 500 U.S. at 33, citing, Mitsubishi Motors Corp. v. soler Chrysler-Plymouth Inc., 473 U.S. 614, 628 (1985).
[7] 500 U.S. at 33 n. 4, citing, Shearson/American Express Inc. v. McMahon, 482 U.S. 220, 232 (1987).
[8] 1999 WL 194438 (4th Cir. April 8, 1999).
[9] Id.
[10] Id.
[11] Id. at * 4.
[12] Id.
[13] Id.
[14] Id. at * 6.
[15] Id. at * 7.

[16] Halligan v. Piper Jaffray Inc., 148 F.3d 197, 201 (2d Cir.), cert. denied, 119 S.Ct. 1286, (1999).
[17] In addition to the grounds enumerated in the Federal Arbitration Act, 9 USC § 1, 10, for vacating arbitration awards, the "manifest disregard of the law" standard is a judicially created basis for overturning arbitration awards. The Second Circuit has noted that manifest disregard means more than "error or misunderstanding with respect to the law. Halligan, 148 F.3d at 202. In order to vacate an arbitration award under the "manifest disregard" standard, a court must find that (1) the arbitrators knew of a governing legal principle yet refused to apply it or ignored it, and (2) the law ignored by the arbitrators is well defined, explicit and clearly applicable. Id.
[18] 148 F3d. at 204.
[19] Id.
[20] Id. at 202.
[21] Id. at 203, citing the Civil rights Procedures Protection Act of 1997, S. 63, H.R. 983, 105th Cong. (1997).
[22] See Kidder Peabody v. Fletcher, NYSE Docket No. 1992-002662 ($55,000 forum fee award assessed against employee on race discrimination claim); Wolfe v. Charles R. Schwab, NYSE Docket No. 1993-003197 (unsuccessful sex discrimination claimant assessed on-half of $82,800 forum fee for 55 hearing session and on discovery conference); Livingston v. Shearson, NASD Case No. 93-00770 (successful sexual harassment claimant assessed $24,800 in forum fees).
[23] 163 F3d 1230 (10th Cir. 1999).
[24] Id. at 1235.
[25] Id. 1234.
[26] Id.
[27] Id.
[28] Id. In Cole v. Burns Int'l Security Svcs., 105 F3d 1465, 1485-86 (D.C. Cir. 1997), the D.C. Court of Appeals held that an arbitration agreement that required an employee to pay all or part of the arbitrators' fees and expenses would be unenforceable. Because the arbitration agreement at issue did not specify who would pay the arbitrators' fees, and in order to render the arbitration agreement valid, the Court construed the agreement as requiring the employer to pay the arbitrators' fees if it wanted to proceed with the arbitration. See also Pladino v. Avnet Computer Technologies Inc., 134 F.3d 1054 (11th Cir. 1998); Howard v. KPMG, 36 F.Supp.2d 183, 185-187 (SDNY 1999) (suggesting that if arbitrators' fees were not assessed against the employer, the Court would vacate the award as violating public policy).
[29] The E.E.O.C. issued a policy statement in July 1997 discouraging the use of pre-dispute arbitration agreement. E.E.O.C. Notice No. 915.002 (July 10, 1997).
[30] NASD Notice to Members 98-65.
[31] Rosenberg, 170 F.3d at 6.
[32] See SEC Release No. 40109 (June 22, 1998) (NASD no longer requires associated persons, solely by virtue of their association or registration with the NASD, to arbitrate claims of statutory employment discrimination); SEC-Release No. 40858 (Dec. 29, 1998) (New York Stock Exchange removes mandatory arbitration of statutory employment discrimination claims from its rules, allowing arbitration only pursuant to a post-dispute agreement to arbitration); SEC Release No. 40861 (Dec. 29, 1998) (Boston Stock Exchange); SEC Release No. 41080 (Feb. 22, 1999) (Chicago Board of Options); SEC Release No. 41350 (May 10, 1999) (Pacific Stock Exchange).