



u.s. supreme court holds that most employment agreements requiring arbitration of claims are covered under the federal arbitration act

MSK Client Alert

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In recent years employers have recognized the benefits of arbitration of employment disputes over costly and time consuming civil litigation to say nothing of the vagaries of juries. Employer imposed arbitration programs, however, have faced difficult challenges by the judiciary, especially the United States Court of Appeals for the Ninth Circuit which has jurisdiction over California. Employers should carefully review this Alert as the United States Supreme Court has removed yet another judicial impediment to such arbitration programs and voiced its favor of arbitration in the employment context.

Background

The Federal Arbitration Act ("FAA") compels judicial enforcement of arbitration agreements that are contained in any contract evidencing a transaction involving commerce. The employment application used by Circuit City Stores contained a provision that the applicant agreed that all employment related disputes, including federal and state discrimination claims, would be settled exclusively by final and binding arbitration.

Two years after his hire as a sales counselor, Saint Clair Adams filed a lawsuit in state court asserting state discrimination and common law tort claims. Circuit City countered by filing suit in Federal Court seeking an injunction to stop the state lawsuit and to compel arbitration. While the Federal District Court entered the requested order, the Federal Court of Appeals for the Ninth Circuit reversed, holding that the FAA does not apply to contracts of employment. Contrary to the holdings of nine other Federal Courts of Appeal that had addressed this issue, the Ninth Circuit, applying its prior decision in Craft v. Campbell Soup Co., 177 F. 3d 1083 (9th Cir. 1999), held that Section 1 of the FAA exempted all employment contracts. Section 1 excludes from that Act's coverage "contracts

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of employment of seamen, railroad employees or any other class of workers engaged in foreign or interstate commerce."

In [Circuit City Stores, Inc. v. Adams](#), decided on March 21, 2001, the U.S. Supreme Court held that the FAA covers employment agreements, except for employment contracts involving transportation employees.

This holding in a 5-4 decision is a significant victory for employers. Most of the text of the opinion is a rather technical application of statutory construction. In deciding the case, the Supreme Court looked carefully at two sections of the FAA -- Section 2, which addresses the basic coverage of the FAA, and Section 1, which addresses the exemptions from coverage. Concentrating on textual construction and using statutory canons of interpretation, the Court held that the exemptions in Section 1 of the FAA for "any other class of workers" constitutes a residual phrase, and is limited to categories of workers that are similar to those which were enumerated in the phrases preceding it. As such, the Court concluded, "Section 1 exempts from the FAA only contracts of employment of transportation workers," and leaves all other employment contracts covered under its provisions.

Various "friends of the Court," including 22 State Attorneys General, urged that interpreting the FAA to include employment agreements intrudes upon State policies that restrict the ability of employers and employees to enter into arbitration agreements. In response, the Supreme Court said that this argument is not relevant to its decision in [Circuit City Stores, Inc.](#), but rather to the Supreme Court's prior holding in [Southland Corp. v. Keating](#), 465 U.S. 1 (1984). In that case the Court held that Congress intended for the FAA to apply in state courts and to preempt state arbitration laws that limit the circumstances under which arbitration can be compelled. By contrast, the Court stated that [Circuit City](#) concerns the application of the FAA in federal rather than state courts. The Court did state, however, that Congress has not moved to overturn [Southland](#), implying the FAA will continue to be interpreted as preempting state laws that attempt to limit the types of claims that can be arbitrated.

In addition to the actual holding regarding the application of the FAA to employment agreements, possibly the most important part of the decision for employers is the Court's expression as to why arbitration agreements are so compelling in the employment context. This insight is a likely harbinger of what the Court will do when it next addresses the issue of compelled arbitration of statutory employment claims.

The Supreme Court specifically noted that arbitration agreements allow parties to avoid the costs of litigation, especially important in employment disputes, which often involve smaller sums of money than commercial contract claims. In addition, the Supreme Court observed that arbitration avoids difficult choice-of-law questions that often arise in the employment context.

The Supreme Court affirmed the importance of arbitration agreements in the workplace, stating that any other holding would "call into doubt the efficacy of alternative dispute resolution procedures adopted by many of the Nation's employers, in the process undermining the FAA's proarbitration purposes." Perhaps most importantly, the Court reminded the parties that it has been "quite specific in holding that arbitration agreements can be enforced under the FAA without contravening the policies of congressional enactments giving employees specific protection against discrimination prohibited by federal law." The Court reasoned that employees do not forgo



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their substantive rights when they agree to arbitrate a statutory claim; instead, they merely resolve it in an arbitral rather than judicial forum.

Although [Circuit City](#) confirms that most employment contracts are covered under the FAA, employers must still ensure that the arbitration agreement and the procedures thereunder conform to statutory, regulatory and decisional case law regarding notice and due process. In California, standards for viable employer imposed arbitration agreements were set out in [Armendariz v. Foundation Health](#) (for a more detailed discussion of [Armendariz](#) see MSK's August 2000 Client Alert or call us for a copy).

This includes the following:

- The agreement between the employer and employee is written in a manner calculated to be understood by the employee or by the average individual eligible to participate.
- The employee cannot be required to bear any expenses other than those required in an action filed in court.
- The agreement cannot be unfairly one-sided by compelling arbitration of the employee's but not the employer's claims.
- The arbitration agreement cannot limit any remedies available by statute, such as punitive damages, front pay and attorneys fees.
- Sufficient discovery must be permitted to adequately arbitrate a statutory claim.
- Arbitrator's decision must be written and reveal the essential factual findings and conclusions of law.

For more information regarding [Circuit City](#) and the use of arbitration agreements in employment contracts, please contact one of the labor and employment attorneys at MSK.

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Labor & Employment Chair

How *Circuit City* Impacts Your Workplace

The Decision

Introduction