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Labor and Employment Law Notes

Arbitration Provisions in Employment Contract May Be Under Fire

The United States Supreme Court recently heard oral argument in the case of Hall Street Associates, L.L.C. v. Mattel Inc. that could potentially impact arbitration provisions in employment contracts governed by the Federal Arbitration Act (FAA). Although not an employment case, the ultimate decision in Hall Street has a potential to impact on many areas of law, especially employment law with its ever increasing use of arbitration provisions and, as will be discussed, a split of decisions on the interpretation of arbitration provisions in employment contracts.

In an environmental cleanup dispute between Mattel Inc. and its Oregon landlord, Hall Street Associates LLC, an arbitration agreement between the parties provided that the arbitrator's findings of fact and conclusions of law could be reviewed by the district court at the request of either party, and that the court could vacate, modify or correct an award if the findings of fact were not supported by substantial evidence or the conclusions of law were erroneous. The parties' dispute involved an indemnification clause in a lease agreement. After well water on the property leased by Mattel tested with levels of trichloroethylene higher than federal limits, Mattel sought to terminate the lease and Hall Street sued for indemnification for environmental cleanup costs. The district court resolved one issue in the case and the parties proposed arbitrating the remaining issues.

Hall Street sought district court review of the arbitrator's finding that Mattel was protected by a contractual exception to the lease's indemnification requirements. The court vacated the award, saying that the arbitrator's decision "defies logic." On appeal, the 9th U.S. Circuit Court of Appeals held that the FAA precluded the district court from reviewing the arbitration award for legal error. Hall Street subsequently appealed to the high court. Specifically, the Supreme Court considered the issue of whether the FAA precludes federal courts from reviewing arbitration awards for factual or legal error if parties have specified in an arbitration agreement more expansive judicial review than that provided for in the statute.

Hall Street Associates, L.L.C. is just one of a number of employment cases decided or soon to be decided regarding arbitration provisions at all levels of the court systems across the country. The issues being decided regarding arbitration provisions/agreements/clauses are wide-ranging. This article will touch on a few recent decisions in the United States Supreme Court, California, Illinois and three federal circuits, pertaining to arbitration agreements in the context of employment contracts.

A. United States Supreme Court

The United States Supreme Court has not directly addressed this issue. Since the decision in Alexander v. Gardner-Denver Co., 415 U.S. 36, 94 S.Ct. 1011, 39 L.Ed.2d. 147 (1974), the Court's views on arbitration have evolved and have become more favorable. For example, the Court has repeatedly "rejected generalized attacks on arbitration that rest on „suspicion of arbitration as a method of weakening the protections afforded in the substantive law.” Green Tree Financial Court – Ala v. Randolph, 531 U.S. 79, 89-90, 121 S.Ct. 513, 521, 148 L.Ed.2d.373, 383 (2000). The Court has emphasized that "Federal statutory claims may be the subject of arbitration agreements... enforceable pursuant to the FAA because the agreement only determines the choice of forum." Equal Employment Opportunity Commission v. Waffle House, Inc., 534 U.S. 279, 295 N. 10, 122 S.Ct. 754, 765 N. 10, 151 L.Ed.2d.755, 770 N. 10 (2002).

According to the Court, "[b]y agreeing to arbitrate a statutory claim, a party does not forgo the substantive rights afforded by the statutes; it only submits their resolution in an arbitral, rather than a judicial, forum. Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc., 473 U.S. 614, 628, 105 S.Ct. 3346, 3354, 87 L.Ed.2d.444, 456 (1985). The Supreme Court has held, however, that statutory rights may be subject to mandatory arbitration only if the arbitral forum permits the effective vindication of substantive rights afforded by statute. Mitsubishi Motors Corp., 473 U.S. at 628. The Court has further instructed that in order to be valid the agreement to arbitrate statutory claims must be clear and unmistakable. Wright v. Universal Merit Time Service Corp., 525 U.S. 70, 119 S.Ct. 391, 142 L.Ed.2d.361 (1998). (Holding arbitration agreement, contained within a union collective-bargaining agreement, invalid because the clause in question was too general in stating that "matters under dispute" would be subject to arbitration).

B. 7th and 9th Circuit Law Regarding Arbitration Agreements

1. 9th Circuit

In a recent Ninth Circuit decision in a case entitled Prudential Insurance Company of America v. Lai, 442 F.3d 1299 (9th Cir. 1994), "the Appellate Court reversed a district court order compelling arbitration on a sexual discrimination claim because the employees did not knowingly enter into the agreement to arbitrate employment disputes. The employees, when applying for the positions of sales representatives with the employer, were required to sign forms containing agreements to arbitrate any dispute, claim or controversy required to be arbitrated under the rules of any organization with which the employees registered. They subsequently registered with the National Association of Securities Dealers, which required that disputes arising in connection with the business of its members be arbitrated. The employees contended that when they signed the forms, arbitration was never mentioned and they were never given a copy of the NASD Manual which contained the actual terms of the arbitration agreement. (Underline added.) Lai, 42 F.3d at 1301. The knowing and voluntary standard annunciated in Lai has been adopted by other courts such as the First Circuit Court of Appeals.

2. 7th Circuit

The Seventh Circuit Court of Appeals has recently questioned the "continued validity" of the Ninth Circuit's "knowing and voluntary waiver" standard in the wake of recent United States Supreme Court decisions, noting "it is clear that arbitration agreements in the employment

context, like arbitration agreements in other contexts, are to be evaluated according to the same standards as any other contract.” (Underline added.) Penn v. Ryan’s Family Steakhouses, Inc., 269 F.3d. 753, 758 (7th Cir. 2001). The Seventh Circuit has also recognized that “[w]hile the Supreme Court has stressed in recent years that federal policy under the FAA favors the enforcement of valid arbitration agreements, the courts have been equally adamant that a party can be forced into arbitration only if she has in fact entered into a valid, enforceable contract waiving her right to a judicial form.” (Citations omitted and underline added.) AT&T Technologies, Inc. v. Communications Workers of America, 474 U.S. 643, 106 S.Ct. 1415, 89 L.Ed.2d. 648 (1986) (Holding arbitration as a matter of contract that a party cannot be required to submit to arbitration any dispute which he has not agreed so to submit.) Whether the parties have agreed to arbitrate is determined under ordinary state law contract principals. Penn, 269 F.3d at 758-759.

In fact, several Federal Circuit Courts of Appeal have endorsed countervailing points of view to the “knowing and voluntary” standard. Counter veiling point of view is that one which holds the determination of the enforceability of a mandatory arbitration agreement between employer and employee turns upon fundamental principals of contract law. Under this approach the non-drafting party consents to arbitration by signing the form or by manifesting assent in another way such as by performance of the contract. That the consumer did not read or understand the arbitration clause does not prevent the consumer from consenting to it, nor does the consumer’s ignorance that an arbitration clause is included on the form.

This approach was enforced by the Third Circuit in Seus v. John Nuveen and Company, 146 F.3d 175 (3rd Cir. 1998). In Seus, the Court of Appeals affirmed the district courts order granting the employers motion to compel arbitration in a suit by an employee alleging multiple claims of discrimination under Title VII of the Civil Rights Act of 1964 and the Age in Discrimination Employment Act of 1967. The employee joined Nuveen brokerage firm in 1982. Nuveen is required to register all employees who deal in securities with the National Association of Securities Dealers. In order to comply with this requirement, employees must sign a U-4 Form in which the employee agrees to arbitrate any dispute which is required “to be arbitrated under the rules.” Although the employee in Sues executed this form, she contended that Congress, “in legislation subsequent to the FAA, has carved out an exception to its provisions for pre-dispute agreements to arbitrate claims under the ADA.” The Seus court rejected this argument by citing Gilmer v. Interstate/Johnson Lane Corp., 500 U.S. 20, 111 S.Ct. 1647, 114 L.Ed.2d. 26 (1991), stating: “The Supreme Court began its analysis by making it clear that exceptions to the FAA’s rule requiring enforcement of agreements to arbitrate are not to be recognized lightly. Because of the strong federal policy favoring arbitration, any exception must be founded on clear indicia of congressional intent.” (Underline added.) The Sixth Circuit in Seawright v. American General (No. 07-5091) recently overturned a district court case holding that an employees knowing continuation of employment after the effective date of the arbitration program constituted acceptance of a valid and enforceable contract to arbitrate.

C. Illinois and California Case Law Regarding Arbitration Agreements

1. Illinois

The issue of mandatory arbitration agreements was recently addressed in the Illinois Supreme Court’s decision in Melena v. Anheuser-Busch, Inc., 219 Ill.2d 135, 847 N.E.2d 99 (2006). The

issue before the Court was whether the mandatory arbitration provisions of a dispute resolution program instituted by the employer Anheuser-Busch, Inc. constituted an enforceable contract binding on its employee, Joann Melena. Melena was an at-will employee when she was informed of the company's new mandatory alternative dispute resolution program. After the policy was distributed Melena suffered a work-related injury. Anheuser-Busch terminated Melena when she was receiving temporary total disability benefits. Melena sued the company for retaliation under the Illinois Workers' Compensation Act. Anheuser-Busch moved to dismiss and compel arbitration, or to stay the proceedings and compel arbitration. The circuit court denied the motion and the appellate court affirmed and ruled that in order to be enforceable, an agreement to arbitrate claims like the one at issue must be entered into knowingly and voluntarily.

The Illinois Supreme Court acknowledged the split among the federal circuits as to which standard courts should use. The Illinois Supreme Court held that after careful consideration it agreed with those federal circuit courts of appeal which base their analysis on principles of fundamental contract law because that approach is more faithful to the FAA. The court ruled that the FAA's plain language makes it clear that arbitration agreements are enforceable except for state-law grounds for ordinary contract revocation. In applying its rule to the facts the court held that the mandatory arbitration agreement was enforceable because the mailing of the dispute resolution program materials was an offer and Melena's continued employment was the acceptance and consideration. Under Illinois law, continued employment is sufficient consideration for the enforcement of employment agreements. Melena was, therefore, estopped from litigating her retaliatory discharge claim.

(Note: On November 30, 2007 the 7th Circuit issued an opinion related to arbitration provisions in employment contracts in a case entitled T. McGann Plumbing, Inc. v. Chicago Journeymen Plumbers' Local 130, U.A., (N.D.Ill.). An employer could depose members of the Joint Arbitration Board (JAB) for the limited purpose of gathering information related to the timeliness of the employer's complaint seeking to set aside the arbitration award that ordered the employer to pay fines to union members, including interest, and entered injunctive relief. The employer was entitled to discovery to challenge the labor union's defense that the employer's complaint was time-barred. The limited depositions would not allow inquiry into the correctness of the arbitrators' decision.)

2. California

Continuing the assault on private arbitration agreements in California, the Court of Appeals recently ruled that a pre-employment arbitration agreement containing a class action waiver was unconscionable and unenforceable. Murphy v. Check n' Go of Cal., Inc., 156 Cal.App.4th 138, 67 Cal.Rptr.3d 120 (2007). The court further ruled that a provision allowing an arbitrator to determine unconscionability was unenforceable because the overall arbitration agreement was a "contract of adhesion." In analyzing the case, the Court of Appeals relied on the California Supreme Court's recent decision in Gentry v. Superior Court, 42 Cal.4th 443, 165 P.3d 556, 64 Cal.Rptr.3d 773 (2007), in which the Court struck down another pre-employment arbitration agreement containing a class action waiver. A retail store manager filed a purported class action against his employer seeking damages for conversion and statutory violations arising from the employer's alleged failure to pay its managers overtime wages to which they were entitled. The employer filed a motion to compel arbitration. The Superior Court, Los Angeles County, granted the motion. The manager filed a petition for writ of mandate. The Court of Appeals initially

denied petition. The Supreme Court granted the manager's petition for review and remanded. On reconsideration, the Court of Appeals denied the petition. The Supreme Court subsequently granted review, superseding the opinion of the Court of Appeals. The Supreme Court, held that: (1) class arbitration waivers in employment agreements could not be enforced if the court determined that class arbitration would be a significantly more effective way of vindicating rights; (2) remand was required for the trial court to determine the propriety of class arbitration; and (3) the arbitration agreement was not free from procedural unconscionability.

Other recent cases in California make it apparent that it will be increasingly difficult for employers to compel arbitration of wage-hour class actions in California. The trial courts have struck down such agreements and the appellate review of trial court decisions is done under a liberal "substantial evidence" standard. Employers should review their arbitration programs in light of this decision and consult with counsel to determine whether their programs should be modified. In addition, employers periodically should audit their wage and hour practices to limit potential liability for such claims.