Should Employers Require that Workplace Disputes Be Arbitrated?

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Many employers are considering mandatory arbitration of employment claims in response to the increasing risks and costs associated with employment litigation. This article reviews the legal developments that have made arbitration a viable option, the pros and cons of arbitration, and the experiences of some employers who have implemented mandatory arbitration. It then addresses employers' use of arbitration as part of a multi-step dispute resolution program, with suggestions on how such programs should be designed.

The Rise in Employment Litigation

During the past forty years employers have seen a steady rise in the volume of employment related litigation as Congress has passed a series of laws (Title VII, Age Discrimination in Employment Act, Americans with Disabilities Act and others) giving employees new legal rights and the ability to enforce those rights in court. In 1991, Congress expanded the types of employment cases tried to juries and broadened the types of damages that employees can recover. Since then, employment litigation in federal courts has increased nearly 300 percent, and state courts have experienced a similar rise in claims.

Many employers feel that a "lottery-type" mentality now exists in which employees – and their attorneys – believe that, with a little luck and the right jury, almost any claim could result in a million dollar verdict. There is some basis for this belief. One recent study showed that one out of every five plaintiffs' verdicts in employment discrimination cases is for over $1,000,000.

For many employers, even more problematic than the risk of an employee "hitting the jackpot" on an employment claim are the costs associated with defending employment lawsuits – even the totally meritless ones. These costs include both the attorneys' fees expended and the considerable management time drained by such litigation. According to one recent study, the average attorneys' fees incurred in a seriously contested employment discrimination case is about $150,000. Indeed, because these cases are usually so fact intensive, attorneys' fees can easily exceed $250,000. Moreover, cases typically take at least two or three years from the initial filing of an administrative charge of discrimination to a court trial, and can serve as a continuing distraction for employers. In light of the above, it stands to reason that most employers would be very interested in implementing a system that resolves employment disputes more quickly, more cost-effectively, and, at the same time, eliminates the risk of a million dollar jury verdict. Is mandatory arbitration such a system? What are the pros and cons of mandatory arbitration? How does an employer design such a program?

The U.S. Supreme Court Speaks: The Gilmer, Circuit City and Waffle House Decisions

Congress enacted the Federal Arbitration Act ("FAA"), 9 U.S.C. § 1 et seq., back in 1925 to address the needs of businesses frustrated by the unwillingness of courts to enforce arbitration agreements. The FAA put arbitration agreements on the same legal footing as other contracts and required the judicial enforcement of arbitration agreements in any "contract evidencing a transaction involving commerce." As a result of the FAA, "commercial" arbitration became a frequently-used system to resolve business disputes.

Although employers began to incorporate arbitration provisions in some employment agreements, enactment of the FAA did not lead to the widespread use of arbitration for employment disputes. Three reasons for the limited use of employment arbitration were: (i) as noted above, the risks and costs of employment litigation were generally viewed to be not as great in the years prior to 1991; (ii) uncertainty existed as to whether arbitration agreements were enforceable as to statutory employment discrimination claims; and (iii) even more fundamentally, uncertainty existed as to whether the FAA applied to most employment relationships at all.

In 1991, the use of employment arbitration received huge boosts from both the United States Supreme Court and Congress. First, in Gilmer v. Interstate/Johnson Lane, 500 U.S. 20 (1991), the Supreme Court changed the landscape by endorsing binding arbitration of employment claims, including statutory employment discrimination claims. Second, Congress passed the Civil Rights Act of 1991, which expanded the right to jury trials in employment discrimination cases and also broadened the damages available to plaintiffs. The Civil Rights Act also included the following legislative endorsement of arbitration:

When appropriate and to the extent authorized by law, the use of alternative means of dispute resolution, including. . . arbitration, is encouraged to resolve disputes arising under the Acts or provisions of federal law amended by this title.

Although 1991 is viewed as a watershed year for employment arbitration, there still remained some uncertainty as to whether the FAA covered most employment relationships. That is because the FAA contains a clause that excludes from its coverage "contracts of employment of seamen, railroad employees or any other class of workers engaged in foreign or interstate commerce." The unresolved issue was whether the FAA's exclusion clause excluded all employment contracts, or only those involving transportation workers.

In 2001, ten years after Gilmer, the Supreme Court finally resolved this issue in Circuit City Stores, Inc. v. Adams, 532 U.S. 105 (2001), holding that the FAA applies to contracts signed by most employees, and excludes from its coverage only the employment contracts of seamen, railroad employees, and other transportation workers. In continuing to endorse the use of arbitration, the Court praised the "real benefits" that arbitration provides, particularly the avoidance of litigation costs – a benefit, the Court noted, "of particular importance in employment litigation."

Just one year after Circuit City, the U.S. Supreme Court again turned its attention to employment arbitration. In EEOC v. Waffle House, Inc., 534 U.S. 279 (2002), the Court considered whether the EEOC was barred from seeking victim-specific judicial relief, such as back pay, reinstatement, front pay and other damages for an employee who had signed a mandatory arbitration agreement. The Court sided with the EEOC against the employer, holding that, because the EEOC had not agreed to arbitrate and had interests independent of those of the individual employee, the agency could bring an action seeking individual relief for that employee. Significantly, however, the EEOC brings relatively few such actions (only 332 nationwide in 2002), and so the practical effect of the decision is limited.

Though legal challenges continue and future court rulings (and possibly legislation) will affect the enforceability of particular arbitration schemes, the following conclusions can be drawn from the Supreme Court's decisions in Gilmer, Circuit City and Waffle House: (1) Arbitration of employment claims is encouraged because it generally offers a faster and more cost-effective process for resolving these claims. (2) Arbitration proceedings must be accessible, fair and provide full remedies under the law. While intended to be a more informal and expeditious process than court litigation, arbitration changes only the forum for resolving disputes, not employees' substantive rights. (3) The EEOC may continue to exercise its discretion to pursue discrimination claims in court where the public interest requires it.

Pros and Cons of Mandatory Arbitration

In November 2000, Carolyn Wheeler, Assistant General Counsel of the EEOC, told The Wall Street Journal: “If the outcome of the Circuit City case is that arbitration agreements are enforceable, then I don’t know why everybody wouldn’t adopt them.” Nevertheless, in considering whether to implement a system requiring the arbitration of employment disputes, employers should first weigh the advantages and disadvantages of arbitration. Arbitration may be a very good idea for most employers, but may not be well-suited for others.?

Avoidance of Juries

Many employers view the avoidance of a potentially plaintiff-friendly, and overly-generous jury as the most significant advantage of arbitration. The unpredictability of juries and the fear that a jury may award excessive emotional distress and/or punitive damages drive many court cases to pretrial settlement. In contrast, arbitrations are usually heard by a single arbitrator or three-arbitrator panel who have substantial knowledge and experience in the area of employment law. Although arbitration does not guarantee well-reasoned decisions or moderate damage awards, the conventional wisdom is that arbitrators tend to be both more predictable in decision-making and resonable in awarding damages than juries. (Indeed, arbitrators who are viewed as unpredictable and overly generous stand to be selected as arbitrators in very few cases.)

Less Expensive

The cost of defending an employment case in court through trial often exceeds $200,000. The average cost of an employment arbitration is $20,000. See Estreicher, Saturns for Rickshaws, Why Predispute Employment Arbitration Should Be Preserved, Currents – The Newsletter of Dispute Resolution Law and Practice, Dec. 2001 – Feb. 2002, at 16. Arbitration is normally less expensive because the proceedings are simpler and there is no appeal. Many court cases settle simply because the cost of defense far exceeds the cost of settlement. Arbitration makes the defense of an employment claim a less costly proposition.

Private

Arbitration is usually a private process. There are no public records and no public hearings. The media generally does not have public access to the details of the dispute as it does in court cases when it can review public court filings and attend trials.

Speed

Court cases frequently take several years to work their way first through the administrative agency process and then the court process. One of the principal objectives of arbitration is to reach a resolution quickly – within months, not years. Protracted litigation tends to cause stress among the parties and witnesses, distract employees from more productive work, and adversely affect morale. Of course, protracted arbitrations can also occur, especially where the parties choose busy arbitrators who can offer only widely-separated hearing dates.

Informality

While arbitration certainly is an adversarial process, and an arbitration hearing proceeds in a manner similar to a non-jury court trial, the process as a whole is less formal than typical litigation. The hearings take place in conference rooms, not courtrooms. Arbitrators usually attempt to accommodate the schedules and needs of the parties and counsel, and generally try to make the arbitration experience as pleasant as possible under the circumstances. The relative informality can aid in the preservation of any ongoing relationship between the employer and the employee. Further, in some cases both the employer and the employee may be able to present their case without the need for counsel.

Finality

Arbitration is final and binding, and the grounds for review are very limited. Neither side has the ability to drag out a case through the appeal process.

Potential Increase in Claims

A major concern employers have with arbitration is that more employees may pursue claims if they can do so easily and relatively cheaply through arbitration. If implementing arbitration results in a significantly greater number of claims, the cost savings associated with arbitration (versus court litigation) may be wiped out. Data indicates, however, that this usually does not happen. Indeed, when arbitration is implemented as the final step in a multi-step dispute resolution program (as discussed below), the experience has been that the number of claims that proceed to arbitration is less than the number of cases that proceeded to court before the program's implementation.

More Cases Are Decided on the Merits

Some of the same things that make court litigation so expensive and protracted – extensive discovery and motion practice – also serve to reduce greatly the number of cases that actually go to trial. It works as a screening process. Most court cases settle out well before trial because the cost of proceeding to trial exceeds the cost of settlement, and/or the extensive discovery conducted has uncovered the strengths and weaknesses of each side's case so the parties and their counsel can evaluate settlement more effectively. Many other court cases are dismissed at the summary judgment stage, after discovery has been completed (and much time and money have already been spent). Some view summary judgment as not available in arbitration.

Consequently, the use of mandatory arbitration may mean that a greater percentage of employment claims will actually be decided on the merits, after witnesses have testified and other evidence has been examined. This may be a "pro" and not a "con" because an employer's decision to proceed to "trial/hearing" will likely be dictated more by the employer's view of the merits and less by the substantial cost of defense.

Mandatory Arbitration as Part of a Multi-Step Dispute Resolution Program

A survey of more than 20 Fortune 500 companies' dispute resolution programs found that most employers who have implemented mandatory arbitration have done so in a way that makes arbitration the last step in a multi-step dispute resolution process.

Most programs require that employment claims first be submitted to a human resources and/or management panel review. Claims that are not resolved are then submitted to mediation. Programs typically provide for the use of a professional outside mediator who will work to obtain a mutually acceptable resolution of the dispute. If mediation is unsuccessful, claims are then submitted to binding arbitration.

The companies surveyed reported very positive results:

- Companies reported that over 85% of all claims were resolved prior to arbitration. Most were resolved internally, without lawyers.
- Companies reported that most claims were resolved within 90 days.
- Companies reported that the costs of handling cases that went to arbitration were less than one-half the average cost of lawsuits that needed to be defended before the program's adoption.
- One large company reported that it had 118 pending employment lawsuits when it adopted its

program, but has had only four arbitrations in the five years since.

- Programs that did not use steps before arbitration did reduce costs but had more arbitrations than multi-step programs. ?

Companies that adopted programs with a problem-solving approach and with the active support of senior management achieved success through multi-step procedures because they were able to address issues as "people problems," rather than legal matters. None of the companies reported that a program's adoption led to increased claims. To the contrary, most companies surveyed reported a decrease.

Designing Dispute Resolution Programs

Employers should not design dispute resolution programs with the goal of limiting the substantive rights or remedies of employees. In endorsing arbitration, the Supreme Court has emphasized that "[b]y agreeing to arbitrate a statutory claim, a party does not forgo the substantive rights afforded by the statute; it only submits to their resolution in an arbitral, rather than a judicial forum." Programs need to be fair and accessible to employees. They should be written clearly and address directly the fact that the program is mandatory and is to be used as an alternative to court. The following issues should be considered and addressed:

- Scope of Disputes – Employers must decide what types of employment disputes can be submitted to their dispute resolution programs. All disputes? Only disputes concerning discipline? Only disputes concerning discharges? Some employers may feel they want to restrict use of the programs to discipline and discharge matters so that employers do not end up wasting their resources addressing every perceived slight experienced in the workplace. However, employers should be mindful that what may start out as perceived slights frequently develop into serious employment disputes. Moreover, where dispute resolution programs are open to all disputes most matters are resolved at the first step(s): the human resources and/or management panel review.

Employers may want to block the possibility of class actions being brought in arbitration by including express language precluding class action arbitrations. The ability to avoid class actions and collective actions (under the Fair Labor Standards Act) is a significant potential benefit to some employers when considering arbitration Beware, however, that a court might conclude that an arbitration agreement's preclusion of class-wide arbitrations makes the agreement unenforceable.

There must be mutuality to the agreement to submit disputes to the program. In other words, employers cannot require employees to submit disputes to the program but, at the same time, reserve the employers' right to litigate in court. If an employee is bound to submit a dispute to a program, so must be the employer; otherwise, the program will not be enforceable. Employers can carve out from programs certain types of disputes where immediate access to court may be important, such as disputes concerning non-competition or trade secret obligations. The "carve out," though, should apply equally to the employer and the employee.

- Selection of the Arbitrator – Dispute resolution programs should provide for the selection of a qualified and neutral arbitrator. Employees should be permitted to participate in the selection from a diverse panel of arbitrators. Dispute resolution organizations such as the American Arbitration Association and JAMS can provide parties with lists of qualified arbitrators and procedures through which an arbitrator can be chosen.
- Representation by Counsel – Employers should permit employees to be represented by an attorney of their choice in arbitration proceedings, though some employees may choose not to be represented by counsel. Employers may consider including a provision that if an employee chooses not to be represented by counsel then the employer will proceed without counsel as well.

- Discovery – As discussed above, some major benefits to arbitration are that it is faster, less expensive, and less disruptive than court litigation. Traditionally, discovery (depositions, written interrogatories, document requests, etc.) in arbitration has been limited. However, courts addressing the enforceability of arbitration agreements have stated that some amount of pre-arbitration hearing discovery, including the taking of depositions, should be permitted to give employees access to information necessary to present their claims. Arbitrators can be given discretion to permit discovery consistent with the concept that arbitration is intended to be less time-consuming and expensive than court litigation.?
- Written Decisions – Arbitrators should be required to issue written opinions explaining their decisions and awards. Written decisions should engender some confidence in the process and provide some guidance to the parties concerning future conduct.
- Scope of Remedies – Employers may be tempted to limit the potential damages/remedies that may be awarded to employees in arbitration (e.g., punitive damages). This would be a mistake because courts will not permit employers to limit statutory remedies. To reduce the risk of legal challenge, employees should be permitted to recover in arbitration anything that would have been available to them under applicable law in court, including attorneys' fees and punitive damages. Remember, arbitration agreements change the forum for resolving disputes, not employees' substantive rights afforded by statute.
- Costs of Arbitration – Arbitrators do not work for free; one or both of the parties must pay the costs of arbitration. In the absence of an agreement on the issue, arbitrators usually expect the parties to split the costs. However, some courts have attacked this practice as unfair to employees who, the courts say, should not have to pay substantial arbitration costs when the court system is free to them, beyond the initial filing fees (currently $150 in federal courts). Employers, therefore, should consider paying the costs of arbitration. In addition to reducing the risk of legal challenge, employer-paid arbitration will increase the chances that the dispute resolution program is well-received by employees. Moreover, looking at the broader picture, paying for the costs of the (hopefully) infrequent arbitration will be a small price to pay for the benefits of an effective multi-step dispute resolution program.

Conclusion

Recent Supreme Court decisions have made it clear that employers can require that employees submit employment claims to arbitration, though legal challenges to mandatory arbitration continue. Many employers have successfully implemented multi-step programs, which include arbitration, to resolve workplace disputes fairly and efficiently. These programs require the support of senior management, and must be designed to meet the employer's objectives. Careful attention must be paid to applicable legal requirements as well as to how the programs are communicated to employees. It appears that most employers who have implemented multi-step dispute resolution programs have experienced very favorable results.

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