AFTER THE GILMER DECISION: EFFECTIVENESS OF ARBITRATION CLAUSES IN EMPLOYMENT CONTRACTS*

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ABSTRACT
Agreements between an employer and employee often contain a provision stating that the individual parties will settle disputes through the use of arbitration. These agreements can cause difficulties later when an employee who believes the employer has not complied with the law takes a case to the courts rather than seek arbitration—and the employer asks that the court refuse to hear the matter. It had been hoped that the U.S. Supreme Court—in the celebrated Gilmer decision—would give a clear red or green light to the use of employment contracts to waive the right to a judicial forum. The high court’s signal gives a yellow light.

Written contracts between an employer and an employee can take a variety of forms. Collective bargaining agreements between a union and management are one type of contract. Rights of an individual employee are determined by the collective bargaining agreement that has been negotiated between the parties’ representatives, an agreement, which normally includes a provision for compulsory arbitration of any work-related dispute.

Other agreements occur between an individual employee and the employer. Such agreements may take place at the beginning of employment or at some time when there is a change in the relationship between the parties. Together with provisions concerning salary and benefits, such agreements often include a provision stating that the parties agree that any dispute will be settled through the use of arbitration. These agreements can cause difficulties when at a later date the

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employee, who believes that the employer has not complied with the law, takes a matter to the courts and the employer, based on the earlier employment contract, asks that the court refuse to hear the matter.

Waivers or releases are another clause found in contracts between employer and employee. Such agreements are the result of an employer's decision to offer an economic incentive to an employee who is being fired or who is being asked to leave voluntarily, often as part of an early retirement program. The economic incentives are given in exchange for the employee's agreement to waive the right to litigate any employment-related dispute. At other times, the employee's waiver occurs at the beginning of employment, for example, with the employee waiving participation in the employer's pension plan. Arbitration clauses are considered partial waivers.

THE GILMER CASE

In last year's U.S. Supreme Court decision in the Gilmer case, the highest court determined that under certain circumstances an employee may surrender the right to bring a legal action against an employer despite the fact that federal statutes may be involved [1]. The case, Gilmer v. Interstate/Johnson Lane Corp., involved an arbitration agreement contained in Robert D. Gilmer's registration with the New York Stock Exchange as a securities representative. Gilmer, a senior vice president for six and one-half years with the Charlotte, North Carolina-based brokerage, was dismissed in 1987 at the age of sixty-two and sought to file suit under the Age Discrimination in Employment Act (ADEA).

It had been anticipated that the Gilmer decision would give a clear red or green light to the use of employment contracts to waive the right to use of a judicial forum. However, the court determined 7-2 that Gilmer had signed a registration statement containing an arbitration clause rather than an employment contract [1]. A registration statement is used in the securities industry where Gilmer was employed. It is considered a contract between the securities exchange and the employee, rather than an employment contract. The court left unresolved the question of whether or not the same decision would have been made if the arbitration clause had been in an employment contract rather than in a commercial arbitration contract such as a registration statement.

This article examines the effectiveness of employment contracts written at various junctures in the employer-employee relationship as a method of limiting an employer's legal liability under federal statutes, distinguishing between group collective bargaining agreements and individual employer-employee contracts. The article analyzes recent court decisions and federal legislation, addressing the question of whether employment contracts which include provisions to arbitrate disputes involving federal statutes are enforceable, a question that has not yet been addressed by the highest court. In addition, the article explores recent amendments to the Age Discrimination in Employment Act (ADEA) that provide specific
requirements which must be met before an employee can waive rights to litigate age discrimination claims and the applicability of these amendments to partial waivers, such as an agreement to arbitrate all employment related claims [2].

**FEDERAL ARBITRATION ACT**

In 1925, Congress passed the Federal Arbitration Act (FAA) [3]. The general purpose of the FAA was to provide that agreements to arbitrate that were contained in contracts “evidencing a transaction involving commerce” would be enforceable [3]. The purpose of the law was to enforce arbitration agreements in the same manner as any other contract at a time in which the courts were holding that such agreements to waive a judicial forum were not enforceable. The FAA provides for a stay of any judicial intervention if the matter is subject to an arbitration agreement and for an order compelling arbitration if a party has failed to comply with the provisions of an arbitration agreement.

In recent years, the U.S. Supreme Court has looked at a number of commercial arbitration agreements in which federal statutory rights were involved. In each instance, the court has determined that federal statutory claims may be determined through arbitration, although in so doing the parties eliminate the availability of taking their statutory conflict to the federal courts [4-5]. Basically, the court has determined that “[b]y agreeing to arbitrate a statutory claim, a party does not forgo the substantive rights afforded by the statute; it only submits to their resolution in an arbitral rather than judicial, forum” and that by agreeing to arbitrate the party “should be held to it unless Congress itself has evinced an intention to preclude a waiver of judicial remedies for the statutory rights at issue [4].

**FEDERAL EMPLOYMENT STATUTES**

*Gilmer* involved an agreement to waive the right to the courts that was included in a registration statement Gilmer signed with the SEC as part of his employment with the securities industry. Later, Gilmer sought to bring a claim involving age discrimination before the courts. The Supreme Court determined that Gilmer had waived the availability of the courts by signing the registration statement. The court concluded that under the FAA the registration agreement bound Gilmer to the use of arbitration for a determination on his age discrimination claim.

It is in a footnote to *Gilmer* that the court raises the possibility of a different result had the agreement containing the arbitration provision been part of an agreement between Gilmer and his employer [1]. In establishing the FAA and the general caveat supporting arbitration, Congress maintained an exception to the general rule that contracts with arbitration clauses were enforceable. The exception stated that “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 [3, §1]. In *Gilmer*, the Supreme Court held that the
exclusion did not apply to Gilmer as his was a registration rather than an employment agreement, and left the question of employment contracts "for another day" [1, 111 S. Ct. at 1651].

However, the dissent in Gilmer saw the issue otherwise, finding the court "skirts the antecedent question of whether the coverage of the [Federal Arbitration Act] even extends to arbitration clauses contained in employment contracts" and that the majority's decision that the contract was with the securities exchange and not the employer was "too narrow a construction of the exclusion contained in Section 1 of the FAA" [1, 111 S. Ct. at 1659]. The legislative history of the FAA indicates that the statute "is not intended [to] be an act referring to labor disputes at all" [6]. The exclusion was made at the request of organized labor, who did not want the courts to have the power to force them to arbitrate disputes with their employers [7].

**TAFT-HARTLEY LIMITS UNIONS**

In the years after the passage of the FAA, the position of organized labor changed dramatically. A limitation was placed on the use of injunctions against labor under the Norris-LaGuardia Act. Employees were given the right to organize and the National Labor Relations Board was created to deal specifically with the relationship between unions and management under the National Labor Relations (Wagner) Act. Finally, the Taft-Hartley Act was passed, placing certain limits on the rights of unionized employees.

In the late 1950s there were a number of cases in the appellate courts which considered whether the court had the authority to enforce an arbitration clause in a collective bargaining agreement. Some courts argued that such a clause was enforceable [8]. Other courts determined that collective bargaining agreements that contained an arbitration clause could not be enforced because of the exception in the FAA, so that unions could not be required to arbitrate grievances under the FAA but could continue to use a judicial forum [9]. As pointed out in American Postal Workers Union v. U.S. Postal Services, the cases were part of a major debate over whether parties could be ordered to arbitrate their differences under the FAA or under Section 301 of the Taft-Hartley Act [7].

In Textile Workers Union v. Lincoln Mills [10], the U.S. Supreme Court determined that under Sec. 301 of the Taft-Hartley Act the courts could require the parties to arbitrate claims arising from collective bargaining agreements, and that the courts were not prohibited from making an injunction requiring the parties to go to arbitration. In doing so, the court did not evaluate whether or not such agreements were "contracts of employment" that were excluded under the FAA [10]. In his dissent in Lincoln Mills, Justice Felix Frankfurter stated [10, 353 U.S. at 466-468]:
Naturally enough, I find rejection, though not explicit, of the availability of the Federal Arbitration Act to enforce arbitration clauses in collective bargaining agreements in the silent treatment given that Act by the Court's opinion. If an Act that authorizes the federal courts to enforce arbitration provisions in contracts generally, but specifically denies authority to decree that remedy for "contracts of employment," were available, the Court would hardly spin such power out of the empty darkness of Sec. 301. I would make this rejection explicit, recognizing that when Congress passed the legislation to enable arbitration agreements to be enforced by the federal courts, it saw fit to exclude this remedy with respect to labor contracts."

The issue remains undecided in 1992. In *American Postal Workers Union v. U.S. Postal Service*, the eleventh circuit determined that collective bargaining agreements are contracts of employment within the meaning of the exclusion in FAA. Therefore, the court concluded that the FAA, in addition to excluding individual employment contracts, does not apply to some forms of collective bargaining agreements [7]. The court also observed that the exclusion may not refer to all contracts of employment. The court noted that some courts have limited the exclusion to "workers actually employed in interstate commerce" such as the transportation industry [11]. The issue did not apply to *American Postal Service*, as the court determined that postal employees were obviously involved in interstate commerce. However, the limitation on the employment contract exclusion for arbitration agreements has been examined by other courts.

Originally, the fourth circuit had determined that all contracts of employment were covered by the arbitration exclusion in FAA, so that mandatory arbitration could not be ordered [12]. However, a recent district court case from the fourth circuit determined that such a decision was no longer relevant as it was made at a time when arbitration was not favored by the legal system [13].

*Hydrick* involved an individual employment contract which contained both an arbitration clause and a restrictive covenant. The district court determined that the arbitration clause was valid under FAA, as only those employment contracts which involved interstate commerce were excepted under the FAA. Further, the court did not find that job placement and relocation (which was plaintiff's occupation) was not the transportation of goods in interstate commerce.

**COLLECTIVE AND INDIVIDUAL AGREEMENTS**

The issue of enforceability of arbitration clauses in employment contracts and whether only specific types of employment contracts are involved is only one portion of the question of enforceability of arbitration provisions. Prior to *Gilmer*, it had been questionable whether rights to court access given under employment statutes (ERISA, Title VII, ADEA) could be waived by an individual who agreed to go to arbitration before the dispute arose [14].
In Alexander v. Gardner-Denver Co. [14], the U.S. Supreme Court said that "federal courts have been assigned plenary powers to secure compliance with Title VII" and that there was nothing in the statute that indicated that use of arbitration either "forecloses an individual's right to sue or divests federal courts from jurisdiction" [15]. Alexander was followed by Barrentine v. Arkansas-Best Freight System, Inc. [16], and McDonald v. City of West Branch [17].

In Alford v. Dean Witter Reynolds, the fifth circuit originally affirmed the district court's refusal to force the parties to arbitrate a Title VII dispute, although Alford had agreed to arbitrate all disputes in the registration statement she signed with the SEC at the time she began employment at Dean Witter Reynolds. However, in Gilmer, the Supreme Court distinguished Alexander and its followers [1]. All three cases were based on the use of arbitration in labor-management disputes under collective bargaining agreements where the employees were represented by their union, which may not have the same interests as the individual. Further, in Gilmer, the court stated that in a labor arbitration, the arbitrator can resolve only questions involving contractual rights ... and does not have "general authority to invoke public laws that conflict with the bargain between the parties" [111 S. Ct. at 2050]. This differs from commercial arbitration in which the individual is asserting a statutory right in the arbitration process. These three points: 1) the difference between contractual rights under a collective-bargaining agreement and individual statutory rights; 2) the potential disparity in interests between a union and an employee; and 3) the limited authority and power of labor arbitrators, radically altered the Court's view of the enforceability of arbitration provisions. Gilmer rejected the theory that the Alexander line of cases prohibited the use of arbitration of employment discrimination cases and rejected the Alexander "mistrust of arbitral process" [1, 111 Sect. at 1656, n. 5].

Gilmer states that claims under the Age Discrimination in Employment Act "can be subjected to compulsory arbitration" [1]. Having made that decision concerning the ability to force arbitration of employment related statutory claims under ADEA, the Supreme Court vacated and remanded the fifth circuit's earlier judgment in Alford [18]. On remand, the fifth circuit concluded that in light of Gilmer, a statutory claim under Title VII could be required to go to compulsory arbitration in a commercial arbitration agreement. Alford also involves a registration statement rather than an employment contract. The fifth circuit stated, "In both this case and Gilmer, the arbitration clause was contained in the employee's contract with a securities exchange, not with the employer. Courts should be mindful of this potential issue in future cases [19].

In Alexander, the court noted that "presumably an employee may waive his cause of action under Title VII as part of a voluntary settlement" but that "mere resort to the arbitral forum to enforce contractual rights constitutes no such waiver" [14, 415 U.S. at 52]. In note 15 the court continues that "[i]n determining the effectiveness of any such waiver, a court would have to determine at the outset that an employee's consent to the settlement was voluntary and knowing" [14, 415
U.S. at 52, n. 15]. Merely submitting a claim to arbitration under a collective bargaining agreement does not constitute a binding waiver.

A waiver is more than an agreement to arbitrate. In waiving the right to bring an action under an employment discrimination statute, the employee gives up the right to bring any action. It goes beyond the question of waiver of forum. Further, there is a question as to whether an employee can waive ADEA or Title VII protections before discrimination occurs [20]. In determining whether a waiver was both knowing and voluntary, the courts have used two different standards, one based on ordinary contract standards, the other based on the totality of circumstances surrounding the waiver. The development of the knowing and voluntary standard has implications for the courts if the decision is reached that arbitration clauses in employment contracts are valid under the FAA. The courts will still have to examine whether the employee made a knowing and voluntary waiver of the right to use a judicial forum. Therefore, the standard developed by the courts and the legislature concerning total waivers is instructive.

**KNOWING AND VOLUNTARY STANDARD**

In *Lancaster v. Buerkle Buick Honda Co.*, the employee signed a termination agreement with his employer shortly after he was fired [21]. In the termination agreement, the employer agreed to pay the ex-employee $39,000 in severance pay, continue to pay the ex-employee's medical insurance premiums for the next six months, and permitted the employee to file for unemployment insurance. In exchange, the employee released the employer from any possible claims based on his firing. Later, the employee filed an action against his former employer, stating that the agreement was invalid and in violation of the Age Discrimination in Employment Act. The trial court granted summary judgment to the employer, a decision affirmed on appeal. The eighth circuit determined that in deciding whether or not the employee had made a knowing and voluntary release of statutorily protected employment rights, ordinary contract principles should be applied.

Those principles state that a party seeking to set aside a contract must establish that some type of fraud, duress, or coercion was present at the time the release was signed. In *Lancaster*, the court found that no contractual defenses could be established. The employee had the agreement for several days before signing it, had considerable input into the agreement, which was written in straightforward language, and was familiar with similar agreements because of his experience in business negotiations. The fact that the release was not supervised by the Equal Employment Opportunity Commission (EEOC) did not change the court's opinion. An unsupervised release may be permitted if the facts indicate that the employee made a knowing and voluntary waiver.
The contractual defense standard has been used by other circuits in evaluating employee waivers [22]. It is also the standard used by the Supreme Court in evaluating the partial waiver of the right to use of the courts made by Gilmer.

**TOTALITY OF CIRCUMSTANCES**

In looking at employee waivers, some circuits have determined that more-than-normal contractual standards should be met before a waiver of release is considered enforceable, concluding that a "totality of the circumstances approach" should be used [23]. The third circuit imposed certain factors to be reviewed in making a determination as to whether the release was knowing and voluntary. These factors include:

1. the clarity and specificity of the release language,
2. the employee's education and experience in business,
3. the amount of time the employee had between receipt and signing of the release,
4. employee's knowledge of the rights being waived,
5. whether the employee was encouraged to or actually received advice from an independent attorney,
6. whether the release was individually negotiated between the parties or offered on a take-it-or-leave-it basis, and
7. whether the employee received more benefits by signing the waiver than he was otherwise entitled to by contract or laws [23].

Other circuit courts of appeals have adopted the totality of circumstances approach in evaluating whether a valid waiver of statutory rights was made [24]. Two recent tenth circuit cases involving the totality of circumstances approach illustrate how the approach is employed by the courts. In *Torrez v. Public Service Co. of New Mexico, Inc.* [25], the court determined that although the release was "clear and unambiguous," it failed to specifically mention that employment discrimination claims were being waived. Torrez testified that he thought he was only waiving claims relating to the termination plan. Further, Torrez did not consult with a lawyer, and was given a choice of a "nearly certain layoff with no retirement benefits or obtaining the future retirement benefits available only if he signed the release" [25, p. 290]. Using a totality of circumstances approach, the tenth circuit found that summary judgment was inappropriate and remanded the matter to the district court.

In contrast, in *Wright v. Southwestern Bell Telephone Co.* [28], the appellate court determined that the former employee had knowingly and voluntarily released Title VII claims against his ex-employer. Wright was fired for "misconduct, poor quality of work, and refusing to do a job" [26, p. 1289]. Wright then filed discrimination charges with the state and federal employment discrimination agencies, claiming racial discrimination by his employer. Thereafter, the parties
agreed that the employer changed the reason for dismissal from misconduct to unsatisfactory service and gave Wright $13,902. Wright signed a release, releasing the employer and his union from any claims. Using the totality of circumstances criteria, the court determined that Wright had made a knowing and voluntary waiver. Wright signed the waiver after he had filed his racial discrimination complaints whereas the Torrez release applied to possible future claims including those that the parties might be unaware of at the time the waiver was signed. Therefore, in Wright, a release of “all claims” was sufficient to release pending claims but insufficient to release future claims against the employer about which neither party knew. In addition, the record indicated that Wright’s education and business experience were sufficient to understand the waiver, and that the consideration he received was greater than what he was otherwise entitled to.

DECISIVE DIFFERENCE?

It appears that Title VII of ADEA protections may not be waived before the discrimination occurs [20, citing 415 U.S. at 52]. This issue was not addressed in Gilmer where Gilmer lost the right to use the courts before he was aware of any possible legal action against the employer. However, in Gilmer the employer did not waive the statutory protection available under the ADEA. This may prove to be a decisive difference. An individual can give up statutory rights to obtain redress for past discrimination, but an individual may not waive those statutory rights prospectively. However, Gilmer indicates that an employee may partially waive a right prospectively by limiting the choice of forum.

In Laniok v. Advisory Committee, the second circuit determined that the totality of circumstances approach should be used to evaluate whether an agreement to waive rights to participate in a company pension plan was knowing and voluntary, concluding that there were material issues of fact present [20]. One question presented was whether the employee gave the waiver at the time of the pre-employment interview, agreeing to waive the pension so that he could get the hours, work conditions, and salary he was interested in, or whether he agreed to waive the pension after he began working without receiving anything of value in exchange, because of fear of losing his job if he failed to sign.

CONGRESS ENDORSES TOTALITY

In 1990, Congress resolved the question of the standard to be used in making a knowing and voluntary waiver of age discrimination claims [27]. Congress established specific statutory requirements which must be met before an employee can waive his right to litigate ADEA claims. The burden of proof for establishing such a waiver rests with the employer, who must establish that all of the requirements have been met. The statute appears to be a codification of the totality of circumstances approach used by some of the appellate courts in establishing a
knowing and voluntary waiver. The requirements include that the waiver is part of a written agreement, makes specific reference to rights or claims under ADEA, does not apply to rights or claims which may occur after the agreement had been signed, is exchanged for value that is in addition to what the employee would otherwise be entitled to receive, and that the employee is given a specific period of time to evaluate the agreement and is given the right to consult an attorney with the employer’s obligation to pay for eight hours of the employee’s attorney’s time.

Two other requirements must be met if the waiver is part of an exit incentive or group termination plan where the agreement is with a group of employees rather than between an individual employee and employer. In such instances, the employer must let affected employees know which other employees are affected, and must also let the employees know what negative consequences, if any, will occur if the employee fails to go along with the termination plan.

In examining the legislative history, it appears that legislators were concerned that employees not be forced to give up rights to litigate ADEA claims at the time of a forced retirement. However, the requirements appear to apply to all waivers, including partial waivers agreeing to arbitrate rather than use the courts to seek redress. The statute does not apply only to those waivers made at the time the employee is fired or retires. A literal reading of the statute may make it impossible for an employer and employee to agree to arbitrate any employment-related dispute, as such agreements look to issues which do not exist at the time the agreement is signed. This restriction applies only to ADEA claims and not other employment-related statute.

CONCLUSION

As indicated at the outset, a number of questions remain concerning the ability of employers and employees to enter into agreements pertaining to future employment-related disputes. It is unclear whether or not employment contracts that contain provisions in which the parties agree to settle all disputes through arbitration are enforceable under the Federal Arbitration Act. Even if the courts determine that, in general, employment contracts that include arbitration clauses are enforceable, the courts must decide whether employment contracts relating to industries involved in interstate commerce are excepted under the Federal Arbitration Act.

Until these questions are answered, employers are well-advised to proceed with caution in this area. It is important that an employer be able to establish that an employee made a knowing and voluntary waiver of any federally protected statutory rights at the time the agreement was signed. A totality of circumstances approach, rather than the contractual defense standard, would seem to provide employers with the greatest protection. In addition, the amendments to the ADEA indicate that Congress is willing to accept agreements between employers and employees, including agreements to arbitrate, if certain protections are
established. Until these questions are answered, employers are well-advised to maintain records that establish the circumstances under which the agreement between the parties was made. The U.S. Supreme Court did not give a clear signal in its decision in *Gilmer*. The Court’s decision concerning the arbitrability of federal employment claims appears to be a yellow light: Proceed with caution.

REFERENCES


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