

# CLIENT ALERT

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## Employment & Labor

### Supreme Court: The FAA Covers Most Employment Agreements

In a significant opinion issued last month, the United States Supreme Court held in *Circuit City Stores, Inc. v. Adams* that the Federal Arbitration Act (“FAA”) broadly covers employment contracts — except for transportation workers — and that the enforceability of arbitration clauses contained in employment contracts is to be determined under the standards of the FAA, rather than state law. In addition, the Court also endorsed the use of mandatory arbitration clauses by employers and, once again, the arbitration of statutory employment-related claims. The *Adams* decision represents an important victory to employers that wish to arbitrate those disputes which may arise with their employees.

#### The Facts of *Adams*

By way of background, in 1995, Adams signed an employment application with Circuit City requiring him to submit all employment-related “claims, disputes or controversies” to arbitration. After Adams resigned from Circuit City in 1996, he claimed that his co-workers had harassed him due to his sexual orientation and made a claim in California state court under California’s Fair Employment and Housing Act (“FEHA”) — a state anti-discrimination statute. Circuit City responded by filing an action in

federal court under the FAA seeking to enjoin Adams’ prosecution of his FEHA claim in state court. In response to Circuit City’s request, the federal district court issued the injunction — thereby stopping the state action from proceeding — and ordered the parties to proceed to arbitration. The Ninth Circuit Court of Appeals, however, disagreed with the district court and ruled that Adams was not required to go to arbitration because the FAA did not apply to employment contracts.

As in its earlier pro-arbitration decisions, the Supreme Court relied in *Adams* on the various policy rationales favoring arbitration, notably that it provides a cheaper and faster means of dispute resolution. The majority decision, which was written by Justice Kennedy and joined by Justices Rehnquist, O’Connor, Scalia and Thomas, holds that the FAA applies to all employment contracts with the narrow exception “seaman, railroad employees, or any other class of workers engaged in foreign or interstate commerce,” *i.e.*, only transportation workers. The dissenters — Justices Stevens, Souter, Ginsburg and Breyer — found that the above language reflected a Congressional intent to exclude *all* employment contracts from the FAA.

Whether or not the employment exception was intended to cover all employment contracts or just those involving transportation workers was in fact the specific legal dispute

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before the Supreme Court. All of the Courts of Appeal that had previously ruled on the issue — except for the Ninth Circuit — found that the FAA was intended to cover all employment contracts with a narrow exception for transportation workers. The Ninth Circuit's disagreement in the *Adams* case with the other Circuits caused the Supreme Court to review the Ninth Circuit's opinion.

In finding that the Congress had intended the FAA to cover almost all employment contracts, the majority used canons of statutory construction to find the exception to be narrow. The majority focused on the actual statutory language, finding that it encompassed a defined set of workers — transportation workers — rather than all workers. In contrast, the dissenters relied on the legislative history of the exception which indicated that Commerce Secretary Herbert Hoover — the drafter of the exception — intended it to be broadly construed and had advised Congress of that intent.

### **The Case's Significance**

Since all of the Circuit Courts — except the Ninth — had agreed with the majority opinion, *Adams* preserves the *status quo* in most jurisdictions. The practical effect of the *Adams* decision is that the enforceability of arbitration clauses in employment agreement is to be determined by a uniform federal standard, rather than the numerous state law standards throughout the country. Since the Supreme Court has issued a series of pro-

arbitration decisions, the ability of state legislatures and courts to limit the enforceability of arbitration clauses in employment contracts has been all but eliminated because in order for a state court to find such an arbitration clause to be unenforceable, the clause must violate the FAA. The Supreme Court's pro-arbitration policy is now plainly mandatory on the states in the context of employment contracts. Consequently, due to the Supremacy Clause, state efforts to limit the enforceability of arbitration clauses often will conflict with the FAA and hence be preempted by federal law.

Had, however, the dissenters prevailed, the enforceability of arbitration clauses in employment contracts would be solely a matter of state law. In a number of jurisdictions — California and New Jersey, for example — there has been judicial and legislative hostility to arbitration in the employer-employee context. *Adams* will force those jurisdictions to rely on the FAA rather than their own policies. Had the dissenters prevailed, there would be no federal constraints preventing those states from invalidating any and all arbitration clauses in employment contracts.

The *Adams* decision does not mean that all arbitration clauses will be found to be enforceable. There are many issues that remain unclear under the FAA and, consequently, employers should avoid one-sided or onerous arbitration clauses. Arbitration agreements that do

not provide the employee the same rights and remedies that she or he would have in a court may not be enforceable under the FAA. Moreover, arbitration clauses that purport to limit the employee's substantive remedies impose unequal benefits or burdens on them or require them to absorb substantial arbitration costs may be poor strategic choices, may be perceived as unfair and may jeopardize an otherwise enforceable agreement.

### **Conclusion**

According to the General Accounting Office, almost one-fifth of the workforce is now covered by arbitration agreements. The *Adams* decision finds that the enforceability of these agreements was intended by Congress to be a matter of federal concern. Given the time and money saved by arbitration of employment disputes, the *Adams* decision provides the employer wishing to implement an arbitration program with its employees the assurance that properly drafted arbitration clauses will be enforced.

*We send these Alerts to our clients and friends to provide information on recent developments in the law. The Alerts, however, should not be relied on for legal advice in any particular matter. If you would like additional information, please contact David W. Garland or Lester Aron, Co-Chairs of the Firm's Employment and Labor Department.*

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