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Court Finds Restrictive Arbitration Clause Unenforceable

By Jessica Summers

For the many companies that utilize arbitration clauses in their independent contractor agreements or employment agreements, a recent decision from the U.S. District Court for the Eastern District of Virginia serves as an important reminder of the care that must be taken in crafting these provisions. Otherwise, what was meant to provide a cost-savings mechanism for dispute resolution may end up actually increasing litigation expenses significantly. As this case demonstrates, the litigants spent substantial time (and no doubt expense) litigating the enforceability of the arbitration provision even before getting to the merits of the case.

In the case of *Winston v. Academi Training Center, Inc.* (2013 WL 989999) (memorandum opinion available here), the District Court refused to enforce an arbitration clause contained in the independent contractor agreements between the defendant and the two plaintiffs. The District Court concluded that, because the arbitration clauses barred any discovery and required the plaintiffs to pay the costs regardless of the outcome, the clauses were both counter to federal statute and unconscionable.

This appears to be the first case in which a court within the Fourth Circuit has considered the enforceability of an arbitration clause containing such a discovery prohibition and a fee shifting provision. However, it is not the first time that a court within the circuit has declined to enforce an arbitration clause on the basis that it overly favors the employer and impedes the legal rights of an employee or independent contractor. The Fourth Circuit itself has declined to enforce arbitration clauses which require that the arbitrator be selected from a list produced by the employer or that the arbitration proceed under broad rules set by the employer.

The ongoing *Winston* case centers on Fair Claims Act (the “FCA”) and state law retaliation claims brought by two independent contractors against Academi Training Center, Inc (“Academi”), a government contractor. Both plaintiffs entered into independent contractor agreements with Academi to provide firearm instruction in relation to a security contract between Academi and the U.S. Department of State. The plaintiffs and other firearm instructors were responsible for observing shooters’ performances and preparing reports which Academi submitted to the State Department.

Plaintiffs claim to have witnessed other Academi contractors submitting false records and one of the plaintiffs claims to have been asked to complete a report using made-up numbers. The plaintiffs reported these incidents to their supervisor and were terminated the next day with the explanation that they had failed to report the fraud sooner and had allegedly participated in the fraud. The plaintiffs filed suit in the District Court claiming retaliation in violation of the FCA and state law.

In determining whether to enforce the arbitration clauses of the plaintiffs’ independent contractor agreements, the Court distinguished between the plaintiffs’ FCA claims and their state law claims. The Court recognized that, because FCA claims are subject to the Federal Arbitration Act, doubts about the enforceability of an arbitration clause as to FCA claims are generally resolved in favor of arbitration. The Court emphasized however, that an arbitration clause should not be enforced if such arbitration would deny the plaintiff his or her rights under the FCA.

The Court identified just such a situation in the *Winston* case. The Court was particularly troubled that the arbitration clause did not allow discovery, particularly in light of the fact that the plaintiffs would need the allegedly falsified documents to prove their claims and that these documents would be difficult, if not impossible, to obtain in the absence of discovery. Further, the Court also found that, as applied, the arbitration clause would frustrate Congressional intent by placing the financial burden of the arbitration on the plaintiff. Counter to the arbitration clause’s provision, the FCA, like many of the federal employment law statutes including Title VII and the ADA, contains a fee shifting provision which awards attorney fees to successful plaintiffs.

In considering the application of the arbitration provisions to the plaintiffs' state law claims, the Court began by refusing to enforce the forum selection clauses also contained in the independent contractor agreements. The Court made this decision on the basis that the clauses called for the application of New York law despite the facts that Academi was a Delaware corporation headquartered in Virginia, that neither plaintiff was from New York and that the agreements were signed in North Carolina. Applying North Carolina law, the Court concluded that the same aspects of the arbitration clause that rendered it unenforceable as to FCA claims would also make the state law claims unfairly difficult to pursue and thus make the enforcement of the arbitration clause unconscionable.

The Court refused to sever the problematic discovery and fee shifting provisions and enforce the remainder of the arbitration clauses because both the Fourth Circuit and North Carolina courts have taken the position that courts should not engage in rewriting unconscionable contracts.

Winston presents yet another example of what Fourth Circuit courts consider to be unenforceable arbitration provisions. Employers would be well advised to take this opportunity to review and revise any of their own arbitration provisions that contain broad restrictions or limits that could render the provision unenforceable.

