ARBITRATION (Pros & Cons)

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ARBITRATION PROS (and a few cons)

1. INTRODUCTION

The arbitration of disputes has steadily been gaining favor in such areas as consumer issues, real estate transactions, and employment. The concept of arbitration as a substitute for litigation is not new and has been a fundamental feature in collective bargaining (union relationships) for decades. E.g., Steelworkers v. Warrior & Gulf Navigation Co., 363 U.S. 574 (1960); Consolidated Rail Corp. v. Railway Labor Executives’ Ass’n, 491 U.S. 299 (1989). Yet, agreements to arbitrate, and the arbitration process itself, are still viewed with uncertainty by many practitioners. See, discussion in Gilmer v. Interstate/Johnson Lane Corp., 500 U.S. 20 (1991) noting the early suspicions toward arbitration and the various reasons for them.

It is my observation that the reluctance to accept arbitration often stems from two factors:

1. A general unfamiliarity with the process itself (the procedures, rules, and mechanics); and/or

2. A sense by plaintiff’s lawyer’s that if their client’s case goes to an arbitrator, the potential for a large verdict is much reduced. This is akin to preferring a jury trial rather than a bench trial.

Nevertheless, it is believed that the arbitration process does offer distinct advantages.

These advantages include the following:

1. A relatively quick process for resolving the dispute. In contrast to court cases which may take one or two years, arbitrations can generally be resolved in two or three months. Even faster if discovery is limited.

2. Lessened expense: In the arbitration process there is a tendency to utilize less discovery, expend less attorney time, and reduce reliance on experts and extraneous witnesses. However, note that many arbitration agreements do not limit the amount of discovery. (Some agreements do have a predetermined number of depositions which can be taken). Moreover, the rules of the American Arbitration Association, which are often incorporated into arbitration agreements, do allow for discovery plans, depositions, and procedures similar to those found in federal court. (See, AAA’s National Rules for the Resolution of Employment Disputes, http://www.adr.org/rules/employment/employment rules 2. html).

3. A relatively skilled fact-finder. Although the quality and experience of arbitrators vary considerably, generally one can select an arbitrator with specific experience in the subject matter of the dispute. This reduces the time “educating the judge”, ensures a more principled approach to the issues, and generally results in a decision based “on the law”. There is less of a chance that the fact-finder will be carried away or diverted by extraneous factors.

4. The award is more likely to fit the facts and the law. Although many plaintiff’s lawyers complain that the potential awards are much smaller than what they are likely to receive from a jury, it should be remembered that arbitrators often adopt a “Solomonesque” approach in cases with close facts. In other words, rather than an “all or nothing” result which might be reached by a jury, the arbitrator may determine (implicitly) that the closeness of the issues warrants some relief to both sides. This is a common approach in labor arbitration cases involving discharges where an arbitrator may order reinstatement, but without backpay.

Despite the many advantages of arbitrations, there are many arguments against arbitrations as a compelled process. However, as noted by the courts, many of these concerns arise from an early suspicion of the process. These, however, have been diminished with the applicability of the Federal Arbitration Act (“FAA”) and more refined procedures for handling arbitrations.

For an exhaustive treatment, and rejection, of the arguments against arbitration, see the discussion on page 14 below, in Gilmer v. Interstate/Johnson Lane Corp., 500 U.S. 20 (1991).
II. PROCEDURAL FRAMEWORK

A. The Federal Arbitration Act, 9 USC § 1 et seq.

i. Brief Description
This federal statute, first enacted in 1925, provides the general procedural and enforcement mechanism for arbitrations. In relevant part, it provides:

Section 2: A written provision in any maritime transaction or a contract evidencing a transaction involving commerce to settle by arbitration a controversy thereafter arising out of such contract or transaction . . . shall be valid, irrevocable and enforceable save upon such grounds as exist at law or in equity for the revocation of any contract.

Note: the statute specifically preserves equitable and legal grounds for revoking the agreement to arbitrate.

Note: Texas courts have held that the creation of an employment relationship which involved commerce is a sufficient “transaction” to fall within Section 2 of the Act. E.g., In re Leadership Ford, Inc., (1999 Tex. App. Lexis 4708) (Tex. App. 5th Dist. Dallas, 1999)(compelling arbitration of employee’s on-the-job injury pursuant to alternative worker’s comp plan).

Section 4 of the FAA provides for federal jurisdiction of suits to compel arbitration. Subsequent provisions describe the mechanics of arbitration, selection of arbitrators, and enforcement of the award in court.

ii. Grounds for vacating an award
Under Section 10, there are limited grounds for setting aside an award that has been rendered through the arbitration procedure. These statutory grounds are as follows:

- Where the award was procured by corruption, fraud, or undue means;
- Where there was “evident” partiality or corruption in the arbitrators;
- Where the arbitrators were guilty of misconduct in refusing to postpone the hearing, refusing to hear pertinent evidence, or any other misbehavior by which the rights of a party have been prejudiced;
- Where the arbitrators exceeded their powers, or so imperfectly executed them that a mutual, final and definite award was not made.

iii. Grounds for Modifying Award
Under Section 11, a court has authority to modify or correct an award in the following cases:

- where there was an evident material miscalculation of figures or an evident material mistake in the description of any person or thing in the award;
- where the award covers a matter not submitted to the arbitrator where the award is imperfect in matter of form not affecting the merits where necessary to effect the intent of the award and promote justice between the parties.

B. Arbitration Services and Procedures
Where there is an agreement to arbitrate, care must be taken to ascertain the precise procedure to be followed. Some agreements set forth their own procedures and limitations, as well as the process for selecting arbitrators. Most, however, refer to the procedures of the AAA (See, AAA’s National Rules for the Resolution of Employment Disputes, [link]) or those of the Federal Mediation and Conciliation Service (29 CFR Part 1404). Although these two sets of procedures are similar, there are important distinctions in the two frameworks.

III. THE JUDICIAL FRAMEWORK

A. General Principles
arbitration agreement and that the issues fall within the scope of the arbitration agreement, the trial court must compel arbitration and stay its own proceedings. Cantella & Co. V. Goodwin, 924 S.W. 2d 943, 944 (Tex. 1996); In re Oakwood Mobile Homes, Inc., 987 S.W. 2d 571, 573 (Tex. 1999). A writ of mandamus is the appropriate appellate procedure for reviewing a lower court’s refusal to compel arbitration. E.g., In re Rushmore Financial Group, Inc. (2000 Tex. App. Lexis 2604) (Tex. App., 5th Dist. Dallas 2000).

B. Is There a Valid Agreement to Arbitrate?

The party seeking to invoke arbitration has the burden of establishing the existence of an arbitration agreement. Cantella & Co. V. Goodwin, 924 S.W. 2d 943, 944 (Tex. 1996); In re Oakwood Mobile Homes, Inc., 987 S.W. 2d 571, 573 (Tex. 1999).

i. Challenges to the Agreement

Once the party seeking arbitration meets its burden, the burden shifts to the party opposing arbitration to show that:

$ The arbitration agreement was procured in an unconscionable manner;


(See below)

$ The agreement was induced or procured by fraud or duress; or

Fraud: To establish fraud, the party must prove:

i. A material misrepresentation was made, and
ii. That it was false.

Oakwood, 987 S.W. 2d at 573; Green Int’l, Inc. v. Solis, 951 S.W. 2d 384, 390 (Tex. 1997).

Where customer/consumer who purchased mobile home was told that the sale would not go through if they did not sign the agreement, and there was no showing that this was false, there was no fraud. Oakwood, 987 S.W. 2d at 573;

Note: There is a distinction recognized in the courts between fraud in the inducement of the arbitration agreement, (which the courts may determine) and a challenge to fraud in the making of the contract as a whole (as to which the arbitration agreement is a part) in which case, the issue of fraud or unconscionability is for the arbitrator to decide. E.g., In re Leadership Ford, Inc., (1999 Tex. App. Lexis 4708) (Tex. App. 5th Dist. Dallas, 1999). However, the Texas Supreme Court has stated the foregoing principle as follows: where the arbitration agreement’s terms are challenged as a whole, the matter is for the arbitrator, but if the challenge is based on fraud in the inducement, it is a matter for the court to decide. Oakwood, supra.

Duress: Claim that the arbitration agreement was part of an adhesion contract (where there is no bargaining power or ability to change the contract terms) is not per se unconscionable or proof of duress. Id; EZ Pawn Corp. v. Mancias, 934 S.W.2d 87, 90 (Tex. 1996).

Federal note: The unequal bargaining power between employers and employees is not a sufficient reason to hold that arbitration agreements are never enforceable in the employment context. Gilmer v. Interstate/Johnson Lane Corp., 500 U.S. 20 (1991)

$ That the party seeking arbitration waived its right to arbitration.

Waiver of right to arbitrate may be express or by implication; if implied, the intention must be ascertained from the facts. Bramcon General Contractors, Inc. v. Wiegley Construction Co., 774 S.W.2d 826 (Tex. App. El Paso, 1989) (waiting until filing of answer and the setting of trial date was waiver).

However, merely ignoring requests to arbitrate when there is no duty to initiate arbitration does not constitute waiver. Oakwood, 987 S.W. 2d at 573. There is a strong presumption against
find a waiver because public policy favors arbitration. *Id.*

ii. Absence of Consideration:

Additionally, employees in an at-will context have experienced seemingly conflicting results in their attempts to argue that the arbitration agreement was not binding because of the lack of consideration. The two approaches by the courts are reflected by the following cases:

**Denying arbitration:** *Tenet Healthcare Ltd. v. Mary Cooper*, 960 S.W.2d 386 (Tex. App. 14th Dist. Houston, 1998): Employee was given handbook which stated she was at-will and that the company reserved the right to change conditions of employment. The handbook also stated that it was not a contract. The acknowledgment of the handbook which the employee signed contained an agreement to arbitrate all employment disputes. The court held that there was a lack of consideration stemming from the at will employment relationship. More specifically, the court held:

- Whether there is an enforceable agreement to arbitrate is determined by State law;
- Consideration for a valid contract in an at-will employment relationship cannot be based on continued employment because such a promise is illusory. Illusory promises cannot support a bilateral contract.
- There was no mutual agreement to arbitrate because continuation of employment was illusory from the inception and handbook disavowed a binding effect on the employer.

**Compelling arbitration:** *In re: Alamo Lumber Co.*, 23 S.W.3d 577 (Tex. App. 4th Dist., San Antonio, 2000): In that case, employees signed an agreement to arbitrate all disputes arising out of employment as part of the company’s “Open Door Policy”. They agreed this was the exclusive means of resolving disputes. The court distinguished *Tenet* and upheld the arbitration agreement, reasoning as follows:

- In Texas, the surrender of a right constitutes valid consideration; Here the language covers, the employer’s claims against the employees, as well as their claims. These mutual promises provide consideration.
- In an at-will relationship, the conditions may be modified if there is notice of the change and acceptance of the change;
- Continuing to work after being notified of a change (the arbitration agreement) constituted an agreement to arbitrate “as a matter of law.” A period of employment after notification of an arbitration policy forms a unilateral contract.

C. **Issues to be Arbitrated must fall within the Scope of the Arbitration Agreement**

In considering whether the parties have agreed to arbitrate the particular issues in disputes, courts are guided be the principle that arbitration is a favored means of resolving disputes and therefore there is a presumption in favor of arbitration. *See, Oakwood*, 987 S.W.2d at 573. However, arbitration agreements must be reviewed to determine if the issues sought to be arbitrated are statutorily excluded from arbitration.

i. **Texas Case Law**

The Texas Supreme Court upheld mandatory arbitration of a consumer case alleging violations of the Magnuson-Moss Warranty Act (federal statute governing warranties) and the Texas Deceptive Trade Practices Act. *In re American Homestar of Lancaster, Inc. and Nationwide Housing Systems*, 2001 LEXIS 51 (Tex. 2001). The language stated that “all claims, disputes and controversies arising out of...sale, purchase, or occupancy [of mobile home]” including claims based on DTPA, tort, contracts, statutes, *etc.* was broad enough to cover plaintiff’s consumer case. *Id.*

ii. **Federal Law**

Language providing that “any dispute, claim or controversy” required to be arbitrated under the rules (which compelled arbitration of any “controversy” between a stock broker and his member organization arising out of the employment or termination of employment) was broad enough to compel arbitration

Language agreeing to arbitrate “any and all claims, disputes or controversies “arising out of” employment or cessation of employment, including ADEA, Title VII, ADA, contract and tort claims, required arbitration of employee’s state law discrimination claims. *Circuit City Stores, Inc. v. Saint Clair Adams, 121 S.Ct. 1302 (2001).*

D. There Must be no Statutory Prohibition of Arbitration of the Issues.

Assuming the existence of an agreement between the parties to arbitrate the issues which have arisen, and assuming the agreement is not vitiated because of fraud, duress, or unconscionability, the next issue which arises is whether the statutory claim is one which the legislature has stated should be excluded from arbitration.

i. Texas Cases

Texas courts follow federal decisions in determining whether a statutory claim is outside of the scope of arbitration. As described by the Texas Supreme Court, the test to be applied is as follows:

The party opposing arbitration must show “a clear congressional intent” to override the FAA’s mandate to enforce binding arbitration agreements. This congressional intent must be evidenced in:

- the statute’s language, or
- the statute’s history, or
- through an inherent conflict between arbitration and the statute’s purposes.


*In re American Homestar of Lancaster,* is a case where the Texas Supreme Court analyzed the Magnuson-Moss Act and held that nothing in that Act prohibited arbitration. The following factors were found insufficient to bar arbitration:

- the FTC’s regulatory position that informal dispute settlement mechanisms shall not be binding on any person;
- the statutory right to sue for damages and equitable relief in any court of jurisdiction;
- legislative history indicating that informal ADR would not be a bar to a civil action on the warranty involved in the proceeding. (the legislative history was inconclusive).

ii. Federal Cases

In *Mc Mahon* (relied upon by *American Homestar*), the United States Supreme Court held that the Security Exchange Act’s conferring of jurisdiction on federal courts did not indicate an intent to bar arbitration of claims under the Act. Also, the Court held that there was no statutory history indicating a congressional intent to prohibit arbitration. Finally, the court held that there was no conflict between the purposes of the Act and the arbitration procedures of the FAA. Similarly, the Court held that RICO claims were not excluded from arbitration.

iii. U.S. Supreme Court Employment Cases

*Gilmer v. Interstate/Johnson Lane Corp. (1991):*

Employee of SEC firm had signed an agreement to arbitrate all employment disputes. The agreement was not in an employment contract, but rather in his application to register with the SEC. Claiming discrimination in violation of the Age Discrimination in Employment Act, he filed EEOC charges, and brought a federal suit. The employer filed a motion to compel arbitration.

*Held:* Although all statutory claims may not be appropriate for arbitration, “having made the bargain to arbitrate, the party should be held to it unless Congress itself has evinced an intention to preclude a waiver of judicial remedies. The person opposing arbitration has the burden of showing the congressional intent against arbitration.

Court’s Analysis:

- Nothing in the text of the ADEA prohibits arbitration.
There is no conflict between the social policies of the ADEA and arbitration. If the prospective litigant can still effectively vindicate his statutory cause of action in the arbitral forum, the statute will still serve both its remedial and deterrent function. The Court noted that compulsory arbitration had been previously held to be appropriate for cases involving claims under the SEC Act, Sherman Act, RICO, and the Securities Act of 1933.

The EEOC will not be undermined. Employees can still file a charge (although not litigate it); the agency can pursue its own investigation; and there is no requirement that the EEOC be involved in all employment disputes.

Although the statute provides for judicial venues, the statutory language is not mandatory and it suggests informal methods of conciliation to be taken by the EEOC.

Arbitration is not inconsistent with the ADEA. In so ruling, the court rejected the following arguments against requiring arbitration:

The speculation of bias by the arbitrator. The FAA allows overturning of decisions where there is partiality or corruption of the arbitrators. The selection procedures protect against conflicts of interest and allow for review of arbitrators’ backgrounds.

Claim of inadequate discovery. The SEC rules allowed for depositions, document production, information requests, subpoenas, etc. Even though the discovery may not be as extensive as in federal court, it is sufficient.

Absence of written opinions which would result in secrecy of an employer’s discrimination, reduced effectiveness of appellate review, stifling of the development of the law. The applicable rules did require written opinions which are available to the public.

Additionally, the Court noted that although review of arbitral decisions is limited, the review available is “sufficient to ensure that arbitrators comply with the requirements of the statute at issue”.

Absence of equitable relief and class actions. Contrary to the argument that arbitration procedures did not allow for equitable relief, the procedures at issue did allow for such relief, as well as collective relief. Moreover, even if class actions were not available, this is insufficient to preclude arbitration.

Inequality of bargaining power. This alone is insufficient to hold that arbitration agreements are never enforceable. Also, there was no evidence of fraud or coercion in entering into the agreement.

**Circuit City Stores, Inc. v. Saint Clair Adams** (2000): Employee who had signed agreement to arbitrate all employment disputes filed state law discrimination case. Employer filed federal action to compel arbitration pursuant to FAA.

**Issue**: Whether the following language in the Federal Arbitration Act (Section 1 of the Act) precluded arbitration of an ADEA claim: “nothing herein contained shall apply to contracts of employment of seamen, railroad employees, or any other class of workers engaged in foreign or interstate commerce.”

**Held**: Section 1 is applicable only to transportation workers, i.e., those workers “actually engaged in the movement of goods in interstate commerce.” The exclusion from arbitration therefore does not extend to all employment contracts. Accordingly, the employee was required to arbitrate his employment discrimination claims.

**IV. CONCLUSION**

The foregoing demonstrates the growing judicial acceptance, and preference for, resolution of disputes through the arbitration procedure. Arbitrations may be viewed as another facet of alternative dispute resolution mechanisms, which are already embraced by the courts as a means of relieving the burdens of their ever-increasing caseloads. No system is perfect, and the arbitral process in no exception. Yet, arbitrations do resolve disputes in a quick and cost effective manner. As such, the procedures should be viewed as a viable mechanism for resolving disputes.