New York Law Journal

OUTSIDE COUNSEL

Arbitration Fee-Splitting Agreement Invalidated in Employment Dispute


Kim J. Landsman

By Kim J. Landsman

July 31, 2009

The conventional wisdom is that employees asserting discrimination claims prefer to litigate in court, while employers prefer arbitration. Some employers impose arbitration agreements on employees who have little to no bargaining power, and the issue whether such agreements to arbitrate should be enforced has generated a fair amount of controversy. The Senate is considering—and many expect it to pass—a bill to be called The Arbitration Fairness Act of 2009 that would make pre-dispute mandatory arbitration clauses in employment agreements unenforceable unless provided under the terms of a collective bargaining agreement.

The American Arbitration Association (AAA) has, since November 2002, distinguished in its arbitration rules between employer-promulgated plans and individually negotiated contracts and agreements. As to the latter, the rules provide for splitting costs, subject to reallocation in the award. As to the former, employers must "pay arbitrator's compensation unless the employee agrees, post dispute, to voluntarily pay a portion of the arbitrator's compensation."[1]

In *Brady v. Williams Capital Group, L.P.*, 2009 WL 1151322 (1st Dept. April 30, 2009), the Appellate Division, First Department, faced the novel situation where a terminated employee wanted to compel arbitration pursuant to a provision of an employer-imposed plan, but invalidate its cost-splitting provision. The First Department held as a matter of contract interpretation that the cost-splitting provision trumped any AAA rules argued (though not ultimately held) to be to the contrary. It invalidated the cost-splitting part of the arbitration provision, but not the arbitration provision itself, and therefore compelled arbitration, with the employer paying.

The decision was split 3-2, with a very lengthy dissent. The employer can appeal as of right to Court of Appeals,[2] so this may not be the last New York opinion we see on the issues.

Facts

Lorraine C. Brady worked for Williams Capital as a securities salesperson from January 1999 until being fired at the end of February 2005. She initially filed a complaint for sex discrimination in the New York State Division of Human Rights and then, after about eight months, withdrew her complaint and commenced arbitration.

Early in her employment, in January 2000, Williams Capital adopted an employee manual that Ms. Brady (and all other Williams Capital employees) signed as a condition of continued employment. It required arbitration of all disputes with the costs to be split and stated that, "except as provided in this Agreement, any arbitrations shall be in accordance with the then-current Model employment Arbitration Procedures of the American Arbitration Association ('AAA')."

When the employee manual came into effect, the AAA rule applicable to costs in such an employment dispute provided that "[t]he arbitrator's compensation shall be borne equally by the parties unless they agree otherwise."[3] By the time Ms. Brady commenced the arbitration, however, the AAA rules distinguished between "Employer-Promulgated Plans" and "Individually-Negotiated Employment Agreements and Contracts." The plan at issue was imposed through Williams Capital's employment manual and was therefore determined to be the former. Pages 1-2 & n.2.

These facts implicated two AAA rules. Rule 1 of the Employment Arbitration Rules states:

The parties shall be deemed to have made these rules a part of their arbitration agreement whenever they have provided for arbitration by the [AAA] or under its Employment Arbitration Rules and Mediation Procedures or for arbitration by the AAA of an employment dispute without specifying particular rules. If a party establishes that an adverse material inconsistency exists between the arbitration agreement and these rules, the arbitrator shall apply these rules.

Rule 48(vi) provided that "The employer shall pay the arbitrator's compensation unless the employee, …post-dispute, voluntarily elects to pay a portion of the arbitrator's compensation."[4]

After the parties had engaged in significant discovery, the AAA sent the employer's lawyer an invoice for the costs of the arbitration. Williams Capital demanded that Ms. Brady pay half, as per the agreement, and she refused. Citing AAA Rule 48(vi), Ms. Brady refused to pay any portion of the costs of the arbitration. The AAA sided with Ms. Brady on the payment issue, but, when the costs remained unpaid after about five months, cancelled the arbitration and prepared to dismiss it. Ms. Brady brought an Article 78 proceeding seeking to compel Williams Capital to pay the costs or the AAA to enter default against her prior employer.[5]

Appellate Decision

Alleged Conflict Between the Contract and the AAA Rules. The trial judge as well as all five appellate judges held that the parties' agreement to split arbitration costs governed, notwithstanding the AAA's rule that the employer pay (subject to later reallocation if circumstances warranted). All judges on both the trial and appellate courts quickly disposed of the AAA's contention that its own rules trumped the parties' agreement, since the parties had agreed to the AAA rules only "except as provided in this Agreement."

Since the parties had agreed to split fees, they had not agreed to the AAA rule requiring the employer to pay. This followed from a combination of well-settled law concerning arbitration and contractual interpretation: Arbitration may not be compelled without a "'clear, unequivocal and extant agreement to arbitrate,'" and the determination of whether such an agreement exists "'is to be made by the court and not the arbitrator.'"[6]

Enforceability of Contractual Fee-Splitting Provision. The issue whether the fee-splitting provision was unenforceable as a matter of public policy was what split the Appellate Division 3-2 and where the appellate majority disagreed with the trial judge, who had ruled that "if [Brady] seeks to arbitrate her claim, she must pay her portion of the AAA fee."[7] That issue is governed by the Federal Arbitration Act, which favors arbitration but only "so long as the prospective litigant effectively may vindicate [his or her] statutory cause of action in the arbitral forum"—i.e., can afford arbitration.[8] The U.S. Supreme Court has "balanced the concerns over cost with the presumption in favor of arbitration by holding that the plaintiff ha[s] the burden of demonstrating the 'likelihood' of incurring prohibitive costs." It has declined to create any bright-line rule as to what constitutes prohibitive costs.[9]

The Second Circuit has not addressed the issue, but most of the other federal courts of appeal have followed the Fourth Circuit's approach in *Bradford v. Rockwell Semiconductor Syst. Inc.*, which

held that in the employment discrimination context the courts should engage in a case-by-case analysis focused on "the claimant's ability to pay the arbitration fees and costs, the expected cost differential between arbitration and litigation in court, and whether the cost differential is so substantial as to deter the bringing of claims."[10]

A 3-2 majority of the Appellate Division held that Ms. Brady had sustained her evidentiary burden of showing that "the risk of prohibitive arbitration cost was more than speculative." The initial half-share of $21,150 was substantial by itself and would not be all that would have to be paid. Although Ms. Brady had been highly compensated in her years of employment, she had been unemployed for 18 months and therefore not in a position to pay such amounts.[11]

The dissent argued that Ms. Brady had failed to produce any evidence that the expense of arbitration would be greater than the expense of litigating in court, nor was there adequate evidence of her inability to pay half the arbitration costs,[12] to which the majority responded that Ms. Brady could probably find a lawyer to take her case on contingency in a court action and, if successful, obtain an award of attorney's fees under the federal anti-discrimination statute. "Thus, in general, it cannot be disputed that the out-of-pocket expenses for an employee filing a legal suit are minimal."[13]

Ultimately, the Appellate Division granted Ms. Brady's requested relief "to the extent of directing Williams Capital to pay the arbitration fees, subject later to reallocation of those costs by the arbitrator."[14]

There is insufficient space to do justice to the extensive dissenting opinion, but it argued that the cost-splitting provision could not be excised without doing violence to the fundamental principle that arbitration must be voluntary. Without the cost-splitting, Williams Capital might not have agreed to arbitration at all: A court should not "fundamentally modify the terms of the agreement" and thereby "force Williams to arbitrate in a manner contrary to the agreement."[15] The two dissenting judges would have affirmed dismissal of Ms. Brady's petition.

Kim J. Landsman *is a partner at Patterson Belknap Webb & Tyler*.

Endnotes:

1. AAA Summary of Changes Employment Arbitration Rules and Mediation Procedures Amended and Effective July 1, 2006.

2. CPLR §5601(a).

3. *Brady v. Williams Capital Group, L.P.*, 17 Misc.3d 325, 844 N.Y.S.2d 584, 585 (Sup. Ct. N.Y. Co. 2007).

4. The rule currently reads: "All expenses of the arbitrator, including required travel and other expenses, and any AAA expenses, as well as the costs relating to proof and witnesses produced at the direction of the arbitrator, shall be borne by the employer."

5. 878 N.Y.S.2d at 696.

6. 878 N.Y.S.2d at 697 (quoting *Matter of Primex Intl. Corp. v. Wal-Mart Stores*, 89 N.Y.2d 594, 598 (1997)).

7. 844 N.Y.S.2d at 587. If one looks strictly at judicial head counts, therefore, each side swayed three judges, which may make further appeal all that more likely.

8. 878 N.Y.S.2d at 698 (quoting *Gilmer v. Interstate/Johnson Lane Corp.*, 500 U.S. 20, 28 (1991)) (internal quotation marks omitted).

9. *Id*. (citing *Green Tree Financial Corp-Ala. v. Randolph*, 531 U.S. 79, 92 (2000)).

10. *Id*. (quoting *Bradford v. Rockwell Semiconductor Syst. Inc.*, 238 F.3d 549, 556 (4th Cir. 2001)).

11. 878 N.Y.S.2d at 700.

12. 878 N.Y.S.2d at 703, 716 (McGuire, J., dissenting). The trial judge had concluded that "[Brady] has not proven that the fees in this case are so great that it deprives her of the opportunity to enforce her rights, if any thing, the evidence is to the contrary."

13. 878 N.Y.S.2d at 700.

14. 878 N.Y.S.2d at 701. The dissent pointed out that the costs of arbitration arising out of employer-promulgated plans is subject to reallocation only "upon a determination that a claim or counterclaim was filed for purposes of harassment or is patently frivolous." 878 N.Y.S.2d at 703.

15. 878 N.Y.S.2d at 705.