Arbitration of Employment Claims: Challenges and Limits on Enforceability in Texas

BY KARL G. NELSON & BENJAMIN D. WILLIAMS

Arbitration of work-related disputes has long been a staple of traditional unionized workplaces. Outside of the collective bargaining realm, however, the jurisprudence surrounding pre-dispute agreements to arbitrate employment claims is more recent and still evolving. Yet, even while the law controlling such agreements continues to develop, employers are increasingly implementing private, contractual processes to adjudicate employee disputes.

Just over a decade ago, the Texas Supreme Court in In re Halliburton Company reaffirmed that both Texas and federal law favor pre-dispute employment arbitration agreements. In doing so, the Court clarified the principles governing enforceability of those agreements. The court also articulated the standards by which Texas courts will invalidate employment arbitration clauses based on illusoriness or unconscionability.

The U.S. Supreme Court has recently reinforced Halliburton’s general principles in two landmark cases. Although those decisions arose in commercial, rather than employment, contexts, their reach undeniably extends to employment-related arbitration agreements as well. At the same time, a growing line of lower-court decisions in Texas continues to buttress the validity of employment arbitration agreements generally.

Given that both Texas and federal law favor arbitration of employment claims, the grounds on which to challenge a properly structured agreement in Texas can be narrow. Nevertheless, a few arguments—principally drawing on the unconscionability and illusoriness principles Halliburton addressed—have found some success in Texas courts.

A. Halliburton Sets the Stage
In Halliburton, the employer adopted a dispute-resolution program with binding arbitration as the exclusive final step for resolving employment disputes. The employer’s notice informed employees that accepting continued employment would constitute acquiescence to the new program. James Myers, an at-will employee who continued to work after the new program’s effective date, filed a lawsuit after the company demoted him, and Halliburton sought to compel arbitration of his claim.

Myers raised a host of anti-arbitration defenses, including that the arbitration agreement was illusory, and that it was both procedurally and substantively unconscionable. The Texas Supreme Court rejected those arguments, holding that the trial court should have compelled arbitration.

In the decade since that decision, Texas’s lower courts have followed and refined Halliburton’s controlling standards.

B. Unconscionability and Arbitration Agreements
In Halliburton’s wake, the most frequent challenges to employment arbitration agreements have invoked theories of unconscionability, which can be divided generally into two categories: procedural unconscionability and substantive unconscionability.

1. Procedural Unconscionability
Procedural unconscionability refers to the conditions surrounding the adoption of an arbitration provision itself. While Texas courts have considered a variety of inventive arguments in this regard, plaintiffs continue to face considerable headwinds: “The only cases under Texas law in which an agreement was found procedurally unconscionable involve situations in which one of the parties appears to have been incapable of understanding the agreement.” Despite such broad pronouncements claimants have had some success invalidating an agreement where they can show that they were misled or not adequately informed of the arbitration obligation.

For example, in Delfingen US-Texas, L.P. v. Valenzuela, the employee-plaintiff was unable to read English. The employer gave a presentation in Spanish concerning various company policies but later asked the plaintiff to sign an arbitration agreement written in English. The employee alleged that the company never explained the agreement’s provisions to her, even though its representative had promised to do so. After finding that the employee willingly signed the agreement,
the court noted that standing alone, illiteracy in English is insufficient to render an arbitration agreement procedurally unconscionable. But the court nevertheless declined to enforce the agreement, finding that the company misled the plaintiff by failing to explain the important provision as promised.11

An agreement might be procedurally unconscionable if the employer illegally coerces the employee to sign or if the employee signs under duress. In Texas, however, claims of duress have generally failed where the agreement to arbitrate is made a condition to continued employment. In In re Frank Motor Company, an at-will employee claimed a jury-waiver was unconscionable because the employer threatened to terminate him if he refused to sign the agreement. The court, in rejecting the employee's duress claim, held that an employer's threat to exercise its legal right to terminate an employee “cannot amount to coercion that invalidates a contract.”12

Parties have also challenged as procedurally unconscionable arbitration provisions for which the employer provided insufficient notice of the arbitration obligation. In Okocha v. Hospital Corporation of America, the employer sought to enforce an amended arbitration agreement over an employee's testimony that he had never received it. The employer claimed that it had distributed notice by e-mail. The court noted that for an e-mail to supply sufficient notice, it must state explicitly that arbitration is mandatory and that continued employment is conditioned on acceptance of the agreement. The employer also must be able to demonstrate that the employee received the e-mail. The e-mail in Okocha was inadequate because it did “not notify an employee that his decision to continue employment will constitute legal acceptance of a mandatory arbitration process.”13 The court held that postings in employee common areas were likewise insufficient to demonstrate notice absent proof that the employee had seen and accepted the notice. Finally, the court held that including notice with the employee's paycheck, providing voluntary information sessions on the new policy, and posting an update on the company's internal website were all insufficient to demonstrate notice under the particular facts because the evidence failed to show that the employee specifically received notice through those means.14

2. Substantive Unconscionability

Whereas procedural unconscionability focuses on the circumstances giving rise to an agreement, substantive unconscionability “refers to the fairness of the arbitration provision itself.”15 Arbitration agreements can be substantively unconscionable, for example, where “the terms of the agreement are themselves legally impermissible.”16 Plaintiffs frequently assert substantive unconscionability where the employer's arbitration agreement allegedly limits procedural or substantive rights to the point that the agreement could be considered one-sided and unfair.17

a. Temporal Restrictions as Substantively Unconscionable

Where an arbitration agreement shortens the time to bring claims to such an extent that it impedes an employee's ability to assert his or her rights, the agreement may be vulnerable to judicial invalidation. In Long v. BDP International, Inc., the plaintiff challenged an agreement that subjected all claims, including those brought under the Fair Labor Standards Act (FLSA), to a one-year limitation period. The court held that although FLSA claims can be arbitrable, the employer's imposition of a shortened time limit for bringing those claims was unconscionable. By providing only a one-year limitation period, the agreement ran counter to the remedial and humanitarian purposes undergirding the FLSA, which require liberal application and full enforcement. The court, however, did not invalidate the whole agreement, but merely severed the limitations provision.

Similarly, in Mazurkiewicz v. Clayton Homes, Inc., the court held invalid a provision limiting the period for bringing ADA and FLSA claims. There, the agreement required that such claims be asserted within six months. The court noted that a contract might validly shorten the time for bringing an action to less than that prescribed by statute, but such a limitation is invalid if it effectively eliminates the substantive right to recovery or otherwise completely bars relief. As to the ADA claim, the court held the contractual period effectively barred plaintiff from suing. Because the EEOC may take up to six months to perform its own investigation, a six-month limitation for all ADA claims could conflict with the EEOC's statutory pre-suit investigation and conciliation obligations. The FLSA limitation was likewise unconscionable because it drastically curbed the damages the plaintiff might be entitled to under a continuing-violation theory. Enforcing the arbitration agreement's limitation period

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could therefore effectively “do away with the congressional determination that employers who willfully violate the statute should be subject to greater liability than those whose violations are inadvertent.” 27

b. Challenges to Restrictions on Substantive Rights of Recovery
Parties have also challenged arbitration agreements as unconscionable where they limit the recovery that would be available in a judicial forum. For example, in Venture Cotton Cooperative v. Freeman, 28 the plaintiff argued an arbitration agreement was substantively unconscionable because it capped the amount of attorney’s fees, consequential damages, and punitive damages a party could recover. The agreement, was therefore unconscionable because it markedly limited a party’s rights. The court also held unconscionable a provision allowing one side to collect attorney’s fees if successful at arbitration, but preventing the other side from doing the same. 29

Similarly, in Pickens v. ITT Educational Services, Inc., 30 the court took issue with an arbitration agreement that limited recovery to actual damages for certain statutory claims. While an arbitration clause that restricts available remedies is not necessarily improper, the court noted that, where parties agree to arbitrate a statutory claim, “a party does not forgo the substantive rights afforded by the statute; it only submits their resolution in an arbitral, rather than a judicial, forum.” 31 Because the clause at issue in Pickens was not part of the arbitration provision itself, however, the court noted the clause was likely severable and the arbitration agreement was therefore otherwise valid. 32

c. Challenges to Procedural Limitations: the D.R. Horton Dichotomy
Plaintiffs have also challenged as unconscionable those arbitration agreements that limit a party’s procedural rights—for example, where an arbitration agreement prohibits employees from bringing class or collective claims against the employer. A growing dissonance has emerged between the National Labor Relations Board (NLRB) and the judiciary over whether arbitration agreements affecting employees covered under the National Labor Relations Act (NLRA) can limit those employees’ class-action rights. In In re D.R. Horton, Inc. and Michael Cuda, 33 the Board found that an employer violated Section 8(a)(1) of the NLRA when it required NLRA-covered employees to sign a mandatory arbitration agreement that prohibited them from filing joint, class, or collective claims in any forum. 34 The Board determined that by preventing collective claims for employment-related disputes, the employer interfered with employees’ rights under NLRA Section 7 to engage in “concerted activities for the purpose of . . . mutual aid or protection.” 35 A series of subsequent NLRB decisions have reached a similar result, noting that D.R. Horton is “controlling Board law.” 36 As of this writing, the NLRB’s D.R. Horton decision is on appeal before the U.S. Fifth Circuit Court of Appeals. 37

Perhaps foreshadowing the prospects for the NLRB’s D.R. Horton decision before the Fifth Circuit, courts have generally tended to disagree with the Board’s position and upheld employment arbitration agreements containing class-action waivers. The Supreme Court’s holding in Italian Colors—that arbitration agreements under the Federal Arbitration Act may not be invalidated simply because they expressly exclude class-wide arbitration of a federal claim—seems to weaken the NLRB’s position. 38 Indeed, the U.S. Courts of Appeal for the Second, Eighth, and Ninth Circuits have said as much. 39

The District Court for the Southern District of Texas came to a similar conclusion in Mazurkiewicz. 40 The employment agreement there barred the employee from taking part in class action litigation against the employer. Recognizing that courts enforce arbitration clauses that expressly contain waivers of collective actions, the court held that a “contractual waiver on [the employee’s] ability to serve as a representative party for others similarly situated [did] not affect his substantive rights and [was] thus enforceable.” 41 The court therefore enforced the employment agreement’s class-action waiver provision and dismissed the plaintiff’s collective action allegations. 42

The U.S. District Court for the Northern District of Texas has taken a slightly different approach. In Jones v. JGC Dallas LLC, 43 the court distinguished the NLRB ruling, holding that it applied only where an employment agreement restricted access to collective action in any forum. Because the Jones agreement’s provisions waived class or collective action only with respect to claims brought in a judicial forum, the court found the limitation on class relief was permissible. 44

d. Challenges Based on Expenses Associated with Arbitration
Another line of substantive unconscionability challenges concerns shifting arbitration-related expenses to employees.
Like most unconscionability contests, those based on allocation of expenses are fact-dependent, with courts frequently applying some form of reasonableness analysis to determine whether expenses are excessive or unfair.

In Sharpe v. AmeriPlan Corporation, the court invalidated a provision that required, as a condition to filing a claim, that each party deposit $25,000 into an escrow account. The agreement also required all parties to bear their own arbitration-related expenses. The court reiterated the maxim that a party asserting an unconscionable financial burden must demonstrate it is likely to incur those costs, but it noted that an arbitration agreement that denies an employee access to a judicial forum, while at the same time making the arbitral forum prohibitively expensive, puts an employee “between the proverbial rock and a hard place.” The court found that the financial requirements under the agreement would represent a “significant financial burden” for many individuals, and the $25,000 fee in particular was a “roadblock standing between each Plaintiff and the arbitral forum . . . .”

By contrast, in Long, the plaintiffs argued that an employee handbook provision was unconscionable because it required employees to bear certain arbitration costs that might be greater than those they would otherwise incur in federal court. But the plaintiffs could not meet their burden to show that they were likely to incur those prohibitively high costs. Under the arbitration agreement, which was governed by the American Arbitration Association’s Model Employment Arbitration Procedure, plaintiffs were obligated to pay only a $175 filing fee, and the employer would bear all other costs. The court found such an arrangement not unconscionable. Where, between the facts in Sharpe and those in Long, cost-shifting provisions will become unconscionable remains unclear. But some courts outside Texas have suggested that the dividing line may be closer to the latter than the former.

C. Illusoriness and Arbitration Agreements

Another basis on which parties attack arbitration agreements is illusoriness. Under Texas law, an agreement is illusory “when it fails to bind the promisor, who retains the option of discontinuing performance.” An arbitration agreement may be illusory where the employer enjoys the unilateral power to alter or terminate the agreement, or where the employer alone can avoid the arbitration’s result.

In Carey v. 24 Hour Fitness, the plaintiff-employee challenged the validity of an arbitration agreement, arguing his employer had retained the unilateral right to amend it—including the ability to retroactively modify its provisions. The agreement gave the employer the “right to revise, delete, and add to the employee handbook,” including the arbitration agreement, subject to providing employees with notice of any changes. The court affirmed that the touchstone for illusoriness is whether “one party can escape its obligations under the agreement.” Because the employer in Carey could retroactively change its policy, the notice provisions were not enough to overcome illusoriness.

In Aviles v. Russell Stover Candies, Inc., an employee similarly challenged an arbitration agreement as illusory because the employer retained the right to amend or terminate the agreement. But that right was qualified by a guarantee that modification “would not reduce any Plan benefit then due a Participant . . . on account of [events] that occurred before the amendment or termination.” The court held this clause sufficiently prohibited retroactive amendment, defeating plaintiff’s claims of illusoriness. The court also noted that even if the agreement could be modified retroactively, a provision requiring the parties’ mutual consent weighed against illusoriness.

The Southern District of Texas further clarified Carey’s holding in Gonzales v. Brand Energy & Infrastructure Services. There, the challenged arbitration agreement granted the employer the right to “amend or modify the [agreement] as needed,” but guaranteed that “no amendment shall apply to a dispute of which [the employer] had notice of intent to arbitrate on the date of the amendment.” The agreement also allowed the employer to terminate the arbitration agreement, but the termination would not apply to disputes that had arisen before the date of termination. The court held these guarantees were sufficient to prevent illusoriness because they cabined the employer’s right to avoid arbitration retroactively. The court rejected the plaintiff’s argument that the employer’s ability to amend an agreement “for potential disputes that have not been instigated” rendered the agreement illusory.

The Fourth Court of Appeals in San Antonio went a step further in Nabors Drilling USA, LP v. Pena. There, as in Gonzales, the employer retained the right to amend or terminate the arbitration agreement. But unlike the agreement in Gonzales, the Pena agreement barred the employer from retroactively avoiding arbitration only for those disputes for which arbitration had been formally initiated. The employer was still free to terminate or amend the arbitration agreement as to claims the employer had knowledge of, as long as it acted before the “initiation of arbitration.” The court held this was sufficient to shield the agreement from illusoriness,
rejecting a California court's finding that, under Texas law, a similar arbitration agreement was illusory.\textsuperscript{65}

\textbf{D. Arguments of Invalidity Under Statute}

Parties also occasionally seek to invalidate arbitration agreements where arbitration is arguably inconsistent with a specific statute's enforcement scheme. Where the statute is silent on alternative dispute resolution methods, such arguments fare poorly in Texas courts, provided the arbitration agreement does not unfairly curtail a claimant's substantive rights under the relevant statute.\textsuperscript{66} Rather, as Concepcion and \textit{Italian Colors} reinforce, the preemptive effect of the Federal Arbitration Act and well-established policy favoring contractual dispute resolution arrangements have generally prevailed over arguments that statutorily granted causes of action cannot be resolved privately.

Where a party argues that federal law expressly precludes arbitration, Texas courts have taken a narrow approach. In \textit{James v. Conceptus, Inc.}\textsuperscript{67} for example, the plaintiff alleged his employer had improperly terminated him in violation of the False Claims Act after he raised concerns about potential Medicaid fraud within the company. The employer moved to compel arbitration under its employment agreement with the plaintiff, but the plaintiff argued that Dodd-Frank's whistleblower protections rendered the agreement unenforceable. The court disagreed, holding that Dodd-Frank's anti-arbitration provisions did not extend to the False Claim Act's anti-retaliation provisions.\textsuperscript{68}

The court in \textit{In re ReadyOne Industries, Inc.}\textsuperscript{69} reached a similar result. After the employee sued her employer for work-related injuries, the employer moved to compel arbitration under the parties' arbitration agreement. The plaintiff opposed arbitration, arguing that the Franken Amendment prevented enforcement of arbitration agreements related to tort claims "arising out of negligent hiring, supervision, or retention." The court disagreed. Applying traditional statutory interpretation rules, the court concluded the Franken Amendment applied only to claims arising out of sexual assault or harassment, and not to plaintiff's personal injury. Thus, the plaintiff could not rely on the Amendment to invalidate her arbitration obligation.

\textbf{E. Conclusion}

Deciding whether to adopt a pre-dispute agreement to arbitrate employment-related claims requires careful consideration, and to be sure, such agreements may not be desirable in every employment setting. But the developing law in Texas continues to favor the enforceability of such agreements. If the agreement is carefully fashioned to avoid the most common pitfalls, employers can be increasingly confident that, should an employment dispute arise, it will be resolved outside the traditional judicial system.

Karl G. Nelson is a partner in the Dallas office of Gibson, Dunn & Crutcher. His practice focuses on complex litigation and arbitration involving labor and employment disputes. Mr. Nelson is a graduate of Duke University Law School.

Benjamin D. Williams is an associate in the Dallas office of Gibson, Dunn & Crutcher. His practice focuses on labor and employment and complex litigation matters. Mr. Williams is a graduate of Southern Methodist University Dedman School of Law.

\begin{thebibliography}{9}
\bibitem{1} In re Halliburton Co., 80 S.W.3d 566 (Tex. 2002).
\bibitem{2} Id. at 568–70.
\bibitem{3} Id. at 571–72.
\bibitem{4} See Am. Express Co. v. \textit{Italian Colors Rest.}, 133 S. Ct. 2304 (2013);
\bibitem{5} AT&T Mobility LLC \textit{v. Concepcion}, 131 S. Ct. 1740 (2011).
\bibitem{6} 80 S.W.3d at 568.
\bibitem{7} Id. at 569–73.
\bibitem{8} Id. at 571.
\bibitem{9} Long \textit{v. BDP Int'l, Inc.}, 919 F. Supp. 2d 832, 845 (S.D. Tex. 2013) (internal quotation omitted).
\bibitem{10} 407 S.W.3d 791 (Tex. App.—El Paso 2013, no pet.).
\bibitem{11} Id. at 801 ("illiteracy is not a defense to enforcement of a contract and will not relieve a party of the consequences of the contract.").
\bibitem{12} Id. at 801–03.
\bibitem{13} 361 S.W.3d 628 (Tex. 2012).
\bibitem{14} Id. at 632.
\bibitem{15} To establish effective notice, an employer must show that it unequivocally notified the employee of definite changes in employment terms and prove that the employee accepted those terms. \textit{In re Halliburton Co.}, 80 S.W.3d at 568.
\bibitem{17} Id. at *4.
\bibitem{19} Halliburton, 80 S.W.3d at 571.
\bibitem{20} Long, 919 F. Supp. 2d at 845.
\end{thebibliography}
The FLSA allows “plaintiffs to recover damages for pay periods as far back as the statute of limitations will reach.” Id. at *7 (internal quotation omitted). Although there is a two-year statute of limitations for inadvertent violations of FLSA, the statute mandates a three-year limitations period for willful violations. Id. at *7–8. The employment agreement’s limitation, then, artificially decreased the recovery a plaintiff was potentially entitled to, and supplanted the distinction between inadvertent and willful violators, rendering the limitations provision unconscionable. Id.

The court noted that the arbitrator would decide whether to sever the remedies-limiting provision.

The Ninth Circuit recently affirmed a finding of unconscionability in Chavarria v. Ralphs Grocery Co., --- F.3d ---, 2013 WL 5779332 (9th Cir. Oct. 28, 2013). Among other deficiencies, the court upheld the district court’s finding that the policy’s arbitrator-fee-apportionment provision would effectively price employees out of the dispute resolution process. Id. at *6–7.

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See, e.g., Mendivil v. Zanios Foods, Inc., 357 S.W.3d 827, 832 (Tex. App.—El Paso 2012, no pet.) (invalidating arbitration agreement where the “employer] never expressly agreed to arbitrate its disputes with [the employee] nor to be bound by the result of such arbitration”); Carey v. 24 Hour Fitness, USA, Inc., 669 F.3d 202, 205 (5th Cir. 2012). (“Put differently, where one party to an
arbitration agreement seeks to invoke arbitration to settle a dispute, if the other party can suddenly change the terms of the agreement to avoid arbitration, then the agreement was illusory from the outset.

54 669 F.3d 202 (5th Cir. 2012).
55 Id. at 206.
56 Id. at 209.
57 Id. at 207–08.
59 Id. at *5.
61 Id. at *3.
62 Id.
64 Id. at 107. In so holding, the court observed, “Since Haliburton, the Supreme Court has consistently held that when an arbitration agreement contains a savings clause that makes any amendment or termination operate prospectively only, it is not an illusory agreement.”
65 Id. at 109.
66 See Section B, supra.
68 Id. at 1029 (“Dodd–Frank’s antiarbitration amendments to other statutes cannot be extended by implication to the antiretaliation provisions of the False Claims Act, especially when Dodd–Frank amended other parts of the False Claims Act but not the provision at issue.”); see also Holmes v. Air Liquide USA, LLC, 498 F. App’x 405, 406–07 (5th Cir. 2012) (holding that Dodd–Frank prohibitions on arbitration agreements were irrelevant where no actual Dodd–Frank claim was brought).