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3rd Circuit: 'One-Sided' Agreement Waives Employer's Arbitration Right

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Jeffrey Campolongo

On June 15, the 3rd U.S. Circuit Court of Appeals sent a strong message to employers utilizing arbitration agreements. Specifically, the court of appeals reversed the U.S. District Court for the District of the Virgin Islands' decision in *Nino v. The Jewelry Exchange Inc.* on the grounds that the "pervasively one-sided nature" of an arbitration agreement foreclosed any possibility of severing the unfair provisions from the remainder of the agreement.

The court held that an arbitration agreement can be voided in its entirety even if only parts of it are determined procedurally and substantively unconscionable. Furthermore, the 3rd Circuit concluded that the right to arbitration can be waived where a party has taken prejudicial actions displaying avoidance of such proceedings,

such as through litigation.

According to the 3rd Circuit's opinion, Rajae Nino, a Jordanian national, was hired by The Jewelry Exchange Inc., which does business as Diamonds International, or DI, as a salesperson and gemologist and was posted in their Aruba retail store in January 2000. Nino was subsequently transferred to DI's Alaska store, and then to its St. Thomas store in the United States Virgin Islands in September 2000.

When Nino began working at the St. Thomas store he was provided with DI's employment contract to acknowledge his receipt of the company's employee handbook, as well as a document entitled "Diamonds International AGREEMENT." Nino signed both the contract and the agreement.

The agreement stated DI's right "to unilaterally amend its rules, regulations, policies, and procedures without prior notice to its employees" and "that the grievance procedure set forth in the employee handbook is my exclusive remedy for my employment-related disputes." Stipulations for filing grievances were provided in both DI's employee contract and the employee handbook. The two documents, however, provided substantively different conditions for doing so, the opinion said.

The employee contract provided guidelines for filing grievances and arbitrating them. According to the opinion, the contract required that a complaint be filed within five days of the incident that precipitates it. Furthermore, the contract required that the resolution of disputes be confined to the given arbitration guidelines and its time limits. If the employee satisfied all of the contract's stringent requirements, DI would request a panel of four arbitrators from the American Arbitration Association, or AAA. Of the four potential arbitrators, DI could strike two while the employee could strike only one. Additionally, the parties to the matter could be represented by an attorney, but at their own expense. The two parties would assume the cost of the arbitrator equally. The contract further stipulated that the arbitrator in his decision, "must interpret, apply and be bound by the Employer's rules, regulations, policies and procedures as well as applicable federal, state, local and common laws," the opinion said.

The employee handbook, on the other hand, made no mention of a right to arbitration and required that a grievance

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be filed within two, not five, days of the incident. The handbook also "makes the decision of the managing director final as to all decisions except terminations, which may be further appealed to a management panel for final resolution." In no document provided to Nino by DI was there any explanation or reconciliation of the conflicting provisions.

Nino, a gay man, claimed that during the course of his employment his colleagues became increasingly preoccupied with his sexual orientation and made hostile comments relating to it. Upon revealing that he was gay, Nino claimed that the harassment escalated to verbal and physical attacks, "to which DI's management turned a blind eye," the opinion said.

In February 2005, an incident allegedly occurred in which Nino was falsely accused of "coming on" to a male co-worker. He was subsequently suspended and then resigned. It was not until March 3, 2006, however, that Nino filed a grievance against DI and the manager at the St. Thomas store regarding his suspension and subsequent resignation. He claims he was "discriminated against on the basis of gender and national origin."

DI subsequently engaged in litigation before the district court from June 2006 to September 2007. On Sept. 26, 2007, after litigating this dispute for 15 months with no mention of the arbitration clause, DI filed a motion to dismiss Nino's claims on the ground that the parties' contract made arbitration the sole method of resolving employment-related disputes. Nino opposed the motion, arguing (1) that the arbitration agreement was unconscionable and, therefore, unenforceable, and (2) that by engaging in extensive litigation of this dispute, the employer had waived its right to compel arbitration.

The District Court for the District of the Virgin Islands held that while portions of the arbitration clause were unconscionable, they could be severed from the remainder of the agreement because they were not an "essential part of the agreed exchange" between Nino and DI." The residual arbitration agreement was therefore enforceable. Moreover, the court found that DI's right to arbitration was not waived as a result of engaging in litigation. It held that "DI had raised arbitrability as an affirmative defense in its answer to Nino's complaint, and because DI had not engaged in dispositive motion practice prior to moving to compel arbitration."

The case was appealed to the 3rd Circuit, wherein Chief Judge Theodore A. McKee and Circuit Judges Julio M. Fuentes and Richard L. Nygaard rendered their decision on June 15. The first issue addressed by the court was the severability of the employment contract's arbitration agreement clauses. The 3rd Circuit rejected the district court's determination that the unconscionable clauses could be severed from the contract, leaving the remaining clauses intact. The 3rd Circuit first set out to determine whether the arbitration agreement was in fact unconscionable, which was a twofold process.

For the arbitration agreement to be deemed unconscionable, it must be procedurally and substantively so. The court found that procedurally, the arbitration agreement furnished by DI was unconscionable as "DI was the stronger contractual party" and therefore held greater bargaining power when it presented the arbitration agreement to Nino "for signature on a take-it-or-leave-it basis."

Substantively, the arbitration agreement imposed an unfair time restriction of five days for filing a grievance, without placing a comparable time constraint on the employer for responding to the claim. Furthermore, the court stated that the arbitration agreement's condition that each party be responsible for its own "attorney fees, costs, and expenses is substantively unconscionable." Finally, the arbitration agreement's stipulations for selecting an arbitrator were substantively unconscionable for the "unreasonable advantage" it gives to DI in determining who will arbitrate the case.

In order to determine whether the unconscionable arbitration agreement would be severed from the remainder of the contract, the court used two "lines of inquiry." First, the court looks to whether the unconscionable aspects of the employment arbitration agreement constitute "an essential part of the agreed exchange" of promises between the parties. Second, does the arbitration clause's unconscionability demonstrate "a systematic effort to impose arbitration on an employee, not simply as an alternative to litigation, but as an inferior forum that works to the employer's advantage"?

To both of these questions, the 3rd Circuit answered in the affirmative, thereby refusing to sever the unconscionable clauses of the contract and allow the remainder to be enforced. The court held that "the pervasive one-sided nature of the agreement forecloses any possibility of severing the unfair provisions from the remainder of the agreement."

Lastly, the court addressed Nino's argument that DI waived its right to compel arbitration by engaging in litigation for 15 months. The court cited its ruling in *Ehleiter v. Grapetree Shores Inc.*, positing that "the right to arbitrate has been waived where a sufficient showing of prejudice has been made by the party seeking to avoid arbitration." In addition, it applied a litmus test developed through *Hoxworth v. Blinder, Robinson & Co. Inc.* for determining whether DI acted prejudicially in avoiding arbitration initially. The *Hoxworth* conditions are: "[1] the timeliness or lack thereof of a motion to arbitrate ... [2] the degree to which the party seeking to compel arbitration has contested the merits of its opponent's claims; [3] whether that party has informed its adversary of the intention to seek arbitration even if it has not yet filed a motion to stay the district court proceedings; [4] the extent of its non-merits motion practice; [5] its assent to the court's pretrial orders; and [6] the extent to which both parties have engaged in discovery."

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This list is "nonexclusive" and a waiver can be granted without the presence of all the conditions. In consideration of these conditions, the court also stated, "The investment of considerable time and money litigating a case may amount to sufficient prejudice to bar a later-asserted right to arbitrate." The court concluded that DI, through its engagement in litigation, had in fact surrendered its right to compel arbitration. •

Jeffrey Campolongo is the founder of the Law Office of Jeffrey Campolongo, a boutique firm focusing on employee rights and counseling aspiring and established entertainers. He can be reached at jcamp@jcamplaw.com or 215-592-9293.

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