Insights, News & Events

TWO AND A HALF LAWSUITS: LESSONS LEARNED FROM THE CHARLIE SHEEN LITIGATION

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The recent termination of Charlie Sheen from "Two and a Half Men," and the swirl of negative publicity around the incident, has shed light on the use of arbitration agreements. After he was fired, Sheen filed a $100 million lawsuit against Warner Bros. He wants the proceedings held in front of a jury rather than being privately adjudicated by an arbitrator as outlined in his Warner Bros. contract.

IN AND OUT OF COURT

Sheen's lawyers filed an emergency restraining order in March to avoid arbitration proceedings initiated by Warner Bros. The court denied Sheen's request. That's one lawsuit. The actor then filed another action to avoid arbitration which was first heard by the Los Angeles Superior Court on April 20, but the court ordered further briefing. That's two lawsuits. The dispute resolution company JAMS appointed an arbitrator in late March to adjudicate the dispute.

Following a lengthy briefing process, on June 15 the court ruled against Sheen. The court ordered that the dispute related to his employment agreement must proceed in arbitration as outlined in that agreement. The agreement spells out that any controversy or claim related to Sheen's employment agreement – including the issue of what matters should be arbitrated – were to be decided by the arbitrator. That's not a lawsuit at all, so we'll call that one the one-half.

The ruling in favor of Warner Bros. is significant for employers in at least two ways. First, it illustrates the significance of arbitration agreements in employment disputes.

The actor and his attorneys would not be trying to avoid arbitration if they thought it was advantageous to their case. Second, this case reminds employers of how critical it is to prepare a well-written arbitration agreement.

Employees are increasingly litigious, so many employers favor arbitration for a variety of reasons. Unfortunately, crafting an enforceable arbitration agreement is a complex exercise. Requirements vary from state to state and it can be easy for employers to find themselves in a situation where an employee, looking to place a wrongful termination or unlawful harassment claim before a jury, challenges the previously-executed arbitration agreement. It is essential to regularly review the details of your arbitration agreement to ensure it's enforceable.

WHAT THE COURTS SAY

There has been significant activity recently in the courts in the area of arbitration in employment both at the federal and state level. The Federal Arbitration Act (FAA) provides that:

> **[a] written provision in any . . . contract evidencing a transaction involving commerce to settle by arbitration a controversy thereafter arising out of such contract . . . shall be valid, irrevocable, and enforceable save upon such grounds as exist at law or in equity for the revocation of any contract.**

Courts broadly interpret the term "involving commerce," so that the FAA governs any arbitration agreement affecting commerce in any way. In addition, the FAA creates a presumption favoring arbitration and requires the enforcement of written arbitration agreements. And the U.S. Supreme Court has consistently made clear that the FAA mandates enforcement of arbitration agreements in employment cases. In one case, the high court reaffirmed the enforceability of arbitration agreements covering employment-related claims by stating: "[t]he Court has been quite specific in holding that arbitration agreements can be enforced under the FAA without contravening the policies of congressional enactments giving employees specific protection against discrimination prohibited by federal law . . . ." The Court further emphasized that:"[w]e have been clear in rejecting the supposition that the advantages of the arbitration process somehow disappear when transferred to the employment context."

THE PUSHBACK

Despite court rulings, challenges to employment-related arbitration agreements, and specifically, whether state law should be preempted by the FAA, continue. One such issue – whether the FAA prohibits states from conditioning the enforceability of certain arbitration agreements on the availability of class-wide arbitration procedures – was recently decided in favor of Arbitrability. This decision indicates that employers may want to consider including a class action waiver in their arbitration agreements. Implementing such a waiver may have important implications, so it's important that you consult with legal counsel before doing so.

Arbitration agreements are also subject to the same defenses available to the enforcement of any other contract. Common challenges to the enforceability of arbitration agreements include arguments that: 1) the agreement is a procedurally unconscionable contract of adhesion, because the employer has far superior bargaining power *vis a vis* the employee; 2) the agreement is substantively unconscionable, because the agreement lacks mutuality, or binds only the employee and not the employer; 3) the employee failed to understand the agreement or there was no agreement because it was not conspicuous; or 4) employee's signature on the agreement was not voluntary, but obtained under fraud, coercion or duress. All these can be addressed in a carefully drafted agreement.

THE BENEFITS V. THE DOWNSIDES

The predictability of arbitration is one of the benefits for employers. Hearings and trial dates can be agreed upon quickly and discovery disputes and legal maneuvers are commonly streamlined because arbitrators often agree to hear issues without protracted briefing and on shorter timetables. An added benefit of arbitration is it's less expensive than litigating in court.

It's almost always a jury that is the fact finder in court, but a neutral arbitrator is charged with the task of deciding the facts in arbitration. Employment cases are highly unpredictable when they go to a jury. All jurors have biases and are more likely to be employees that have disagreed with their employers than employers who have had to manage problem employees. They are more likely to empathize with an employee-plaintiff than management-side witnesses. They are more likely to take a negative view of a "big corporation" private employer. Jurors are also more likely to forgive or minimize an ex-employee's misconduct because it may be similar to their own. Finally, because arbitration is private and not public, an adverse outcome is less likely to attract media attention.

Arbitration has its downsides. Generally there is no right to appeal an arbitration decision. So if the arbitration decision is adverse, the employer is stuck with it. In addition, some arbitrators may be less likely than a court to toss out a case based on

a motion to dismiss or a motion for summary judgment. The arbitrator forfeits significant arbitration fees with an early disposition and that could have some bearing on this reluctance.

Further, in some states, the employer must pay the entire arbitration fees, which are not generally imposed by the courts. In these states, employees' lawyers may take advantage of the employer by involving the arbitrator in every pre-arbitration dispute no matter how small, which increases the company's cost. Finally, especially in cases with low settlement value, lawyers may use potential arbitrator fees as leverage to inflate the settlement value of their otherwise weak claims.

BEST PRACTICES FOR IMPLEMENTING AND ENFORCING ARBITRATION AGREEMENTS

What are some best practices for avoiding the common pitfalls when drafting and implementing arbitration agreements? The following guidelines will help you avoid these common pitfalls:

1. DON'T LIMIT REMEDIES

Any provision limiting damages could be considered one-sided and gives an employee a chance to invalidate the agreement claiming it is "unconscionable." Make sure all remedies available in court are also available through arbitration.

2. DON'T REQUIRE EMPLOYEES TO PAY COSTS UNIQUE TO ARBITRATION

Some states – like California, where Charlie Sheen's agreement was drafted – mandate that employers cannot require employees to bear any expense that they would not otherwise be required to bear had they elected to bring the action in court. As a result, for those states where the employer must bear the costs of arbitration, the agreement should not require the employee to pay for costs that are unique to arbitration, such as arbitration forum costs.

Because arbitrators are private judges, they generally charge an hourly or daily fee in addition to administrative costs that are not levied if the matter is handled in court. These fees, unique to arbitration, must be paid by the employer in certain states. The rationale behind this rule is that requiring employees with less funds and less bargaining power to incur costs they would not otherwise have to incur to enforce their rights constitutes an unfair burden.

Stated differently, requiring an employee to pay for arbitration is generally contrary to public policy, which disfavors creating barriers for employees to assert their

rights. Be sure to work with legal counsel that specializes in your state's specific arbitration agreement guidelines.

3. MAKE SURE THE ARBITRATOR IS NEUTRAL

Using only neutral arbitrators in contractual arbitration is essential. Whether an arbitrator is selected or appointed, maintaining impartiality during all stages of the arbitration is imperative to upholding the integrity and fairness of the process and helps ensure a valid and secure arbitration agreement.

4. REQUIRE A WRITTEN ARBITRATION AWARD

The rules of the American Arbitration Association state that, for employment cases, there should be a written award unless the parties agree otherwise. A written award will show that the arbitrator's decision is well-reasoned and justified and will go a long way towards preventing an employee from invalidating the decision in the event of a post-award challenge.

5. PROVIDE FOR ADEQUATE DISCOVERY

The denial of adequate discovery may violate an employee's rights and may disadvantage an employer in preparing for arbitration. Both parties should be entitled to discovery, such as requests for necessary documents, land inspections and subpoenas. A lack of specific discovery procedures in an arbitration agreement may not necessarily be fatal but the agreement should contain specific provisions providing for adequate discovery and investigation, such as depositions.

6. KNOW WHICH ITEMS CANNOT BE ARBITRATED

Certain matters, such as workers' compensation and National Labor Relations Board disputes, cannot be compelled to arbitration by way of a pre-dispute employment arbitration agreement. Knowing what to exclude will make the agreement more enforceable.

7. MAKE SURE THE AGREEMENT IS CLEAR, CONSPICUOUS, AND UNAMBIGUOUS

Make sure the arbitration agreement is in a clearly labeled document separate from other pre-employment forms to defend against a possible challenge that the employee did not actually agree to arbitration because the executed agreement was in small print, or buried in an employee handbook. If the arbitration agreement is only

included as part of an employee handbook, employment application or employment contract, it is even more critical that the agreement be conspicuous.

8. DEFINE THE SCOPE OF THE AGREEMENT INCLUDING WHICH EMPLOYER-RELATED ENTITIES WILL BE BOUND BY THE AGREEMENT

Arbitration agreements should specify that the agreement will apply to any and all employment-related disputes. This should effectively deter any challenge that the employment-related dispute at issue is outside the scope of the agreement. But an issue commonly overlooked is which employer-related entities or employees are covered by the agreement. In employment disputes, particularly harassment claims, employees will often allege claims against supervisors or co-workers, as well as parent and affiliated companies. Since you will want to avoid litigating in multiple venues, make sure that the agreement specifies that it applies to all related entities.

9. COVER CURRENT EMPLOYEES

Even if you have not implemented arbitration before, you may require that current employees agree to arbitration. Continuation of employment is generally considered adequate consideration for an agreement to arbitrate, although there might be some variances by state. Should a current employee refuse to sign an arbitration agreement, consult with legal counsel before taking any adverse action.

10. REQUIRE EMPLOYEES TO SIGN THE AGREEMENT

Courts have rendered different opinions as to whether and in what medium an arbitration agreement must be signed. Some courts have found proof of email distribution of the employer's arbitration policy to be sufficient to show that an employee agreed to be bound by the arbitration agreement. Other courts have found an arbitration agreement not to exist where the employee did not sign it. It is a good idea to err on the side of caution and make sure employees actually sign their names to the arbitration agreement.