Beyond Pre-Dispute Arbitration Clauses in Employment Contracts: Time for Another Look
by Janet A. Lenaghan and Martha Weisel

The diversity of the American workforce continues to grow without any signs of slowing down. According to the Bureau of Labor Statistics, the diversity of the workforce population will significantly increase by 2050, with the number of Hispanics contributing to the largest percent increase. Specifically, the white, non-Hispanic population will comprise only 50% of employees. Hispanic/Latinos will make up 25% of the workforce, followed by African-Americans with 14.5%, and Asian-Americans with 8%. The Bureau of Labor Statistics also predicts that the number of disabled workers will increase as well in that same time period. Similarly, one can expect that the average age of the workforce will increase as many employees are opting to remain in the workforce as a result of diminished retirement savings. Each of the main factors contributing to a diverse workforce (gender, religion, race, ethnicity, age, disability, and sexual orientation) is projected to grow by 2050. Employers reap a wide array of benefits from a highly diversified workforce. Research suggests that teams with more diverse members actually produce better results than more homogeneous groups. Yet, one cannot ignore the increased possibility of conflict in the workplace that arises from different perspectives and beliefs. These conflicts can escalate quickly from minor disagreements to major disputes, which often result in litigation. The popular press is replete with daily reports of employment disputes. Numerous laws that determine how each party must resolve disagreements to major disputes, which often result in litigation. ADR includes a wide variety of techniques, including negotiation, mediation, and arbitration. In an effort to avoid the courts, employers embraced one form of ADR—arbitration. Employers, together with their attorneys, developed clauses in employment contracts that require the parties to use arbitration rather than the courts in the event of a dispute. These pre-dispute arbitration clauses are usually part of a contract that is signed at the time a person is hired for a position. The use of these pre-dispute arbitration clauses stemmed not only from the employers need for a better process, but also, from the courts’ support of such agreements. But has arbitration lived up to its promise as an informal, inexpensive, and timely method for resolving employment disputes? There is a growing awareness that in many instances arbitration has become increasingly similar to litigation. It is no longer informal, inexpensive, or timely. Although the courts clearly support the use of pre-dispute arbitration clauses as a way of resolving employment disputes, it may be time to acknowledge that neither litigation nor arbitration are effective tools in the workplace. Other forms of ADR, specifically mediation and collaborative law, may better meet the needs of employers and employees.

The Legal Landscape
The use of the courts as a method of resolving employment disputes has been on the rise. As a reminder, the recent decision of Muniz v. United Parcel Serv., Inc., from the United States Court of Appeals for the Ninth Circuit, illustrates the futility of using litigation to deal with workplace conflicts, including the time involved in resolving the dispute, the adversarial nature of the proceeding, and the exorbitant costs involved. Although Ms. Muniz received only $27,000 in damages, UPS was required to pay her attorneys nearly $700,000 in attorneys’ fees. How could this happen? Let’s take a look.

Ms. Muniz’s employment discrimination lawsuit began with a number of claims. These included allegations of age discrimination, retaliation, gender discrimination, and negligent supervision and training. In addition, she sought punitive damages. The court dismissed some of these claims before the trial began. Other claims were not pursued at the trial. In the end, the case went to trial solely based on allegations of employment discrimination relating to gender, including: retaliation for failing to give her a stock bonus; her poor job placement; and her demotion. The jury only found one argument to be valid: her demotion from division manager to supervisor. Based on its decision, the court determined that she was entitled to $27,000, which included lost earnings and medical expenses.

Despite the relatively small amount of damages, the trial court awarded Ms. Muniz’s lawyers’ attorneys’ fees of $700,000. The appellate court acknowledged that there was a huge disparity between the jury award and the amount of attorneys’ fees granted; however, the court determined that it was not necessary to reduce the award. The plaintiff had been successful, although in a very limited way—one successful claim out of seven possible claims. However, these were not the only costs involved. What about employee hours lost in the workplace, the hours finding documents, the hours involved in discovery, and the number of employees who had to be prepared to testify and who had to spend time in court? What about the fees paid to the UPS attorneys? What about the aftermath of the litigation—anonymity in the workplace and the lack of trust engendered by the process? The court proceedings ran from 2009 to 2013, but the alleged incidents began several years before that. The futility of litigation as a method of resolving disputes led to the use of alternative problem solving methods. Despite the relatively small amount of damages, the trial court awarded Muniz $700,000 in attorneys’ fees.

Past and Present
In the beginning there was the Federal Arbitration Act. Although the statute was passed by Congress in 1925, the courts were not initially amenable to pre-dispute arbitration clauses in contracts because such clauses eliminated judicial intervention. However, that changed in 1985 when the U.S. Supreme Court decided that a pre-dispute arbitration clause is binding as long as contractual requirements are met. The case involved an American auto dealer who entered into an agreement to sell Japanese cars at its dealership. The contract contained a pre-dispute arbitration clause stating that “all disputes, controversies, or differences” between the parties would be settled through arbitration using Japanese law. Later, when problems arose, the Japanese car manufacturer sought to enforce the pre-dispute arbitration clause in the contract. The U.S. car dealer argued that the Japanese manufacturer had engaged in impermissible conduct under the Sherman Act, and that a court could only decide such issues. The Court determined that all contract elements had been met. The parties intended to enter into a contract, the agreement was voluntary, and there was no fraud, duress, or undue influence. The parties to the agreement were sophisticated business people. They negotiated an agreement that both were comfortable with at the time the agreement was signed. The Court determined that the statutory rights (such as those under the Sherman Act) could be decided by arbitration, as the substantive rights given under the statute were not lost in an arbitration proceeding, concluding that the utility of selecting a forum such as arbitration in international decisions should be encouraged.

Next, the Court embraced the use of pre-dispute arbitration clauses in employment contracts. The fact that the parties were not on an equal footing did not bother the Court. The Court determined that the Federal Arbitration Act was designed to put arbitration agreements on an equal footing with other contracts. Therefore, the defenses used to rescind other contract such as fraud, duress, and undue influence, can be used to rescind an arbitration clause. Mr. Gilmer had signed the agreement and he was aware that it represented a violation of contract law, such as those previously stated, the pre-dispute arbitration clause is considered to be knowingly and voluntarily made. The Court’s decision in Gilmer v. Interstate-Johnson Lane Corp. has had a profound impact on the employee-employer relationship. More and more, individual employment contracts, often only a single page in length, contain a pre-dispute arbitration clause. These clauses may also appear in an employee handbook, which the employee signs—either as a condition of employment or as a condition binding the employee to the use of arbitration in a later dispute. A burgeoning business of professional organizations has developed to accommodate the demand for the large number of arbitrations conducted annually.

It should be noted that these types of clauses are not only used for disputes between individual employees and employers. Such agreements are widely used in all types of consumer contracts. Supreme Court decisions show the growing acceptance of pre-dispute arbitration clauses. Recently, the Court approved the use of this type of clause in contracts between a nursing home and their patients or the patient’s family, depending on who entered into the contract with the nursing. The contract required that claims based on negligence or breach of contract be resolved through arbitration. The Supreme Court has approved consumer credit card contracts that contain arbitration clauses. In addition, the Court approved an arbitration clause that prohibited class action suits, saying that it was not unconscionable, but a legitimate contract provision.
Industrial theory

Although the role of the courts is important, one could certainly argue that it is the rapid rise in pre-dispute arbitration clauses in employment contracts that is partly explained by the need for legitimacy. Institutional theory suggests that formal structures are merely manifestations of inter-organizational roles, which bind organizations to similar institutions. Organizations structurally reflect or imitate socially constructed values creating norms of rationality, which society expects and requires. Therefore, the adoption of arbitration clauses might have been driven by the need for employment disputes to be heard by a neutral without the delays of litigation. One might argue that the reason for the rapid rise of arbitration clauses might be the result of mimetic isomorphism. Employers may simply be responding in an effort to maintain legitimacy by adopting these clauses without fully exploring the implications for organizational culture. The espoused legitimacy is based on strategic isomorphism, the regulatory endorsement of such practices.

How arbitration has changed

In light of institutional theory, it is important for employers to fully understand the arbitration process. Arbitration is a form of alternative dispute resolution that does not involve the courts, judges, or juries. It is often referred to as “private judging” in that the arbitrator makes a decision and the decision is binding on the parties. In the same way as a judge/jury makes a decision, an arbitrator reaches his/her decision by hearing witnesses and examining evidence presented by the parties or their attorneys. Lawyers, or the parties if they are representing themselves, may make opening and closing statements.

Before getting to the actual arbitrations, the parties often engage in discovery. This is a process in which both sides seek to gain information about the other party’s case. This can be done through depositions of witnesses by the attorneys for each side or by the parties themselves if proceeding without an attorney. The parties may also engage in motion practice, asking the arbitrator for various types of relief (for example, dismissal of the complaint) before the arbitration takes place.

Arbitration has become increasingly complex. It is no longer the cheap and quick process of the past. Arbitration has become more expensive. In a 2008 survey of litigation and arbitration trends, employers reported that over 40% of the disputes had costs over $100,000. In 2011, arbitration was the most expensive type of dispute resolution.

Proposed legislation

Employers, employees, attorneys, and legislators have begun to question the efficacy of pre-dispute arbitration clauses and are questioning some of the court’s recent decisions. The pendulum may have gone too far in one direction and needs to be rebalanced. Spurred in part by recent events, businesses are considering the impact of pre-dispute arbitration clauses involving consumers and employees beyond a level that is acceptable to the rights of said individuals. In 1925, legislation was necessary because the courts were not receptive to the use of arbitration as a method of resolving disputes. The Federal Arbitration Act (“FAA”) was a response to the reluctance of the courts to accept arbitration. That is no longer the case. Therefore, the FAA, which was introduced during the 2011-2012 session, is a response to the need for more transparency in the process. The proposed legislation is in large measure a response to the United States Supreme Court’s decisions, unilaterally supporting the use of pre-dispute arbitration clauses in disputes involving laypersons-including employment agreements. As stated in the introduction to the bill, the proposed statute is necessary because “the Federal Arbitration Act was intended to apply to commercial enterprises.” Supreme Court decisions have changed the meaning of the law. Consumers and employees have little bargaining power. The proposed legislation has several important components.

The first postulates that the parties are unable to agree to arbitration, the employment contracts will not be valid or enforceable. Similar clauses in consumer contracts will not be allowed. Arbitration clauses that attempt to arbitrate civil rights issues will no longer be permitted. Second, the proposed law requires that the determination as to whether or not a pre-dispute arbitration clause is valid must be made by a court and not by an arbitrator. This provision will apply whether the dispute concerns the validity of the employment agreement as a whole or just the portion of the agreement dealing with the enforceability of these clauses. It should be noted that the AFA does not include collective bargaining agreements between management and unions, except to the extent that even in a collective bargaining agreement, the employee cannot waive the right to seek court enforcement of a right provided by: the United States Constitution; a state Constitution; or a federal or state statute.

Implications for employers

Given the increasing litigious nature of arbitration as well as the proposed legislation, it is time for employers to consider new policies that are very different from the current approach. To avoid pre-dispute arbitration clauses. In Gilmer, the Court noted that the applicable New York Stock Exchange arbitration rules provided a great deal of protection to the parties to the arbitration itself, including the right to have a fair hearing. To avoid arbitration clauses, employers should take certain steps. For example, employers need to protect the transparency of the clause by ensuring that the employee’s signature was made knowingly and voluntarily. They might consider providing employees with information about the process. Another factor that might show that the employer knew what he or she was signing is for the employer to provide the employee with a period of time between receiving and signing the document. In the Older Workers Benefits Protection Act (“OWBPA”), Congress resolved the question of the standard to be used in making a knowing and voluntary waiver of age discrimination claims, using a totality of circumstances approach. Generally, a waiver is required which must be made before an employee can waive his right to litigate age discrimination claims under the OWBPA. These changes can be used to define different pre-dispute arbitration clauses.

Mediation & Collaborative law approaches

It is the position of the authors that arbitration should not be the only mechanism to be considered by employers. Rather, there are other types of alternative dispute resolution that may be more successful than arbitration in resolving workplace disputes. While further securing the legality of existing pre-dispute arbitration clauses, we suggest that employers begin to prepare for the possibility of legislation being enacted, which weakens the enforceability of these clauses, while also recognizing that legitimacy can be gained through innovative practices which yield competitive advantages.

As such, employers can begin to explore other avenues to resolve the inevitable employment disputes that arise in increasing numbers. Employees need to look beyond mimetic isomorphism and truly engage in a process, which yields results while maintaining the integrity of the process.

Mediation is one form of ADR that should be considered by employers. Just as employment contracts routinely include a pre-dispute arbitration clause, so too should the agreement include a clause that requires the parties seek mediation before a request for arbitration can be made. Mediation offers several advantages over arbitration. Unlike arbitration, the parties remain in control during the entire process. An agreement is reached only when both parties are satisfied. Parties who are involved in an ongoing relationship (such as employers and employees) can benefit most from using mediation as a method of resolving disputes. Once an arbitration session has begun, it is highly unlikely that the parties will work together effectively.

Another possible method can be found in the use of collaborative law. In addition to mediation, other forms of ADR should be considered. Another possible method can be found in the use of collaborative law, which has been used successfully in a number of different contexts, including divorce and business disputes. Collaborative law provides an interdisciplinary team approach to resolving conflict. It is a problem solving approach rather than a quest for the assignment of fault. It allows the parties to resolve their conflict in an environment focused on resolution without the fear of losing other remedies. The parties agree to work together to resolve the problem, but maintain the right to pursue other
options—arbitration or litigation—if efforts fall short. There are a few caveats that make the process unique. First, the party may hire an attorney to engage in the collaborative process, but should the dispute find its way into arbitration or litigation, then the party must hire a new attorney. Second, the collaborative lawyer is not permitted to represent the party beyond the collaborative process. Third, and finally, collaborative meetings can be done with full transparency without jeopardizing positions should the dispute go forward to arbitration or litigation. These meetings are confidential and not subject to disclosure. The protections are meant to lessen the concerns of the parties and encourage them to actively engage in responsible conversations in order to fully resolve the issues.

Collaborative law focuses on the honest, open dialogue of both parties who are intent on solving the problem. It requires skillful employee counseling to create the needed atmosphere to ensure success. If done well, the process creates a successful resolution, as each party perceives the process to be fair, and therefore, satisfied with the resolution. Some argue that collaborative law resolves disputes in an expeditious manner with less financial resources and increased fairness perceived by both parties.

Employment disputes and conflicts will continue to increase as the workforce becomes more and more diverse. Although pre-dispute arbitration clauses are commonplace in the employment relationship, dissatisfaction with the cost and time involved in arbitration together with proposed legislation, strongly suggest that employers adopt more creative avenues for resolving these issues. Mediation and collaborative law provide viable alternatives with large potential for positive outcomes while preserving the rights of the parties.

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REGIONAL LABOR REVIEW, vol. 18, no. 1 (Fall 2015).
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