New York's Highest Court Sets Forth New Standard for Challenges to Cost-Sharing Provisions in Arbitration Agreements

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New York's highest court recently decided a case of first impression regarding a financial services industry employee's challenge to an arbitration agreement. In *Matter of Lorraine C. Brady v. The Williams Capital Group, L.P.*, 2010 NY Slip Op. 02434 (Mar. 25, 2010), the employee challenged a fee-sharing provision requiring her to split the cost of an arbitrator with her employer. The New York Court of Appeals held that when presented with such a challenge, lower courts must resolve the question of whether the employee is financially able to share the costs. The Court set forth a new standard by which lower courts must resolve the financial ability question, including certain factors that must be considered. Significantly, the Court left open the question of what the remedy should be if the cost-sharing provision is found unenforceable and raised the possibility, notwithstanding the existence of an otherwise valid and enforceable arbitration agreement, of allowing an employee to elect to proceed in court instead.

BACKGROUND AND LOWER COURT PROCEEDINGS

As a securities salesperson for investment bank Williams Capital Group, Lorraine Brady was required to sign an employment manual that included an arbitration agreement. The agreement provided that all disputes were to be arbitrated and that the parties would equally share the fees and costs of the arbitrator. At the time the agreement was entered into, the "equal share" provision was consistent with the rules of the American Arbitration Association ("AAA"). The agreement stipulated that, except as otherwise provided, any arbitration would be conducted in accordance with the then-current Model Employment Arbitration Procedures of the AAA.

After Williams Capital terminated Brady's employment, Brady filed a demand for arbitration with the AAA, seeking damages for race and sex discrimination under federal and state law. By the time Brady filed her demand, the AAA's rules had changed. Under its new "employer-pays" rule, the AAA required employers to pay all arbitration expenses and the arbitrator's compensation. In accordance with that rule, the AAA sent Williams Capital an invoice for advance payment of the arbitrator's compensation in the amount of $42,300. Williams Capital refused to pay the entire amount and demanded that Brady pay half under the arbitration agreement. When Brady refused to make payment, the AAA eventually cancelled the arbitration.

Brady commenced an Article 78 proceeding seeking to compel Williams Capital to pay the arbitrator's fee, or alternatively seeking to compel the AAA to enter a default judgment against

Williams Capital. The Supreme Court dismissed the petition, holding that the arbitration agreement – with its equal share provision – prevailed over the AAA's employer-pays rule. The court also rejected the argument that requiring Brady to pay half the arbitrator's compensation was prohibitively expensive, citing her earnings over her five years with Williams Capital, which ranged from a low of $100,000 to a high of $405,000.

On appeal, the Appellate Division reversed, holding that the equal share provision was unenforceable as against public policy. The court found that Brady had met her burden of establishing that the arbitration costs were so high as to discourage her from vindicating her statutory rights in the arbitral forum. Noting New York State policy favoring arbitration, the court held that it was proper to sever the equal share provision rather than void the entire arbitration agreement. Williams Capital appealed the ruling to the New York State Court of Appeals.

THE COURT OF APPEALS DECISION

At the outset, the Court of Appeals cited New York State's policy of interfering "as little as possible with the freedom of consenting parties in structuring their arbitration relationship" and noted that the "court's role is limited to interpretation and enforcement of the terms agreed to by the parties." The Court agreed with the lower courts that the terms of the parties' arbitration agreement controlled, rather than the AAA rules, but the Court found that the lower courts erred in determining the enforceability of the agreement's equal share provision because neither court properly resolved the question of whether Brady was financially able to share the arbitration costs.

In formulating a new standard for courts to use to resolve the financial ability question, the Court surveyed prior federal case law. First, the Court noted that in *Gilmer v. Interstate/Johnson Lane Corp.,* 500 U.S. 20 (1991), the United States Supreme Court determined that statutory claims can be subject to mandatory arbitration agreements so long as the prospective litigant effectively may vindicate his or her statutory cause of action in the arbitral forum. On the subject of large arbitration costs, the Supreme Court in *Green Tree Financial Corp. v. Randolph,* 531 U.S. 79 (2000), adopted a case-by-case approach and held that when a party seeks to invalidate an arbitration agreement on the ground that arbitration would be prohibitively expensive, that party bears the burden of showing the likelihood of incurring the costs that would deter the party from arbitrating the claim.

In keeping with these principles, as well as several federal circuit court opinions on the topic, the Court of Appeals held that the issue of a litigant's financial ability is to be resolved on a case-by-case basis, and the inquiry should at a minimum consider the following questions:

(1) whether the litigant can pay the arbitration fees and costs;

(2) what is the expected cost differential between arbitration and litigation in court; and

(3) whether the cost differential is so substantial as to deter the bringing of claims in the arbitral forum.[1]

The Court stipulated that there should be a written record of the findings pertaining to a litigant's financial ability but noted that a full hearing is not required in all situations. The Court left to lower courts' discretion the documentation courts should request to resolve this issue. Notably, the Court stated that because it was remitting the case for hearing before the lower court, it would not decide what the remedy should be if the equal share provision were found unenforceable. If that were to happen, the Court concluded that the lower court should decide, in the first instance, "whether to sever the clause and enforce the rest of the Arbitration Agreement, or to offer petitioner a choice between accepting the 'equal share' provision or bringing a lawsuit in court." The Court did not offer any guidance as to how a lower court should make such a decision.

PRACTICAL CONSIDERATIONS

Note that in this case, the employee-litigant was a low- to mid- six-figure wage earner over a period of many years, and nonetheless the Appellate Division held that she had made a satisfactory showing of hardship in paying one-half of the arbitration costs.[2] Thus, employers should carefully review their employment agreements and human resources policies that require arbitration of employment-related claims to analyze how costs are apportioned, especially those agreements and policies applicable to employees in lower-paid positions. Employers with a strong preference for arbitration over litigation should consider agreeing to pay the arbitrator's fees and costs to avoid subjecting their arbitration provisions to challenge. Alternatively, employers should include a severability clause and also can stipulate that if a

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[1] In support of the case-by-case approach to the financial ability analysis, the Court cited to decisions from the United States Courts of Appeals for the Third, Fourth and Sixth Circuits. *See Morrison v. Circuit City Stores, Inc.*, 317 F.3d 646 (6th Cir. 2003); *Spinetti v. Service Corp. Int'l,* 324 F.3d 212 (3d Cir. 2003); *Bradford v. Rockwell Semiconductor Sys., Inc.*, 238 F.3d 549 (4th Cir. 2001). Notably, California's highest court takes a contrary view, opting for a categorical approach mandating that an arbitration agreement cannot require an employee to bear any type of expense that he would not be required to bear if the action were brought in court. *See Armendariz v. Foundation Health Psychcare Servs., Inc.*, 24 Cal. 4th 83 (2000).

[2] Historically, arbitration of employment claims, especially in the collective bargaining agreement context, was a fast, efficient, economical and informal method of resolving disputes, largely due to the absence of any formal discovery proceedings (*e.g.*, depositions, interrogatories and document productions) other than the ability of the parties to subpoena persons or materials for appearance or production at the hearing. Motion practice in employment arbitration was largely unheard of. As such, those arbitration costs, which are most often shared to preserve the independence of the arbitrator, were relatively modest. More recently in the wake of the *Gilmer* decision cited above, with statutory claims of employment discrimination now also being heard in arbitration, courts in various jurisdictions have held that at least some discovery, akin to that available in court, must be available for the employee-litigant to have a fair process for arbitral adjudication of the statutory claims. Parties (notably employers' counsel) have also sought to engraft what had been exclusively court procedures (*e.g.*, motions to dismiss or for summary judgment, and motions in limine) on the arbitral process. These factors have driven up the costs of arbitration, and driven down the speed, efficiency and economy of arbitration of employment claims for most employees. It is this increase in costs that may be partially behind the courts' increasing concern that individual employee-litigants of even moderate means cannot be expected to shoulder even half the costs of arbitration.

determination is made by a court that an employee does not have the financial ability to share arbitration costs, the court can modify the cost-sharing provision in accordance with its findings. Employers can also consider strategies to limit arbitration costs, such as designating a hearing location convenient for the employee and agreeing to limit the extent of discovery or length of arbitration, although these limitations are at best a double-edged sword and could be used by the individual in attempting to prove the inadequacy of the arbitral forum as compared to being in court for the trial of statutory claims.

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