A Note on the Economics of Imposed Employment Arbitration Agreements

by Norman Brand, Esq.

150 Lombard Street, Suite 3
San Francisco, CA 94111-1133
Phone:(415) 982-7172
Fax: (415) 982-8021
Email: adrmaster@abanet.org

I. What Is a Case Worth?

There has been significant debate about the propriety of imposed employment arbitration agreements. Most of this debate has tiptoed around the economics and dynamics of settling cases. Each side has a significant economic interest, each side engages in settlement talks with the hope of convincing its opponent that it is better to settle for what it offers than to continue litigating. Both sides are affected by substituting arbitration agreements for jury trials.

The debate over the propriety of employment arbitration is really about how much the case is worth—the dollar amount it will settle for. Understandably, employers want to reduce the potential settlement value, and plaintiff's lawyers want to increase it. Both sides recognize the potential for what an employer would call a "runaway jury" and what a plaintiff's lawyer would describe as a proper jury valuation that sends a message to the employer. Both understand that a settlement driven by fear of a jury will be higher than one predicated on a judicial or arbitral decision.[1] Employers want to reduce costs and exposure, plaintiffs want to maximize the monetary settlement. While there is a realistic possibility that a jury award may be reduced significantly on appeal, the transaction costs for getting that reduction may be quite high. The most important consideration, however, is that the overwhelming majority of cases settle before a trial. Thus, the uncertainties associated with jury verdicts and the increased transaction costs of appeals are factored into settlements by defendants and plaintiffs, respectively. What a case is worth, that is, how much it settles for, reflects the unpredictability of juries and the transaction costs of litigation. The equation must be revised when employment arbitration replaces a jury trial.

The settlement value of a case decreases when an employment arbitration agreement removes the threat of a "runaway jury." Some believe that the mere presence of an arbitration agreement makes the employer less likely to settle. It is certainly true that where there is an employment arbitration agreement, the employer is not motivated to settle for an amount that might be awarded by a jury, because both transaction costs and economic exposure are reduced. But that does not necessarily mean the employer is unwilling to settle at all. Rather, the employer may only be willing to settle the case for an

[1] Fear of a jury verdict is increased where a statutory claim permits punitive damages, although imposed employment arbitration agreements must give arbitrators the same remedial power as juries. (See, footnote 6) Employers do not equally fear an arbitrator awarding punitive damages. Employers recognize that professional arbitrators must maintain their reputation for rationality and fairness to both sides, while a jury is an ad hoc group that need not be concerned with rationality or impartiality.

amount that reflects the transaction and exposure costs of an employment arbitration rather than a jury trial.

Employment arbitration agreements may have effects on an individual case that are different from those on potential employment claims in general. Two major pieces of information that would tell us how these interests are affected are currently missing. First, we do not know whether the presence of arbitration agreements, as a general matter, will lead to many more claims being brought, thus leading to greater expense for employers and more frequent recovery by employees. Second, we do not know—as a general matter—how much cases are worth in employment arbitration. Little empirical research has been done on how arbitrators value cases.

Studies done by Lewis Maltby demonstrate that, in the cases he reviewed, employees are far more likely to win at employment arbitration, albeit for lesser amounts.[2] If the amount of a win is adjusted for the greater likelihood of winning, then according to Maltby's study arbitration may ultimately be a more employee-friendly forum. Thus, a major effect of imposed employment arbitration agreements may be to lower the range of potential settlements, while increasing the number of successful employee suits.

For the small percentage of cases that involve statutory issues[3] there is another significant question: Will the purpose of the statutes—to eliminate discrimination—be forwarded or retarded by employment arbitration? Arbitration is, according to Maltby's study, likely to produce more wins for employees. Whether this will promote employment arbitration because of an increased chance of success is unknown. If it does, then employers will face regular and significant costs for prohibited behavior. In addition, they may attract state or federal antidiscrimination agencies that can use the arbitral findings of fact to support an agency finding of a pattern or practice of discrimination. This could result in remedial orders. What we do not know empirically is whether a combination of an increased number of lower-value employment arbitration awards plus agency oversight is more effective at changing prohibited behavior than fewer but larger (often reduced) awards combined with existing agency enforcement. That remains to be studied.

II. Some Practical Tips for the Plaintiff's Lawyers

Plaintiff's lawyers should learn to use arbitration to their advantage. In light of the Supreme Court's decision in *Circuit City Stores, Inc. v. Adams*[4] imposed employment arbitration agreements that provide due process are likely to be enforced in statutory cases. Even the Ninth Circuit—the only circuit that was unwilling to enforce imposed employment arbitration agreements that cover statutory claims—has been obliged to conform to the Supreme Court's view of the coverage of the Federal Arbitration Act. Counsel must assess their

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[2] Lewis Maltby, *Private Justice: Employment Arbitration and Civil Rights,* 30 COLUM, HUMAN RTS. L. REV. 29 (Fall 1998).

[3] Only 13% of the employment cases filed with the American Arbitration Association (AAA) in 1999 involved statutory discrimination claims. The number of such claims is likely to rise because of court decisions requiring the employer to pay the entire cost of the arbitrator when a statutory discrimination claim is made*. Armendariz v. Foundation Health* Psychcare Servs., 24 Cal 4th 83, 6 p3d 669, 99 Cal Rptr 2d 745 (2000), *Cole v. Burns Int'l Security Servs*. 105 F.3d 1465, 72 FEP Cases 1775 (D.C.Cir. 1997). These decisions provide an incentive to make statutory claims, regardless of their merit, in order to shift the costs of the arbitration.

[4] 532 U.S. 105, 85 FEP Cases 266 (2001).

clients' claims in light of that reality in order to use employment arbitration to the client's advantage. Before attempting to avoid arbitration, plaintiff's counsel should consider four questions about whether arbitration is advantageous to the client.

1. *Will the client be more willing to bring legitimate claims of emotional distress?* Although discovery may still be intrusive, employment arbitration protects against a public airing of the plaintiff's psychological, emotional, or sexual history. It will be done, if at all, in a private forum.

2. *Will the speed and finality of employment arbitration affect the client's willingness to go forward?* If the client is anxious to get on with his or her life, arbitration may be more acceptable than a "discounted" offer from an employer planning on extended litigation.

3. *Is the client's personality or history a problem?* Professional decisionmakers are more likely than juries to have some appreciation of the realities of the workplace, including the fact that plaintiffs can be troubled (and troublesome) individuals and still be entitled to recovery. As a result, they are also more likely to be aware of their own biases and to compensate for them by working to be fair to a problematic plaintiff. If the case is otherwise solid on the law and facts, then arbitration holds less risk for this type plaintiff.

4. *Does the absence of the summary judgment process change the risk analysis?* The majority of statutory cases are lost at summary judgment. The percentage of cases under the Americans with Disabilities Act that survive summary judgment is extremely low. Although it is possible for an arbitrator to award summary judgment, such awards are rare. Arbitrators have no compulsion to clear a calendar, and no aversion to complicated cases. Furthermore, they know that if they mistakenly dismiss a case on summary judgment there is no appellate court to give plaintiff another opportunity to be heard. The finality of arbitration makes arbitrators cautious about summary adjudication.

Counsel should always consider mediation when there is an employment arbitration agreement. In California (as in the D.C. Circuit and a number of other courts), the employer must pay any costs of arbitration beyond the fees and costs that would be required if the case were litigated[5] In addition, with the extremely small likelihood of summary judgment,

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[5] Armendariz v. Foundation Health Psychcare Servs., 24 Cal. 4th 83, 6 P.3d 669, , 99 Cal. Rptr. 2d 745 (2000).

[6] *See Armendariz,* 24 Cal. 4th 83, in which the California Supreme Court refused to enforce an imposed arbitration agreement that failed to provide essential due process protections. The court adopted the standard of *Cole v. Burns Int'l Security Servs.*, 105 F.3d 1465, 72 FEP Cases 1775 (D.C. Cir. 1997), stating: "Five minimum requirements exist for the lawful arbitration of statutory civil rights pursuant to a mandatory employment arbitration agreement. Such an arbitration agreement is lawful if it: (1) provides for neutral arbitrators, (2) provides for more than minimal discovery, (3) requires a written award, (4) provides for all of the types of relief that would otherwise be available in court, and (5) does not require employees to pay either unreasonable costs or any arbitrators' fees or expenses as a condition of access to the arbitration forum. Thus, an employee who is made to use arbitration as a condition of employment 'effectively may vindicate his or her statutory cause of action in the arbitral forum.'" *Armendariz*, 24 Cal. 4th at 102 (citing *Cole,* 105 F.3d at 1482).

[7] The term is not Meyer's, but comes from a report issued by a committee of the Society of Professionals in Dispute Resolution that made recommendations on how to successfully implement a pervasive dispute resolution program in business and government entities. That report can be found at http://www.spidr.org./.

the employer has to prepare its entire case before arbitration commences. The employer can avoid these substantial transaction costs by settling. Thus, there may be a very strong impetus toward a mediated settlement when there is an employment arbitration agreement. The amount for which the case will settle, however, may still be less than plaintiff's counsel believes it would settle for if a jury trial were available.

[8] The U.S. Postal Service has an internal mediation program called REDRESS. In studying the complaints that were addressed through this program, it discovered that over 90% of the discrimination complaints were not actually claims of any statutory violation. Rather, they were complaints that had been characterized as federal EEO violations, because that was the only mechanism through which the employee's complaint could get an official hearing prior to implementation of the REDRESS program. The REDRESS program permitted work-related complaints to be heard and resolved without requiring them to be cast as statutory violations.