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Arbitration

INSIGHT: The Brightening Spotlight on Mandatory Arbitration Clauses

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Now more than ever, corporations are using mandatory arbitration clauses in contracts with employees and customers. Arbitration agreements provide a number of benefits to employers and businesses, most significantly by the inclusion of non-disclosure provisions that protect the confidentiality of the claims brought against them. Over the past several years and due in part to their ubiquity, mandatory arbitration clauses (or ''forced'' arbitration clauses, to their critics) have been the target of demands for reform from consumer and employee rights activists, as well as the focus of federal and state regulation.

With the emergence of the #MeToo movement, and the concerns it has focused on regarding confidentiality requirements in arbitration, the rallying cry against mandatory arbitration is perhaps as loud as it has ever been. In response, state and federal legislation is being promoted to end the mandatory arbitration of sexual harassment claims in employment contracts. But if Supreme Court precedent and past efforts to limit mandatory arbitration clauses are any indication, the survival of such legislation is not assured.

In this shifting landscape, how should companies approach mandatory arbitration clauses? This article looks at what lessons can be drawn from recent attempts to eliminate mandatory arbitration clauses, analyzes the benefits (and pitfalls) of mandatory arbitration clauses for companies, and provides takeaways for companies standing in limbo.

Push Against Mandatory Arbitration of Disputes It's no secret. Arbitration clauses are ubiquitous in consumer and employment contracts. A study by the Economic Policy Institute from September 2017 found that over half of American nonunion private-sector employees are subject to mandatory arbitration. Moreover, such clauses are even more commonplace in consumer contracts. In March 2015, the Consumer Financial Protection Bureau found that tens of millions of consumers use financial products or services that are subject to arbitration clauses.

Critics of mandatory arbitration argue that such clauses are harmful to consumers and employees because they are mandatory and require confidentiality, which prohibits parties from bringing certain claims to court and from making their accusations public. These critics say that court is better for individual plaintiffs because arbitration can have advantages for ''repeat players,'' like businesses, that can benefit from appearing in front of the same arbitrator or arbitration provider multiple times. Arbitration clauses also commonly lay out procedural rules for arbitration, including limitations on time and discovery, that many employees and consumers never negotiate before agreeing to them. And many arbitration agreements prohibit plaintiffs from joining their claims as a class, a benefit that proponents argue makes many types of claims more financially viable and that plaintiffs can take advantage of in court.

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This criticism has not gone unheeded from lawmakers and regulators. For example, the Consumer Financial Protection Bureau (''CFPB'') studied arbitration agreements in the financial products sector, and determined in 2015 that class action waivers in banks' and credit card companies' arbitration agreements were harmful to consumers. In July 2017, the CFPB issued a rule that would have banned class action waivers in such arbitration agreements. However, the rule was widely criticized as being anti-consumer, anti-business and promoting frivolous litigation, and in October 2017, Congress voted to nullify the rule before it went into effect.

More recently, criticism of mandatory arbitration in the employment context has grown in the wake of the #MeToo movement. This movement, voicing support for victims of sexual misconduct or gender discrimination in the workplace, has initiated a debate about the propriety of clauses mandating arbitration for sexual harassment claims in the employment context. As one letter sent to Congress earlier this year, signed by every U.S. Attorney General, states, ''[w]hile there may be benefits to arbitration provisions in other contexts, they do not extend to sexual harassment claims.'' Namely, the confidentiality of arbitration for sexual harassment and discrimination could perpetuate the ''culture of silence'' surrounding this conduct, prevent potential plaintiffs from learning of other harassment and discrimination claims and pursuing their own relief, and protect perpetrators who benefit from their conduct remaining secret.

Lawmakers have begun trying to address the #MeToo arbitration maelstrom, proposing legislation at both the federal and state level to eliminate mandatory arbitration in this context. Currently, Congress is considering the Ending Forced Arbitration of Sexual Harassment Act of 2017, a bipartisan bill (S. 2203) sponsored by Senator Kirsten Gillibrand that would effectually invalidate mandatory arbitration for gender-based harassment and discrimination claims in the workplace.

States are working to enact similar legislation. Notably, a bill in California (A.B. 3080) authored by Assemblywoman Lorena Gonzalez Fletcher—which would prohibit employers from requiring prospective hires from signing arbitration agreements and sexual harassment confidentiality agreements as a condition of employment—has been passed in the state Assembly and is being considered by the state Senate. In New York, a bill (S7848A) sponsored by Senator Catharine Young prohibiting mandatory arbitration clauses based on sexual harassment claims has passed the state Senate and has been delivered to the state Assembly and referred to the Governmental Operations Committee. In South Carolina, a similar bill (H. 4433) was introduced in the state House and referred to the Committee on Judiciary.

Likewise, a bill has been sponsored in Massachusetts (H. 4058) that would void any employment contract provision that waives ''any substantive or procedural right'' relating to claims of discrimination and harassment. This bill was introduced in the state House and, along with an accompanying study order (H. 4708), is now pending in the House Rules Committee. In New Jersey, identical bills (S. 121 and A. 1242) are being sponsored in the state Senate and Assembly that bar agreements in employment contracts that ''conceal details relating to discrimination claims.'' The state Senate's bill was passed in the state Senate and has been received in the state Assembly; the state Assembly's bill was has been reported out of the state Assembly Labor Committee with amendments.

If and when such state legislation passes, the fate of mandatory arbitration clauses is still uncertain. This is because such state-level legislation may face preemption issues under the Federal Arbitration Act (''FAA''), a statute enacted by Congress in 1925 to ensure the validity and enforcement of arbitration agreements. 9 U.S.C. § 2. The U.S. Supreme Court has heard cases about whether the FAA preempts state law over a dozen times, and it has consistently held that the FAA supersedes state requirements that restrain the enforceability of mandatory arbitration agreements.

Though initially the FAA was presumed to apply only to a narrow range of commercial disputes in federal court, the abundant litigation it has generated has shown that it applies to all types of disputes, whether brought in federal or state court. *See e.g., Southland Corp. v. Keating*, 465 U.S. 1, 15 (1984) (applying the FAA to state court disputes); *Mitsubishi Motors v. Soler Chrysler-Plymouth*, 473 U.S. 614 (1985) (expanding the scope of the FAA to include statutory disputes); *Gilmer v. Interstate/Johnson Lane Corp.*, 500 U.S. 20 (1991) (expanding the scope of the FAA to include employment disputes). Note, however, that some exceptions exist to the rule that the FAA supersedes state restraints on enforceability of arbitration agreements. For example, the California Supreme Court has found that the FAA does not preempt state law as to unenforceability of waivers of Private Attorney General Act (''PAGA'') claims. *Iskanian v. CLS Transp. Los Angeles, LLC*, 59 Cal. 4th 348 (2014); followed by *Sakkab v. Luxottica Retail N. Am., Inc.*, 803 F.3d 425 (9th Cir. 2015).

So, businesses that use mandatory arbitration clauses in their contracts are likely to challenge the state legislation on FAA preemption grounds. If challenged, these issues could make their way through the California courts on appeal and eventually to the U.S. Supreme Court.

To Include a Mandatory Arbitration Clause or Not? In light of the shifting landscape around mandatory arbitration clauses, it is no surprise that some corporations have already enacted policy changes regarding mandatory arbitration clauses—in December 2017, Microsoft announced that it was waiving the requirement in its employment contracts for the arbitration of sexual harassment claims. However, many in-house attorneys are likely still evaluating the inclusion of such clauses in their companies' employment and consumer contracts. And given the CFPB's failure in passing regulation surrounding arbitration provisions just last year and the lack of clarity in court cases regarding FAA preemption of state legislation, it is perhaps prudent to wait and see how the regulatory landscape progresses before rushing to change existing contracts.

While waiting for legislators and regulators to act, in-house counsel should take this moment to weigh the benefits and the downsides of arbitration. While it is a hot topic, many in-house (and firm) attorneys have not actually experienced arbitration and many not be aware of some of the fundamental differences between arbitration and litigation in court that make arbitration both appealing and unappealing. The following are some pros and cons regarding the arbitration process that

will help inform an evaluation of whether arbitration is right for your company:

PROS:

■ **Confidentiality.** Arbitration is generally a confidential and non-public proceeding. Filings are not publically available and arbitrators, as well as arbitration providers like JAMS and AAA, are subject to confidentiality requirements. But note that while the arbitral forum provides more confidentiality than a court proceeding, it is not in and of itself a panacea—neither JAMS's nor AAA's rules require that the parties maintain confidentiality. Thus, to maximize the likelihood that your dispute will be confidential, an arbitration provision should provide that the parties maintain the confidentiality of the arbitration. This confidentiality requirement can be of significant benefit to companies in the long-term, as potential plaintiffs may not be able to learn of previous lawsuits against a company, thus discouraging copy-cat litigation.

■ **Efficiency and flexibility.** Because there are not long wait times for hearings in arbitration, a dispute is likely to come to final resolution in arbitration more quickly than via a court proceeding. This means that arbitration is also generally less expensive than going to court (though parties do have to pay for arbitrators' time). Arbitration is also more efficient in that it is easier to contact an arbitrator than a judge. For example, if you have a dispute with opposing counsel at a deposition, you are more likely to be able to get your arbitrator on the phone and resolve the dispute then and there (rather than having to end the deposition and seek written relief from a judge). Finally, discovery is generally streamlined in arbitration, which expedites the timeframe in which it occurs; still, parties to arbitration have the flexibility to build a discovery process that makes sense in terms of the monetary value of the dispute.

CONS:

■ **Lack of appeal.** A major drawback of arbitration is the lack of appellate rights. Unless you draft a provision that preserves this right (either preserving the right to appeal back to JAMS or AAA, or alternately, to appeal to a state or federal court), your right to appeal will be limited to the statutory bases (such as the award being procured by corruption, misconduct of an arbitrator, or refusal of an arbitrator to hear material evidence). These statutory bases are strictly construed by reviewing courts.

■ **Loose admission of evidence.** An arbitration hearing is not like trial. Generally, unless the arbitration provision requires strict application of the rules of evidence, arbitrators tend to be flexible in terms of allowing in evidence that may normally be subject to a hearsay or relevance objection. This looser standard of admission of evidence can lead to a situation where you are forced to address issues or problematic documents that would normally be excluded in court.

■ **Split the baby result.** Arbitrators may be more likely than judges to ''split the baby'' and craft what is deemed to be an equitable or fair result to the parties. Bottom line, while there are many advantages to arbitration, it is not a panacea and careful consideration must be given to the type of cases that may be subject to arbitration and the ultimate objective(s).

Conclusion Bottom line, there are changes happening on both a national and state level with respect to the enforceability of contractual arbitration clauses. But there are several affirmative steps you can take to control your company's experience in this sphere. It is imperative to stay informed about this shifting legal landscape to be aware of what claims are appropriate for arbitration. You should ensure that when you are drafting and negotiating contracts, you consider whether the subject matter is appropriate for arbitration in light of the pros and cons of arbitration. And once you determine that arbitration is right for a particular dispute, consider how to craft an arbitration provision which meets your company's objectives with respect to dispute resolution.

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