

Managing Risks in Human Resources: Employment Arbitration

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In recent years the high cost of litigation of employment disputes has resulted in the many employers adopting alternative dispute resolution mechanisms. Employment arbitration has been the choice of many firms to minimize the risk associated with wrongful dismissal and other employment related issues. Arbitration is faster and simpler than courtroom litigation. However, perhaps the main reason for this move to employment arbitration is that arbitrators are limited to a make whole remedy virtually eliminating the pain and suffering and exemplary damages which may be awarded in court. There are specific issues which must be addressed if employment arbitration is to be enforced in the courts and is going to serve the purposes of minimizing litigation risks, these are reviewed in this paper. There are also questions which should be examined in deciding if employment arbitration will serve a useful purpose in any organization.

RISK MANAGEMENT: INTRODUCTION

In an increasingly competitive global economy risk management is critical to the successful enterprise. In recent years employers have adopted a strategy to ameliorate risk from litigation concerning employment issues – that strategy is employment arbitration. Arbitration is already a familiar alternative to courtroom litigation to those working in the unionized sectors of the U.S. economy. Virtually all collective bargaining agreements contain grievance procedures which end in final, and binding arbitration. Employers could not help but notice that the arbitration of discharge cases were quicker, had lower litigation costs, and perhaps most importantly, limited awards for the employee to back pay and benefits, with interest in some cases. The high dollar parts of jury awards, exemplary damages and pain and suffering are not within the authority of an arbitrator under collective bargaining agreements (Elkouri and Elkouri, 1997).

Many non-union employers have observed that the arbitration provisions under collective bargaining have some obvious risk ameliorating advantages over courtroom litigation. The limitation of remedies to simply making employees whole, should they prevail, makes this system of dispute resolution attractive to employers. Like most incentives, there are details concerning both benefits and costs which are not so obvious. These details are worthy of consideration before either adopting or rejecting this approach to employee dispute resolution. Before proceeding to a discussion of the risk management associated with employment arbitration and brief review of the judicial history of this form of arbitration will set the stage for what can be expected if this approach is adopted.

THE LEGAL GENESIS: UNSETTLED JUDICIAL REVIEW

Employment arbitration differs from labor arbitration because employment arbitration is unilaterally promulgated by employers, but labor arbitration is a creation of collective bargaining between a union and an employer. Normally, in labor arbitration the arbitrator is jointly selected and compensated for services by the employer and union together. In employment arbitration, there is no union therefore either the employer picks up the bill, or the employer and employee split the bill in some fashion, with employees often paying a smaller fraction so as to make the process affordable to them.

Employment arbitration first gained notice in cases where discrimination claims were brought against employers. The United States Supreme Court decided an issue involving claims of age discrimination by a non-union employee. The Court decided that a contract of employment signed by the employee which provided for the arbitration of employment disputes (including discrimination) was enforceable in the Federal Courts *Gilmer v. Interstate Johnson Lane Corporation* (500 U.S. 20 (1991)). However, this decision resulted in an apparent inconsistency with the position the Court took in its celebrated *Alexander v. Gardner-Denver* (415 U.S. 36 (1974)) decision in which the Court ruled that employees could take discrimination claims to the EEOC even if the dispute had been arbitrated. After the United States Supreme Court's decision in *Gilmer* the question of whether matters not involving alleged violations of the Civil Rights Act of 1964 could still be arbitrated and enforced in the courts remained.

In 2001 the Court was presented with a case which did not involve EEOC claims in *Circuit City v. Adams* (532 U.S. 143 (2001)). In this case, the United States Supreme Court found that Adams had executed an employment application in which he agreed to resolve all claims arising from his employment in final and binding arbitration. In this case the Court confirmed its position, held in union grievance matters, that arbitration was a desirable and appropriate method whereby disputes arising out of employment can be fairly and expeditiously resolved without resort to the courts. The Court also stated that rather than the National Labor Relations Act being the authority for such enforcement, that the Federal Arbitration Act (9 U.S.C., Section 1, *et seq.* (1925)) was the authority for Federal Courts to enforce employment arbitration awards.

The current status of employment arbitration is that employees in non-union settings may be subject to agreements to arbitrate employment disputes and thereby give up their rights to courtroom litigation. Employees who have discrimination claims against their employers may still take these claims to the EEOC, even after otherwise final and binding employment arbitration. In cases not involving claims by an employee of their statutory rights being abridged it is much more certain that the Courts will continue to enforce employment arbitration awards in matters which approximate the fairness and due process considerations prevalent in labor arbitration.

EXTENT OF EMPLOYMENT ARBITRATION

Employment arbitration has grown over the years since the Court's decisions in *Gilmer* and *Circuit City*. One study estimates that between 1997 and 2001 the number of employees who have signed employment arbitration agreements has increased from three million to six million (Hill, 2003). Other studies have been reported citing ranges from 2.1 percent of the total workforce to 22.7 percent of nonunion employees were covered by employment arbitration agreements (Colvin, 2007). The research to date, suggests that a growing number of employment arbitration agreements are being executed in private, nonunion employment, and nearly as many nonunion employees are now covered by such arrangements as there are union employees covered by collective bargaining agreements. Such growth in employment arbitration is consistent with employers and employees determining that their mutual interests are best served by having arbitration to resolve employment disputes rather than relying on more judicial remedies.

EMPLOYMENT ARBITRATION AS A STRATEGY FOR RISK MANAGEMENT

Risk from high damage awards and prolonged litigation have resulted in the search for alternative ways to resolve such disputes. The right to hire, fire and direct the workforce of any organization is important to efficiency of operations, and at the core of entrepreneurial discretion. However, with these managerial prerogatives comes the inherent risk that an employee may take exception to an adverse personnel action and sue the employer. In labor arbitration under collective bargaining contracts, should the employer not prevail before the arbitrator, the remedies due the aggrieved employee are limited. No tort reform yet enacted eliminates pay and suffering and exemplary damages (although many limit these portions of awards), yet this is precisely the limitation imposed on an arbitrator's authority. An arbitrator can make an employee whole for lost wages and benefits, sometimes including interest, but nothing more in monetary remedy. From this perspective, employment arbitration is attractive. However, there is a down-side. Because arbitration is less expensive than the courts, plaintiffs will take more matters to arbitration than they would have taken to the courts. The employee must put up fewer dollars for the uncertain outcome in arbitration, than would have been the case in a lawsuit. The fact that employment arbitration is growing suggests that the decreased risk of court awarded damages outweighs any increased filings for employment arbitration.

Employment arbitration is not without its problems. One study has shown that there are questions about the fairness of many of the agreements which have been drafted by employers. Too often these arbitration agreements contain provisions which lack due process or favor employers (Zack, 1996). Such one-sided agreements are unlikely to be well received by the Courts and lack value-added as a method of risk amelioration because the courts will not enforce arbitrations procedures which lack basic fairness (hence due process). Therefore, any employment arbitration agreement must be drafted in such a manner as they will be more likely to receive a hospitable reception in the courts. Otherwise you simply add one more layer of litigation to any employee grievance – hence increasing rather than mitigating any risks faced from the employer-employee relation.

There are a few basic principles that seem to have emerged as legal scholars have considered these issues. Pre-dispute agreements to arbitrate which limit employees' statutory rights are likely not to be enforced in the courts. Public policy constraints concerning employees' statutory rights have been raised above the private law of contracts particularly in matters involving discrimination, the Fair Labor Standards Act, and the National Labor Relations Act. There is not agreement among legal scholars concerning the dilemma of employment arbitration agreements overlapping with statutory procedures and rights. Under collective bargaining arrangements, some administrative law agencies routinely defer to private arbitration (e.g., National Labor Relations Board, while others do not EEOC). It is clear that any arbitration arrangements must clearly identify any statutory basis for claims which are to be brought to arbitration, and even then administrative law agencies and the courts may still assert jurisdiction due to unconscionability (Jaffe, 2003).

Under collective bargaining agreements the scope of the grievance/arbitration provisions is generally limited to the collective bargaining agreement and disciplinary issues. In employment arbitration the scope is not so clear. The box below provides some guidance concerning the scope of employment arbitration provisions.

Checklist of employment arbitration agreement provisions

Jurisdiction

1. Specific definition of disputes which are subject to arbitration (grievance definition, statutory claims etc.)
2. There must be adequate discovery of evidence similar to labor arbitration procedures sufficient to assure a fair hearing for the employee (and not the technical courtroom rules)
 - a. a formal pre-hearing conference or
 - b. a multiple step grievance process to bring out the facts of the matter

Arbitrator

3. Procedure must provide for a competent and neutral arbitrator (not an employee of the company)
 - a. Typically selected from an administrative agency such as American Arbitration Association or Federal Mediation and Conciliation Service
4. Both parties have a voice in the selection of the arbitrator

Due Process

5. Due process rights - employee has a right to representation of their own choosing
6. There must be a written award by the arbitrator laying out the findings of fact, and the reasoning for the award – legal or contractual (and the award be made public)
7. The costs of arbitration must be borne by both parties, and may not be excessive to discourage employees from bringing matters to arbitration (taking into account the employees' ability to pay)

see Judge Harry Burns, *Cole v. Burns International Security Services.* (105 F.3d 1465, DC Cir. 1997)

With that said, the issues which may still be brought to employment arbitration are considerable and far exceed what is covered by statute, (i.e., discipline, promotion, layoffs, recalls, transfers, etc.). There is beginning to emerge guidance concerning the efficacy of employment arbitration agreements (Jaffe, 2003; Wolters and Holley, 2000). Legal scholars have concluded that much of what has been accepted in labor arbitration in unionized settings is applicable to employment arbitration. The checklist above presents the characteristics of employment arbitration agreements which will make these instruments more likely to withstand scrutiny by the courts.

From the checklist above, there are three categories of issues employers must consider in promulgating employment arbitration procedures: jurisdiction, the arbitrator, and due process issues. The jurisdictional issues to be considered before creating an employment arbitration process is twofold. What sorts of issues should be included and what issues should not be included. For example, wrongful discharge has a high risk resulting from historically high damage award, but should that include more mundane disciplinary issues such as letters of warning or short suspensions? Issues that do not involve potentially high dollar remedies in a court, are issues with minimal or uncertain benefits by adopting

employment arbitration. While employee morale and a sense of fairness may result from broad inclusion of issues, it must be remembered there is a monetary cost to including these issues.

Discovery is also a matter of jurisdiction. Basic fairness requires that there be formal rules for discovery, but they need not be cumbersome or approximate the courtroom rules. Generally a formalized grievance process (multiple step, with time limits for filing and answering grievances) in which positions and evidence are exchanged will provide for basic fairness, and often times results in a settlement short of arbitration.

The selection of an arbitrator is also not as simple as it sounds. The arbitrator should be a competent, neutral third party. Such persons are readily available from the administrative agencies who provide such persons to union and employers in labor arbitration cases. The American Arbitration Association and the Federal Mediation and Conciliation Service maintain lists of competent persons who have experience as neutrals in such matters. There should be built into the process of employment arbitration a method of selecting an arbitrator which allows the employee to have an equal say with the employer as to who the arbitrator will be. Most union contracts do this by striking names from an odd-numbered list provided by one of the administrative agencies.

There are numerous due process issues which must be considered by the parties. The employee should be permitted to have a representative of their own choosing in both the arbitration process, and the discovery evidence phase of the procedure. There should be a written decision in which the arbitrator makes a finding of facts and outlines the reasoning for the decision. Further, that award should be made public within the organization to demonstrate the fairness of the process and its results. The costs of the process to the employee cannot be excessive to the point that the employee cannot afford to avail themselves of the process. There is no union present to spread the financial burden of the costs of arbitration.¹ The ability of the employee to pay will not be as great as the employer's in most cases, and the distribution of costs should reflect that fact – otherwise the process will also be viewed as less than fair.

WHEN TO USE ARBITRATION

Arbitration is designed to be a quick and inexpensive alternative to courtroom litigation. If the company is a small organization in which few employees view their positions as careers then it is unlikely that arbitration would minimize any risks from lawsuits. Employers whose workforce is highly skilled or educated, and whose employees view their positions as careers rather than easily replaced jobs may find themselves at greater risk of litigation over human resource issues and may wish to consider the establishment of employment arbitration provisions. These are the obvious questions, what is less obvious is how employees receive such arbitration provisions.

If an employer has a workforce that is career oriented and has little alternative save to sue if they believe they are wronged, then a little homework will provide some valuable insights. Fairness, responsiveness to needs, and security may all be issues which employees may perceive as being enhanced by having access to employment arbitration provisions. Before creating such provisions employers are well advised to seek input from their workforce as to whether such provisions would be well received and, if so, what sorts of things should be included in the process from the employees' perspective. Providing employees with "voice" in such matters does enhance the perception of a fair-minded employer and does provide valuable insight into what matters to the employees.

ENDNOTE

1. The costs of the services of an arbitrator for the hearing and writing the award generally are less than a few thousand dollars. The Federal Mediation and Conciliation Service reports that the median arbitrator's per diem in Indiana is \$740. In most cases three or four days per diem is what is necessary, plus expenses – resulting in an arbitrator's fees being less than \$4000.

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