management matters

Supreme Court Removes Doubts About the Enforceability of Arbitration Agreements

By Jonathan A. Wexler

In March 2001, the U.S. Supreme Court handed down its decision in *Circuit City Stores, Inc. v. Saint Clair Adams*. In its ruling, the Court resolved the question of the enforceability of agreements in which employees pledge to submit employment-related disputes, notably including discrimination claims, to binding arbitration rather than proceeding in court.

Background

In 1995, Saint Clair Adams took a job with Circuit City Stores in Santa Rosa, Calif. The employment application that Adams completed and signed included a provision in which Adams agreed to settle disputes arising out of his "application or candidacy for employment, employment or cessation of employment with Circuit City, exclusively by final and binding arbitration before a neutral Arbitrator."

In 1997, Adams filed a lawsuit in California state court alleging discrimination under California's Fair Employment and Housing Act. Based on the arbitration agreement contained in Adams' employment application, Circuit City filed suit under the Federal Arbitration Act ("FAA" or the "Act") in federal district court to enjoin the state suit and compel arbitration of Adams' claims.

The district court granted Circuit City's request, but the Court of Appeals for the Ninth Circuit reversed that ruling. The Ninth Circuit held that, because the arbitration agreement was contained in an employment contract and employment contracts are not subject to the FAA, the agreement to arbitrate was not enforceable. The Ninth Circuit's holding that employment contracts are not subject to the FAA conflicted with every other Court of Appeals (including the Second Circuit covering New York) that previously considered the issue.

The Supreme Court's Decision

The U.S. Supreme Court reversed the Ninth Circuit's holding, and settled the issue by determining that arbitration clauses contained in most employment agreements are enforceable under the FAA. The Ninth Circuit's idiosyncratic view of the FAA arose from an exemption contained in section 1 of the Act. While section 2 specifically renders valid an agreement to arbitrate controversies arising out of a contract involving "commerce," section 1 provides that the FAA does not apply to "contracts of employment of seaman, railroad employees, or any other class of workers engaged in foreign or interstate commerce." The other Courts of Appeals that had considered the question concluded that the exemption was limited to employees in transportation industries (i.e., workers actually engaged in the movement of goods in interstate commerce).

The Supreme Court rejected Adams' argument that an employment agreement is not a contract involving commerce and thus does not come within the FAA's purview. The Court reasoned that if all employment contracts are beyond the reach of the Act, the employment-contract exemption in the Act would be rendered superfluous.

The Supreme Court also went on to reject Adams' assertion that the exemption clause's language—"any other class of workers engaged in foreign or interstate commerce"—includes all employees in any industry coming under Congress' power to regulate interstate commerce, which would include the vast majority of employers in the country. Rather, the Court found that the phrase is residual language that references the immediately preceding mention of seaman and railroad employees, thus limited to workers who are engaged in the movement of goods in commerce (i.e., "transportation workers").

Arbitration Agreements in the Future

Although the *Circuit City* decision changed the law only in the Ninth Circuit, employers may now implement a policy requiring employees to execute arbitration agreements with the knowledge that such agreements will be enforceable under the FAA. The Supreme Court reiterated its prior holdings that the FAA applies in state courts and preempts state laws that prohibit the enforceability of arbitration agreements.

The Court also mentioned the advantages of arbitration as an alternate dispute mechanism, including avoiding the costs of litigation. Finally, the Court pointed out that, in arbitrating statutory claims, 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."

In this latter regard, an employer will have to be careful to structure any arbitration mechanism that it implements to safeguard and preserve the substantive/remedial and procedural rights that the employee would have enjoyed in court. First, the employee's waiver of the right to a court proceeding and attendant jury trial should be knowing and voluntary, and the arbitration agreement should therefore be contained in a separate agreement that specifies that statutory claims, among others, are required to be arbitrated.

Courts have found that a policy requiring arbitration contained in an employee handbook is not a sufficient waiver of an employee's right to sue in court. Some degree of discovery should be available to the employee, especially in view of what is generally the employer's superior access to documentary and testimonial evidence. The private arbitration industry (the American Arbitration Association, for example) has created arbitration mechanisms that generally comport with the "due process" requirements that the courts have endorsed.

Of course, requiring employees to sign arbitration agreements may not be appropriate or desirable for every employer. Because arbitration is a lower-cost dispute resolution process and easier to commence than litigation, more claims may be brought by employees who are obligated to arbitrate than by employees who must go to court to have their claims heard.

On the other hand, arbitration, unlike litigation, is a private proceeding, and it limits the extent to which a company will be subject to unfavorable publicity. The number of employment-related claims the employer typically faces, as well as the company's corporate culture, also bear upon the desirability of mandatory arbitration.

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