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 behave shape the relationship between employer and employee. From 1997-2011, the Equal employment Opportunity Commission ("EEOC") reported a 24% increase in charges filed. It is interesting to note that the largest share of charges reported by the EEOC in 2011 were retaliation based on a variety of employment related statutes, thus indicating a growing awareness by employees of their statutory rights in the workplace. Under these statutes, an employee may not be retaliated against for exercising his/her rights by filing a discrimination claim. Changes in job assignments, hours, overtime, promotion, and firing may be considered retaliatory. Employers may be successful in establishing that they did not discriminate against the employee, however, if it can be established that they changed a workplace condition in retaliation against the employee for asserting such a claim, the employer will still be liable for damages.

Initially, the human resource strategy adapted to handle the increasing diversity was aimed at meeting legal obligations through the use of litigation. However, the time and money at stake in using litigation as a strategy can be detrimental. This led to the current trend of adapting certain types of alternative dispute resolution ("ADR") as a mechanism to address employment claims. As Ariel C. Avgar asserts: "Employers are increasingly abandoning traditional 'reactive' authoritarian methods that emphasize managerial prerogative and litigation, in favor of proactive and strategic methods that can help create a culture in which informal disagreements can be resolved before they escalate into serious formal disputes." 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 remains an unpalatable choice. 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 lawyers 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—animosity 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.

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 anti-trust violations 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 a 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 bound by it. Absent 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,—indicating that he has read the agreement—effectively 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 personal injury or wrongful death while at the nursing home be decided by 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.

Institutional Theory

Although the role of the courts is important, one could certainly argue that the rapid adoption of pre-dispute arbitration clauses in employment contracts can be 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 initiatives. Organizations structurally reflect or imitate socially constructed values creating norms of rationality, which society expects and requires. Therefore, the adaption of pre-dispute arbitration clauses as the main outlet for employment disputes may 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 plans.

How Has Arbitration 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 as 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 the mandatory exchange of documents, including emails and texts. In addition, discovery may include depositions of the parties and 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 simple, informal process that many employers envision. The reality is that there may not be that many differences between arbitration and litigation. It is not necessarily faster and less expensive. In a 2008 survey of litigation and arbitration trends, large companies reported that 23% of their employment disputes cost between $50,000-$100,000 and 19% cost over $100,000. In smaller companies, the report indicated that 33% of the disputes cost between $50,000-$100,000 and 19% cost more than $100,000. The costs were the same whether the case went to litigation or arbitration. Further the study indicated that the arbitration process averaged 21 months and litigation took approximately 17 months. From the employer's perspective, there are other aspects of arbitration that may not be desirable. There are very limited reasons for appealing the decision of the arbitrator. A court may not reverse the arbitrator's decision on the grounds that the arbitrator did not follow the law. In many states, an arbitrator does not have to write a decision explaining his award.

Proposed Legislation

Employers, employees, attorneys, and legislators have begun to question the efficacy of pre-dispute arbitration clauses and are questioning some of the courts recent decisions. The pendulum may have gone too far in one direction and needs to be rebalanced. Specifically, the belief is that the courts have extended their embrace of pre-dispute arbitration clauses in contracts 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. The Arbitration Fairness Act ("AFA") of 2011 was introduced during the 2011-2012 session. 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 provision is that pre-dispute arbitration clauses that apply to 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 the arbitration clause. 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 increasingly litigious nature of arbitration as well as the as the proposed legislation, it is time for employers to consider new options. At the very least, employers need to revisit their 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 and to the arbitration itself, including discovery. To ensure the enforceability of these 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. In looking at employee waivers, employers need to create a "totality of circumstances," i.e., the clause should be clear, unambiguous, and specific. Terms such as arbitration should be defined and information about the process explained. Another factor that can show that the employee 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 Benefit 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 and establishing specific statutory requirements, which must be met before an employee can waive his right to litigate age discrimination claims under OWBPA. These changes can be used to counteract some of the issues that have been raised in the proposed legislation, possibly allowing employers to maintain a modified pre-dispute arbitration clause.

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 possible avenues to resolve the inevitable employment disputes that arise in an increasingly diverse workforce. Employers 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 be able to deal with one another effectively. Too much dirty linen has been aired. Too many horrible things have been said. The level of animosity only grows as the arbitration goes on. In contrast, where parties have mediated an agreement, they tend to be better able to maintain a working relationship with one another. After all, it is an agreement that they have created.

Unlike an ombudsman, an outside mediator selected by both parties remains neutral. The process varies, but has some basic steps. First the mediator, sometimes referred to as the neutral, meets with both parties and their attorneys (if the parties have counsel). Often, the neutral has already been sent an overview of the disputed issues by the parties. At the initial meeting, both parties explain their respective positions; there is some venting (more or less depending on the neutral's approach); and the parties' attorneys say as little as possible (again depending on the neutral's approach). One of the critical features of a successful mediation is that it gives control to the parties. This is vastly different from arbitration, where the lawyers, the arbitrator, and the process are in control. In mediation, the parties can tell their "story." After meeting with both sides together, the mediator can meet with each side separately. This is a radical departure from both the arbitration and litigation models where the judge/arbitrator is not permitted to meet with only one side. During the individual meeting, the mediator can find out important information. The parties often want something other than the damages that they are requesting. The mediator is able to use this information if the parties agree. Otherwise, the information must be kept confidential. The mediator acts as a go-between. This process may continue—group meetings, individual meetings, and meetings between the neutral and the attorneys for each side—until the parties reach an agreement or decide that further discussion is futile. If mediation is not successful, the parties are off to arbitration or litigation.

Employer interest as a way of resolving workplace disputes appears to be growing. A 2011 survey of Fortune 1000 companies found that the use of mediation had grown while the use of arbitration had gone down. These statistics were determined by comparing the results of a similar study in the 1990s to the 2011 survey. To encourage employers to use mediation in individual employment disputes—as compared to class action suits—the Equal Employment Opportunity Commission ("EEOC") has instituted a program in which employers agree to mediate any eligible claim against the employer. These agreements are entered into before there is an investigation by the EEOC and before any litigation or arbitration has commenced. These agreements are referred to as universal agreements to mediate ("UAM"). Employees are not required to agree to mediation under a UAM. If the employee refuses mediation, an investigation will be commenced by the EEOC. At the end of fiscal year 2012, employers had signed 2141 UAMs. Further, 96% of those employers who had participated in a UAM indicated that they would use the process again. It should be noted that in addition to class actions, UAMs might not be used in disputes involving the Equal Pay Act of 1963.

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.

Conclusion

Employers are faced with constant change creating a dynamic climate where obsolete models need to be reviewed. The pending legislation provides the impetus for such a review and an opportunity to embrace new methods for dealing with employment disputes. The importance of human capital to the organization's success cannot be underestimated. Employers need to find innovative ways to address workplace disputes in a fast and equitable manner so as to capitalize on the advantages employees can provide. Employers must be able to leverage their human capital to fully realize a competitive advantage. Providing an avenue in which workplace conflicts are dealt with in a fair and expeditious manner certainly supports that goal. Research suggests that employees feel more motivated and engaged when they believe that the organization respects them, and most importantly, values them. Mediation and collaborative law provide an excellent opportunity to disclose fears and concerns that the employees involved in a claim may have, and focus on finding an amicable resolution in a timely manner. Such an approach does not have to be limited to situations in which the employee has already filed a complaint with the EEOC or has begun the arbitration process. Having alternative ADR methods available at the early stages of a conflict may be the most effective tool and benefit both employer and employee.

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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