

## Employment Law

# Arbitration Lives

## Employers Should Mesh Agreements Carefully With State Law

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**T**he fate of arbitration agreements in the employment context has been hanging in the balance for some time. For many employers, the U.S. Supreme Court's decision in *Circuit City Stores v. Adams*, 532 U.S. 105 (2001), put the issue to rest.

Yet employers relying on arbitration for protection from costly lawsuits may need to re-evaluate their dispute resolution programs. Despite the Supreme Court's pronouncement in *Circuit City* that arbitration is an appropriate forum for resolving employment discrimination claims, several other court decisions have emerged that call into question the benefits conferred on employers by *Circuit City*.

### Employment Arbitration in the 9th Circuit

In an effort to reduce the costs and uncertainty of litigation, employers increasingly have come to rely on the use of arbitration as a means of quickly resolving employment disputes. Many employers routinely include arbitration agreements in employment applications, requiring newly-hired employees to agree to arbitrate rather than litigate their employment-related claims.

However, employers in Alaska, Arizona, California, Hawaii, Idaho, Montana, Nevada, Oregon, and Washington for years have been wary about arbitration agreements. This concern originated from the 9th U.S. Circuit Court of Appeals' view that employment arbitration agreements are not covered by the Federal Arbitration Act and, as a result, are unenforceable. The U.S. Supreme Court recently resolved this particular concern by pronouncing that the act is in fact applicable in the employment context. This pronouncement, however, hardly eliminates all risk for employers in connection with arbitration agreements.

### U.S. Supreme Court Enforces Arbitration

Congress enacted the law in 1925 to counteract the hostility of American courts toward the enforcement of arbitration agreements. Section 1 of the act excludes from its purview "contracts of employment of seamen, railroad employees, or any other class of workers engaged in foreign or interstate commerce." 9 U.S.C. Section 1. Practically all of the federal circuit courts had interpreted this exclusion as applying only to transportation workers, while the 9th Circuit found that it applied to all employment contracts.

When Saint Clair Adams applied for a job at a Circuit City store in California, he was required to sign an employment application form that included an agreement to resolve any and all employment disputes exclusively by binding arbitration. After working for Circuit City for two years, Adams filed an employment discrimination lawsuit in state court, claiming that the retail chain discriminated against him for being gay.

Circuit City responded by filing suit against Adams in federal court, seeking to compel him to arbitrate his claims under the act. The District Court entered the requested order for Circuit City compelling arbitration. The 9th Circuit reversed, interpreting Section 1 of the act as exempting all employment contracts from the act's reach.

The U.S. Supreme Court disagreed with the 9th Circuit's



interpretation of the act and remanded the case. It held that the exemption in Section 1 applies only to employment contracts for transportation workers. Considering the language in Section 1, the court reasoned that Congress would not have used the phrases "seamen" and "railroad employees" if those same classes of workers were included within the meaning of the clause "workers engaged in ... commerce."

The U.S. Supreme Court championed the enforcement of arbitration agreements as allowing parties to avoid the costs of litigation, a benefit of particular importance in employment litigation often involving smaller amounts of money than disputes concerning commercial contracts.

### The 9th Circuit Has the Last Word

On remand from the U.S. Supreme Court, the 9th Circuit held in *Circuit City v. Adams*, 279 F.3d 889 (9th Cir. 2002), that the arbitration agreement was unenforceable. Only this time, the court struck down the agreement on different grounds. It held that the agreement was unconscionable under California contract law, rather than on grounds involving the act.

In assessing whether the agreement was procedurally unconscionable, the court considered the equilibrium of bargaining power between the parties to the contract and the extent to which the contract clearly disclosed its terms. The Circuit City agreement failed this test because it was a "standard-form" contract, drafted by the party with the superior bargaining power, relegating to the other party [the employee] the option of either adhering to the terms of the contract without modification or rejecting the contract [and a job] entirely. In essence, employees were required to take the contract or leave it. Further, in assessing whether the agreement was substantively unconscionable, the court found that, while the agreement bound employees to arbitrate all of their claims, Circuit City was free to litigate a dispute with its employees in court.

To have a valid arbitration agreement, the court explained, some "modicum of bilaterality" is required so that arbitration does not appear to be a means of maximizing employer advantage. For instance, in *Circuit City Stores v. Ahmed*, 283 F.3d 1198 (9th Cir. 2002), the 9th Circuit considered issues identical to those addressed in the remanded *Circuit City v. Adams* case but arrived at a very different outcome, primarily because the arbitration agreement at issue in the *Ahmed* case allowed the

employee a meaningful choice not to participate in arbitration. Under the arbitration agreement in *Ahmed*, Circuit City employees had the genuine possibility to opt out of the arbitration program by mailing in a simple one-page form.

In contrast, the arbitration agreement in *Circuit City v. Adams* was inequitable because the agreement required only employees to arbitrate their claims, limited relief available to employees, required employees to split arbitration fees with Circuit City and imposed a strict one-year statute of limitations which deprived employees the benefit of the continuing violation doctrine. The 9th Circuit found this agreement unconscionable and, therefore, unenforceable.

### A Balanced Arbitration Agreement Bypassed

Even a well-balanced arbitration agreement that is valid under state contract law may not protect an employer from having to litigate employment disputes in a judicial rather than an arbitral forum.

In *EEOC v. Waffle House Inc.*, 122 S.Ct. 754 (2002), the U.S. Supreme Court decided that the Equal Employment Opportunity Commission was not barred from seeking and ultimately obtaining victim-specific judicial relief against Waffle House despite the existence of an arbitration agreement between Waffle House and its employee.

Waffle House, a chain of Southern restaurants, required Eric Baker to enter into an agreement that "any dispute or claim" concerning his employment would be "settled by binding arbitration." After a few weeks on the job, Baker had an epileptic seizure at work and lost his job shortly thereafter.

Baker never initiated arbitration proceedings but rather filed a timely discrimination charge with the commission, alleging that his termination violated the Americans with Disabilities Act. After investigating Baker's charge, the commission filed suit against Waffle House in District Court, seeking both injunctive relief and damages on behalf of Baker.

On appeal, the 4th U.S. Circuit Court of Appeals ruled that the commission could seek injunctive relief against Waffle House but that the arbitration agreement precluded the agency from seeking victim-specific relief that would benefit Baker. The U.S. Supreme Court granted certiorari and reversed the 4th Circuit's decision. It held that the commission could seek both injunctive relief and damages.

Waffle House argued that allowing the commission to get victim-specific relief would undermine the federal policy favoring arbitration agreements, but the Supreme Court disagreed. The commission was not a party to the arbitration agreement between Waffle House and Baker. Therefore, as the "master of its own claim," the commission was not barred from bringing its own action. The court stated that there was nothing to suggest that the existence of an arbitration agreement between private parties materially changed either the commission's statutory function or the remedies that otherwise exist. Accordingly, the court reversed the 4th Circuit, thereby allowing the commission to bypass arbitration agreements and seek victim-specific relief in employment discrimination cases.

### Approach Mandatory Arbitration Programs Cautiously

Although the 9th Circuit's *Circuit City v. Adams* decision, on remand, and the *Waffle House* decision shade U.S. Supreme Court case law favoring arbitration, they do not undermine arbitration agreements altogether. These agreements can protect employers from lawsuits filed by current or former employees. Employers, however, should be cautious in drafting and reviewing arbitration agreements to ensure that the agreements comply with the relevant state's contract law. Likewise, employers should continue to take commission charges seriously, recognizing that, should the commission intervene, it can bypass an employer's arbitration policy entirely.

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