Employment disputes are one of the most critical risks to Japanese companies doing business, not only in New York but in the United States. In the United States, it is not uncommon for companies to have arbitration agreements with their employees, given the risk and significant cost of litigation. As recent case law has shown, courts may not enforce arbitration agreements as drafted that do not permit employees to vindicate their rights. As discussed in detail below, one important factor courts consider is whether the employee can afford the cost of arbitration.

Many employers prefer arbitration to litigation because often arbitration results in speedier resolutions, no juries, limited discovery, confidential proceedings and the possible avoidance of class actions, among other reasons. Nevertheless, there are downsides as well, including a limited appeal process. Once an award is rendered, the grounds to vacate the award are narrow. Additionally, administrative costs to arbitrate, including the arbitrator’s or panel’s fees, can be quite significant. Conversely, the cost of commencing an action in court is nominal (a couple hundred dollars) and, of course, the parties do not pay the judge or the court for their time.

For those employers that choose to arbitrate, it is best to enter into an arbitration agreement with the employee that sets forth the parameters of the arbitration, such as scope, what law governs, venue and, of course, which party pays for the arbitration. In the absence of a contractual provision governing the payment of fees, such as a fee-splitting arrangement, the rules of the arbitral body selected by the parties to arbitrate the dispute govern. For instance, the American Arbitration Association (AAA), a popular arbitral forum, employs an “employer-pays” rule, where the employer is responsible for paying the costs of arbitration. As a result, many arbitration agreements provide for a fee-splitting arrangement whereby the parties are equally responsible for the arbitral costs.

Factors New York Courts Weigh To Determine Who Pays Arbitration Costs

New York state’s highest court has made clear, however, where such an agreement is challenged, courts must weigh the following factors to determine an employee’s financial ability to pay to arbitrate: (1) whether the litigant can pay the arbitration fees and costs; (2) the expected cost differential between arbitration and litigation in court; and (3) whether the cost differential is so substantial that it would deter the bringing of claims in the arbitral forum. Brady v. Williams Capital Group, L.P., 14 N.Y.3d 459 (2010). This analysis is performed on a case-by-case basis.
In Brady, the petitioner, who was a registered representative, argued that the equal sharing of arbitration fees and costs precluded her from pursing her statutory rights in an arbitral forum. At the time the petitioner was terminated, she was making more than $200,000; during her five years with the company, her salary peaked in 2003, when she earned $405,000. Petitioner also had been unemployed for 18 months at the time she brought the proceeding. The AAA, pursuant to its “employer pays” rule, sent the employer an invoice for $42,300, which included advanced payment for the arbitrator’s compensation. The employer demanded that petitioner pay half the fee in accordance with the arbitration agreement, which petitioner refused to pay.

The Brady Court remitted the matter back to the trial court to weigh the newly enunciated factors. The Court, however, left open what documentation a court should request to resolve the issue of financial ability, holding “[s]uch matters are best left to the [trial] court’s discretion.” The Brady Court further declined to articulate the remedy should the clause be found unenforceable. The Court held that the trial court should decide whether to sever the clause or offer petitioner the choice between accepting the “equal share” provision or suing in court.

Brady Factors Do Not Apply to Employers

Unlike employees, employers, on the other hand, seemingly will be stuck with the arbitration agreement they enter into with their employees. According to one New York trial court, the Brady factors did not apply to employers trying to get out of their contractual commitments. A few months after Brady was decided, the New York Supreme Court, Nassau County in Matarazzo v. L.R. Royal Inc., 28 Misc. 3d 1036 (N.Y. Sup. Ct. 2010) held that an employer could not get out of a fee-splitting arrangement whereby the employee’s fees and expenses for arbitration before the AAA were capped at $3,000. The employer refused to pay the outstanding balance of $23,968.75, claiming the company was not represented by counsel at the time it entered into the agreement; the agreement was drafted by the employee’s counsel and, therefore, should be construed against the employee; and the employer could not afford the arbitration costs. The Matarazzo Court rejected each of these arguments, declining to apply the same rules where an employer alleges that arbitration is too costly.

Agreement to Arbitrate Upheld Where Employer Agreed to Modify Clause

In another matter governed by New York law, although the arbitration clause as drafted by the employer was one-sided and seemingly penal toward the employee, the employer was able to waive certain provisions of the clause that resulted in a finding by New York’s highest federal court that the clause was not unconscionable as modified. In Ragone v. Atlantic Video at the Manhattan Center et al., 595 F.3d 115 (2d Cir. 2010), the employee alleged claims under federal and New York state and city laws, claiming she was retaliated against after numerous complaints of sexual harassment. The plaintiff in that matter argued that she should not be compelled to arbitrate because the arbitration clause was biased in favor of the employer.
The clause, among other things: 1) shortened the statue of limitations for bringing an arbitration demand to 90 days; 2) required attorney’s fees be awarded to the prevailing party; and 3) prevented the employee from appealing the award in court. Prior to the Court’s determination, the employer voluntarily agreed to waive the statues of limitations and fee shifting provisions in the agreement. The employer further agreed that the employee could move to vacate the award in federal court. As a result, the Ragone Court held that the agreement, as modified, was enforceable under New York law, yet cautioned that its holding may have differed if the employer had not voluntarily modified the clause.

Conclusion

Employers are well aware that employee disputes can be costly. As discussed above, one important decision employers can make to help control such costs is whether to arbitrate or litigate employment-related disputes.

It is important when drafting an arbitration clause for employers to keep in mind that a clause that effectively precludes employees from pursuing their claims will, most likely, be held unenforceable. In addition, employers that choose arbitration over litigation should be aware that, despite fee-splitting clauses in arbitration agreements, the possibility exists that the employer may be forced to pay the bulk, if not the entire amount, of the arbitration costs.

A well-drafted clause, on the other hand, still can provide employers with an effective way to handle delicate and often sensitive disputes in a confidential forum. For instance, most employers do not want employee disputes to be decided by a jury, most of whom will have empathy for the employee. In addition, sensitive and proprietary information may be at issue that the employer does not want to make known in civil court where documents are publicly filed and trials are open to the public.

Moreover, usually the employer bears the burden of producing the bulk of the documents and having to make available its employees to be deposed, processes that can be extremely disruptive to the workforce. Arbitration often limits discovery, including the number of depositions a party can take and the scope of the document production. As such, arbitration proceedings can be less intrusive and disruptive to a company’s business. Finally, there has been encouraging case law interpreting a recent U.S. Supreme Court decision, AT&T Mobility LLC v. Concepcion et al., 131 S. Ct. 1740 (2011), that appears to uphold employee class action waivers in arbitration agreements. If upheld in the employment context, the benefits to employers of such a waiver are enormous and can significantly limit potential liability in wage and hour matters and other types of class actions.

Employers should consult knowledgeable employment counsel regarding the drafting of arbitration clauses in the employment context so that their interests are fully protected.

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1 Generally, employees have 300 days to administratively file a federal discrimination claim, one year to file a New York State or City claim; and three years to commence an action in civil court alleging state or city discrimination claims.
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