Client Alert: Employee Arbitrations May Be Costly To Employers

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Employers may be compelled more often to pay all of the costs of arbitrations with their employees under a recent decision by a New York appellate court. The Appellate Division, First Department, voting 3-2 in *Brady v. Williams Capital*, held unenforceable a clause requiring an employee to split the cost of an arbitration with her employer because, in the Court's view, it precluded the employee from "effectively vindicating" her rights.

The arbitration costs there, however, were relatively modest. Total arbitration fees were $42,300, and the employee had earned a salary ranging from $100,000 to $400,000 during her five-year period of employment. Given these facts, arbitration costs are likely to be imposed on employers in the great majority of arbitrations, particularly if they are against former employees unemployed at the time of the arbitration.

The Developing Law of Employment Arbitration Costs

The *Brady* decision is just the latest in a long string of decisions about the imposition of arbitration costs on employees who would otherwise be permitted to go to court, where the tribunal costs are lower. Arbitration tribunal costs are much higher than court costs, which are rarely more than filing fees, costing a few hundred dollars. Arbitration filing fees alone can run well into the thousands of dollars. In arbitration, more importantly, the arbitrators are paid by the parties, at rates of some hundreds of dollars per hour, while judges are paid by the government.

The trend is definitely in favor of either relieving employees of the obligation to arbitrate or imposing the arbitration costs on employers. There is clearly a rule that arbitration clauses imposing arbitration costs on an employee will not be enforced where, in the words of the *Brady* majority, the arbitration costs preclude the employee from "effectively vindicating" his or her rights. (This language came from an earlier decision by the New York Court of Appeals in *Schreiber v. K-Sea Transportation Corp.*, 9 N.Y.3d 331, 849 N.Y.S.2d 194 (2002).)

The majority of decisions, including a U.S. Supreme Court case called *Green Tree Financial Corp.-Ala. v. Randolph*, 531 U.S. 79 (2000), require a case-by-case analysis of the ability of the employee to bear arbitration costs, rather than a blanket rule requiring the employer to bear such costs. *Brady* endorsed the case-by-case approach.

The American Arbitration Association employment arbitration rules state that the employer is to bear the costs of the arbitration. They also say that if there is an arbitration agreement having an "adverse material inconsistency" with the AAA arbitration rules, the arbitrator is to ignore the agreement and apply the AAA rules instead. The *Brady* court, noting that arbitrations are and have always been governed by the arbitration agreements between the parties, overruled the AAA rule and held that the contract controlled on the issue of who pays the arbitration costs. Both the dissent and the majority in *Brady* agreed on this point.

Where the majority and the dissent disagreed in *Brady* was on whether an employer could be forced to arbitration if a Court invalidates the fee-splitting part of the arbitration agreement. The majority said yes, the dissent, no. If the employer is inclined to continue the fight, it appears to have the right to appeal to the New York Court of Appeals.

Should Employers Arbitrate Employment Disputes? Should They Try To Split Costs?

Arbitrating employee claims, particularly employment discrimination claims like the one involved in the *Brady* case, has obvious advantages for employers. There are no juries in arbitration and the proceedings are not public. The *Brady* decision, however, introduces another variable.

In *Brady*, the arbitration expenses were $42,300. While legal fees for the trial of a substantial matter are typically higher, comparable legal fees are commonly incurred in arbitration, and these arbitration costs are substantial enough to consider in deciding whether to include an arbitration clause in employee agreements. Also, these costs, if the employer must bear them, may affect when and if, and what price, to settle employee claims.

Assuming that an arbitration clause is desired, it is not entirely obvious that employer should include a fee-splitting clause.

A fee-splitting clause is good for employers because, while it may be held unenforceable in a particular case, it will only be invalidated on a case-by-case basis, creating uncertainty and, at the very least, additional legal work for the employee's lawyer, who bears the burden of invalidating the clause. At the same time, however, possible outcomes of litigation over such clauses include, as in *Brady*, that the arbitration goes forward exclusively at the employer's expense. Indeed, a Court that agrees with the *Brady* dissent and holds that parties can only be compelled to arbitrate in accordance with their agreements, could invalidate the clause entirely and send the case to court.

The employer who is determined to assure that any dispute with an employee is arbitrated and not litigated in court would be well advised to forgo the chance to split the fee with the employee and leave the matter to be determined in accordance with the rules of the arbitration tribunal.

Finally, the New York Court of Appeals case that preceded *Brady*, and upon which both the majority and dissent relied in *Brady*, left open, by a cryptic comment at the end of the opinion, the possibility that fee-splitting clauses might ultimately be held entirely unenforceable in New York. The Court of Appeals in *Schreiber v. K-Sea Transportation Corp.*, 9 N.Y.3d 331, 849 N.Y.S.2d 194 (2002) was mainly concerned with the question whether a fee-splitting clause in the arbitration agreement that stated that the employer would advance any arbitration filing fee up to $750 was deceptive because arbitration fees are typically considerably higher. Having remanded the case for a finding as to whether that clause was deceptive (and therefore unenforceable), the Court made the following comment:

> Even in that event [that the clause was not deceptive], however, Schreiber should not compelled to bear costs which would effectively preclude him from pursuing his claim [cip.om.] Thus, any order compelling arbitration should be conditioned on K-Sea's agreement to bear any costs not waived by the AAA, subject to reallocation of those costs by the arbitration.

9 N.Y.3d at 341, 849 N.Y.S.2d at 200.

This conclusion, invalidating the fee-splitting clause, was reached apparently without a case-by-case analysis of the facts. Did the Court of Appeals mean that the arbitration fees in that case – $10,000 – were too burdensome for the employee as a matter of law? Probably only the next New York Court of Appeals case will tell us.

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