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## Taxing Employers for Imposing Mandatory Arbitration, Class Action Waiver, and Nondisclosure of Dispute Provisions

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# TAXING EMPLOYERS FOR IMPOSING MANDATORY ARBITRATION, CLASS ACTION WAIVER, AND NONDISCLOSURE OF DISPUTE PROVISIONS

*Rebecca N. Morrow\**

## ABSTRACT

*Employers impose coercive dispute resolution terms on their employees more frequently, more broadly, and with greater legal success than ever before. Recent survey data indicates that mandatory employment arbitration provisions bind more than 60 million American workers—over half of the U.S. private-sector nonunion workforce. Employment class action waivers bind nearly 25 million American workers.*

*In 2018, the Supreme Court held 5–4 that mandatory arbitration provisions and class action waivers imposed by employers on their employees do not violate the National Labor Relations Act. These terms prohibit employees from exposing employer wrongdoing in open court, bar employees with valid wage and hour claims from collectively—and thus cost-efficiently—asserting those claims, and prevent employees who have suffered workplace harassment from establishing or even knowing that similar claims have been made by other employees, thereby allowing patterns of harassment to continue. Yet the Supreme Court’s recent ruling means that millions more American workers are likely to become subject to these coercive employment dispute resolution terms.*

*While harming more than 60 million American workers, coercive employment dispute resolution terms do something else—something that tax law enforcers historically and currently ignore. They enrich the employers who impose them. They give employers a new, valuable intangible asset that the employers did not have before. For the employers who impose them, coercive employment dispute resolution terms are an accession to wealth, clearly realized, and in the employer’s control. They are income to the employer, and they should be taxed as such.*

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## I. INTRODUCTION

“BEST Wishes Kevin” was piped in frosting below an American flag.<sup>1</sup> Navy Reserve Lieutenant Commander Kevin Ziober attached a picture of the cake that his employer bought him to written testimony that he submitted to the House Subcommittee on Antitrust, Commercial, and Administrative Law.<sup>2</sup>

In 2012, Ziober, then a manager at federal contractor BLB Resources, “received official orders from the Navy to deploy to Afghanistan for 12 months.”<sup>3</sup> Publicly, his employer hosted a surprise party with decorations, gifts, and the cake<sup>4</sup> to thank Ziober for his service.<sup>5</sup> Privately, and on the same day as the party, his employer—in violation of the Uniformed Services Employment and Reemployment Rights Act—fired Ziober and told him that his job would not wait for his return from active duty.<sup>6</sup> As Ziober describes,

Around 4:45 that same afternoon, I was summoned to a meeting . . . . I was fired on the spot and told that my position would not be waiting for me upon my return from active duty.

The shock of learning that I was being terminated from my job on the eve of my deployment to a combat zone created an unimaginable amount of concern and anxiety about how I would support myself and my family when I returned home. In the course of a few hours, I went from feeling supported, proud, and focused on serving my country, to feeling embarrassed, confused, and concerned about the well-being of my loved ones.<sup>7</sup>

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1. *Justice Denied: Forced Arbitration and the Erosion of our Legal System: Hearing on H.R. 1423, H.R. 7109, and H.R. 2631 Before the Subcomm. on Antitrust, Commercial, and Admin. Law of the H. Comm on the Judiciary*, 116th Cong. 4 (2019) [hereinafter *Forced Arbitration Hearings*], <https://docs.house.gov/meetings/JU/JU05/20190516/109484/HHRG-116-JU05-Wstate-ZioberK-20190516.pdf> [<https://perma.cc/D9H8-P3B6>] (statement of Kevin Ziober, Lieutenant Commander, U.S. Navy Reserves).

2. *Id.*

3. *Id.* at 3–4.

4. *Id.* at 4.

5. *Id.*

6. *Id.*

7. *Id.*

It was a day that revealed the stark contrast between how some employers behave in open, public forums and how they treat their employees in private.

When Ziober returned from Afghanistan, he filed suit in federal court to enforce the Uniformed Services Employment and Reemployment Rights Act.<sup>8</sup> The first order entered in his case was an order of dismissal.<sup>9</sup> Before even allowing discovery, the court closed its doors to Ziober. In Ziober's words, his former employer "immediately filed a motion to compel arbitration, arguing that the paperwork that I was forced to sign . . . took away my right to go to court. The judge granted the motion, dismissing my case and sending it to a private arbitration company for resolution."<sup>10</sup>

You see, BLB Resources had imposed on its workforce a mandatory arbitration provision that shielded BLB from judicial enforcement of the law.<sup>11</sup> As Ziober testified before the House Subcommittee,

Six months into my tenure at BLB, the company asked me and other employees to sign several legal documents, including an arbitration agreement as a condition of keeping our jobs. Like other employees who needed their jobs to make ends meet, I felt that I had no choice but to sign the papers. I had no intention of losing my livelihood. Plus, things were going well for me at the company, I didn't foresee any legal issues arising, and I didn't want to cause any problems, so I signed the paperwork and I moved [on to] doing my job to the best of my ability.<sup>12</sup>

Ziober was not alone:

[I]ncreasingly employers are requiring reservists to enforce their rights in secret arbitration proceedings that are often overseen by arbitrators selected by employers with a limited opportunity for reservists to discover the key facts in their cases. These employers hope that the secrecy of arbitration will prevent the public from learning about how they have mistreated reservists or veterans, even if it means taking away many of the key rights that Congress has bestowed upon reservists since the 1940s.<sup>13</sup>

Indeed, military service members are not alone. Employers often unilaterally impose their preferred form of dispute resolution on their collective workforces and bar employees from seeking open, public resolution of workplace disputes in court. As Ziober testified, "arbitration does not just impact servicemembers or veterans. The increasing and systemic use of forced arbitration is impacting every American and taking away our rights to enforce the federal and state laws that promote economic oppor-

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8. *Id.* at 5.

9. *Id.*

10. *Id.*

11. *Id.*

12. *Id.* at 4.

13. *Id.* at 3.

tunity and security, protect our health and safety, and stamp out fraud.”<sup>14</sup> Mandatory employment arbitration provisions undermine the rule of law and particularly harm victims of wage theft and sexual harassment, whose best recourse against employer misconduct is an open court.

The law student-founded People’s Parity Project recognizes these harms and advances its mission of “demystifying and dismantling the coercive legal tools that allow the powerful to get away with violating workers’ rights.”<sup>15</sup> It exposes law firms that use mandatory employment arbitration clauses, class action waivers, and nondisclosure provisions that “prohibit employees from publicly discussing if they experience workplace harassment or abuse” and uses collective action and public exposure to stop them.<sup>16</sup> For example, it maintains a spreadsheet tracking the use of coercive employment dispute resolution terms by nearly four hundred law firms.<sup>17</sup> Unfortunately, despite the excellent work of the People’s Parity Project, “[s]ome firms have dropped coercive contracts in response to student pressure, but others have not.”<sup>18</sup> More broadly, workers in most other industries do not have an organization like the People’s Parity Project.

Employers require mandatory arbitration of workplace disputes for half of the U.S. workforce<sup>19</sup> and, in the process, shield themselves from complaints by their employees, judicial enforcement of law, and publicly accessible court orders.<sup>20</sup> A dispute that would otherwise be public and unflattering becomes private and contained.<sup>21</sup> Further, employers prohibit class action and other collective dispute resolution mechanisms and require that 23.1% of private-sector nonunion U.S. workers “go it alone” in individual arbitration proceedings of employment disputes.<sup>22</sup> This Article will collectively refer to employer-promulgated pre-dispute

14. *Id.* at 9.

15. PEOPLE’S PARITY PROJECT, <https://www.peoplesparity.org/> [https://perma.cc/6N3H-GJXZ].

16. *Coercive Contracts*, PEOPLE’S PARITY PROJECT, <https://www.peoplesparity.org/coercivecontracts/> [https://perma.cc/HXW6-69AA].

17. *See id.*

18. *Id.*

19. *See* ALEXANDER J.S. COLVIN, ECON. POL’Y INST., *THE GROWING USE OF MANDATORY ARBITRATION* 5 (2018), <https://www.epi.org/files/pdf/144131.pdf> [https://perma.cc/9X3M-GNKX].

20. While arbitration filings and rulings are private, most court pleadings and orders are unsealed, publicly accessible, and increasingly available through searchable online sources.

21. KATHERINE V.W. STONE & ALEXANDER J.S. COLVIN, ECON. POL’Y INST., *THE ARBITRATION EPIDEMIC: MANDATORY ARBITRATION DEPRIVES WORKERS AND CONSUMERS OF THEIR RIGHTS* 17 (2015), <https://www.epi.org/publication/the-arbitration-epidemic/> [https://perma.cc/W2H5-ETJZ] (“Arbitration processes in general involve some form of private tribunal that adjudicates the issue in dispute. Arbitration procedures are typically a simpler, more informal version of court procedures, for example relaxing the formal rules of evidence. Underneath these generalizations, however, there is a great deal of variation in arbitration procedures. Different arbitration procedures vary considerably in their degrees of formality, similarity to court procedures, and amount of due process provided to the participants. The arbitration agreement itself is the primary source of the rules governing the arbitration process.”).

22. COLVIN, *supra* note 19, at 11.

mandatory arbitration terms,<sup>23</sup> class action waivers, and provisions prohibiting disclosure of disputes in employment contracts as *coercive employment dispute resolution terms*.

When coercive employment dispute resolution terms are the result of full and fair bargaining between adversaries with equal bargaining power—such as between an employer and an equally powerful union—it might be reasonable to assume that the coercive employment terms were exchanged for adequate consideration, likely in the form of higher compensation.<sup>24</sup> In such circumstances, the coercive employment terms are bilaterally imposed. This Article will briefly describe how bilaterally imposed coercive employment dispute resolution terms are currently ignored by the tax system, with the unfortunate result that they are effectively tax-subsidized.<sup>25</sup> However, bilaterally imposed coercive employment dispute resolution terms are neither the norm<sup>26</sup> nor the focus of this Article.

Employers impose the vast majority of coercive employment dispute resolution terms unilaterally.<sup>27</sup> Courts uphold and enforce these terms even if they are imposed after an employment relationship has begun and without any additional compensation or other consideration.<sup>28</sup> Employers can require employees to sign mandatory arbitration agreements

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23. This Article will use the definition of *mandatory arbitration* provided by Cynthia Estlund. Cynthia Estlund, *The Black Hole of Mandatory Arbitration*, 96 N.C. L. REV. 679, 683 (2018) (defining the term “mandatory arbitration” as “employer-promulgated pre-dispute arbitration agreements in the non-union workplace”).

24. See STONE & COLVIN, *supra* note 21, at 14 (“In the unionized setting, labor arbitration provides a jointly established mechanism for enforcing the provisions of collective-bargaining agreements and providing industrial justice in the workplace. Labor arbitration has been one of the most enduring and successful features of the American industrial relations system because it has served the interests of both unions and management, and both parties are equally involved in establishing and administering the system.”).

25. Bilaterally imposed coercive employment terms receive an unjustified and improper tax subsidy. See *infra* notes 175–79 and accompanying text. However, this Article focuses on unilaterally imposed coercive employment terms, which are more common, and which receive a greater and even more problematic tax subsidy.

26. Just 10.3% of the workforce is unionized, and the power of a prospective employee to do other than sign an employment contract with adhesive terms drafted by the employer is low. See News Release, Bureau Lab. Stat., U.S. Dep’t Lab., Union Members—2019 1 (2020).

27. COLVIN, *supra* note 19, at 15 n.18 (“One of the most important differences is that labor arbitration procedures are jointly established and administered by unions and management, in contrast to mandatory arbitration, which is unilaterally established by the employer. In addition, most labor arbitration procedures do not bar employees from bringing statutory employment claims separately through the courts.”).

28. This distinguishes mandatory arbitration provisions and class action waivers from noncompete agreements (where adequate consideration is often asserted by employers, required by law, or both). Indeed, even when a mandatory arbitration provision is included in an unconscionable contract, courts require that the claim of unconscionability be arbitrated. See, e.g., STONE & COLVIN, *supra* note 21, at 9 (“In 2010, in *Rent-A-Center West v. Jackson*, 561 U.S. 63 [(2010)], the Court expanded the separability doctrine in a way that eliminated many unconscionability challenges to arbitration clauses. In that case, the Court held that a party who claimed that the arbitration clause in his employment contract was unconscionable under his state law had to bring that claim to arbitration because the aspect of the arbitration clause he alleged was unconscionable was not the same aspect to which he objected.”).

(MAAs) as a condition of employment, and they can refuse to hire prospective employees who do not sign.<sup>29</sup> These terms are enforced even if they are first disclosed in “welcome” packets for new employees, emailed to existing employees, or adopted through unilateral changes to company policy.<sup>30</sup> Coercive employment dispute resolution terms are upheld against employees who did not even know that they existed.<sup>31</sup>

Unilaterally imposed coercive employment dispute resolution terms *enrich* the employers who impose them. They prevent workers from bringing claims, make it less likely that workers will win employment-related disputes, and depress damages. They are stunningly effective at shielding employers from liability for violating wage and hour laws, antidiscrimination laws, sexual harassment laws, and more. By imposing a coercive employment dispute resolution term, an employer obtains a new and extremely valuable intangible asset that the employer did not have before—a legally enforceable right that closes court doors to employees claiming misconduct, makes meritorious claims less likely to be brought and less costly to the employer when brought, and prevents the employer from being publicly exposed for its unlawful conduct.

This Article exposes the previously ignored tax consequences that should apply to an employer who imposes a coercive employment dispute resolution term on an employee. It proposes a new check on mandatory arbitration, class action waiver, and nondisclosure of dispute provisions by arguing that when employers impose these terms on their workers, proper tax treatment requires that the employers report the benefit received as gross income and pay tax on it.<sup>32</sup>

Some experts have called coercive employment dispute resolution terms free insurance policies that shield employers from the consequences of their own misconduct;<sup>33</sup> others have called them “get out of

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29. See COLVIN, *supra* note 19, at 2.

30. See Jean R. Sternlight, *Mandatory Arbitration Stymies Progress Towards Justice in Employment Law: Where To, #MeToo?*, 54 HARV. C.R.-C.L. L. REV. 155, 171–72 (2019); *infra* notes 31 and 301 and accompanying text.

31. Katherine Van Wezel Stone, *Mandatory Arbitration of Individual Employment Rights: The Yellow Dog Contract of the 1990s*, 73 DENV. U. L. REV. 1017, 1018 (1996) (explaining that courts will treat a mandatory arbitration provision in an “Employee Handbook as a waiver of your rights to sue in court under most federal and state employment laws. Thus the employer, by giving you the booklet and unilaterally establishing an arbitration procedure, has relieved herself of numerous burdensome employment regulations”); STONE & COLVIN, *supra* note 21, at 4–5 (“Arbitration clauses are also often included in the company orientation and personnel materials a worker receives when beginning a new job. Because these arbitration clauses are usually buried in a sea of boilerplate, many people who are subject to them do not realize that they exist or understand their impact. These terms are called mandatory or forced arbitration because if the employee . . . does not agree to arbitration, he or she will be denied employment . . . . The employee . . . has no real choice or ability to negotiate the terms of the arbitration clause. Mandatory arbitration in the . . . employment setting is very different from arbitration clauses in contracts between two businesses or a company and a union; in those cases, the parties have voluntarily negotiated as equals and knowingly agreed to arbitrate disputes between them.”).

32. See *infra* Part V.

33. See *infra* note 61 and accompanying text.

jail free” cards for unscrupulous employers;<sup>34</sup> others have called them “wealth transfers” from workers to employers.<sup>35</sup> Each analogy shows why employers should be taxed for imposing coercive employment dispute resolution terms. The imposition of these terms gives employers a new and valuable intangible asset that they did not have before, occurs due to the employers’ exercise of control, and enriches the employer at the expense of employees (rather than, for example, in exchange for payment or other consideration). No one would doubt that a taxpayer who receives free insurance coverage (or who receives a get-out-of-jail-free card, if such a card existed) realizes gross income upon the receipt. Nor should we doubt that an employer who enriches itself by imposing coercive employment dispute resolution terms on its workforce realizes gross income upon that imposition. Indeed, employers acknowledge the value of these terms in other contexts.<sup>36</sup> The matter, therefore, becomes how to approximate the value of the gross income that an employer receives by imposing such a term.

In addition to arguing that the imposition of a coercive employment dispute resolution term results in gross income to the employer and should, at long last, be taxed as such, this Article proposes a method to approximate the value of that gross income based on the damages that employers predictably save by imposing these terms.<sup>37</sup>

While taxing employer-imposed mandatory arbitration and other coercive employment dispute resolution terms is an incomplete solution that should be combined with public and legislative efforts to discourage employer-imposed mandatory arbitration, class action waiver, and nondisclosure provisions, it is an incomplete solution with promise. Requiring employers to pay tax on the benefit that they receive by imposing coercive employment dispute resolution terms would discourage the increasingly frequent and broad use of these terms. It would uphold foundational principles of tax law and raise revenue to fund the enforcement of labor laws, antidiscrimination laws, and workplace accommodation laws.

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34. STONE & COLVIN, *supra* note 21, at 3.

35. Deepak Gupta & Lina Khan, *Arbitration as Wealth Transfer*, 35 YALE L. & POL’Y REV. 499, 502 (2017).

36. Andrea Cann Chandrasekher & David Horton, *Arbitration Nation: Data from Four Providers*, 107 CALIF. L. REV. 1, 16 (2019). Chandrasekher and Horton note that some companies find mandatory arbitration so valuable that, even when they unilaterally impose arbitration, they include in their mandatory arbitration provisions “rewards for plaintiffs to arbitrate those claims on an individual basis.” *Id.* For example, “AT&T, Sallie Mae, and Verizon promised to pay a bounty of between \$5,000 and \$10,000 and up to double attorneys’ fees to any consumer who won an award that exceeded the company’s settlement offer” in an effort to increase the chances that a court will uphold their mandatory arbitration provision. *Id.*; see also Myriam Gilles, *Killing Them with Kindness: Examining “Consumer-Friendly” Arbitration Clauses After AT&T Mobility v. Concepcion*, 88 NOTRE DAME L. REV. 825, 857–58 (2012) (describing various “[b]ounties, [p]remium [p]ayments, and ‘[b]ump-[u]ps’” that many companies, including Clearwire, T-Mobile, Sally Mae, Netflix, Verizon, Microsoft, and Sovereign Bank, proffer to pay customers in the forced arbitration provisions they impose on their customers).

37. See *infra* Section IV.C.

## II. PREVALENCE AND HARMS

Employer-imposed pre-dispute mandatory arbitration provisions bind an increasing number of American workers. These provisions often include bars to collective or class action style dispute resolution and nondisclosure provisions that silence employees who might otherwise honestly report that their employers violate wage and hour laws, engage in unlawful discrimination, or perpetrate sexual harassment. Employers claim that these provisions benefit workers as well as employers by keeping time and cost spent on dispute resolution low. Claims of mutual benefit might resonate if post-dispute, voluntary arbitration agreements were the norm. Unfortunately, they are not. Instead, employers subject employees to arbitration as a condition of employment in ways that give employees little to no meaningful alternative and bind them despite their wishes.<sup>38</sup> Unfortunately, the consequences are severe. For a time, “there was no evidence on how mandatory arbitration would actually work when designed by the more powerful party in the highly asymmetric employment relationship and imposed as a condition of initial or continued employment. The empirical evidence . . . is now in.”<sup>39</sup>

Far from providing mutual benefit, employer-imposed mandatory arbitration is extremely beneficial to employers and extremely harmful to employees:

[B]y imposing mandatory arbitration on its employees, an employer can ensure that it will face only a miniscule chance of ever having to answer for future legal misconduct against employees. Such a provision amounts to a virtual *ex ante* waiver of substantive rights [of employees] that the law declares non-waivable.<sup>40</sup>

The extensive and increasing use of these terms and their favorable reception at the Supreme Court is especially damaging in light of the severity of harm they cause.

### A. OVER HALF THE WORKFORCE AND GROWING

A large and growing number of American workers are or have been subject to MAAs with their employers that often prevent them from bringing collective or class-action-like challenges to unlawful employment practices and silence their efforts to warn fellow workers and the public about illegal activity by their employers.

The trend began in 1991, when, in *Gilmer v. Interstate/Johnson Lane Corp.*, the U.S. Supreme Court held that mandatory arbitration provisions in employment contracts were enforceable.<sup>41</sup> “*Gilmer* gave the

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38. Stone, *supra* note 31, at 1020 (“[I]n the nonunion setting . . . mandatory arbitration is often imposed as a condition of employment, without any consent or bargaining.”).

39. Estlund, *supra* note 23, at 707.

40. *Id.*

41. *Gilmer v. Interstate/Johnson Lane Corp.*, 500 U.S. 20, 35 (1991) (holding that mandatory arbitration provision could be applied to former employee’s claim that employer violated the Age Discrimination in Employment Act (ADEA) by firing him when

green light to employers to require employees to sign arbitration agreements as a mandatory term and condition of employment. The case and its progeny allowed employers to unilaterally introduce arbitration procedures to cover statutory employment rights” that would bar employees from enforcing their statutory employment rights in open court, and, further, allowed employers to “make these procedures mandatory in the sense that the employer would refuse to hire a job applicant who would not sign the arbitration agreement.”<sup>42</sup>

These employer-imposed mandatory arbitration provisions

bar access to the courts for all types of legal claims, including employment discrimination and sexual harassment claims based on Title VII of the Civil Rights Act, protections for employees with disabilities under the Americans with Disabilities Act, rights to maternity and medical leaves based on the Family and Medical Leave Act, and entitlements to minimum wages and overtime under the Fair Labor Standards Act.<sup>43</sup>

In the early 1990s, mandatory arbitration employment terms were extremely rare. A 1992 study found that only about 3.7% of companies surveyed included arbitration provisions in their employment terms.<sup>44</sup> With these provisions being held enforceable, however, employers quickly ex-

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he was sixty-two years of age). The majority enforced the mandatory arbitration provision despite a compelling dissent by Justice Stevens that highlighted many of the failings of mandatory arbitration. *See id.* Justice Stevens wrote in dissent:

Not only would I find that the [Federal Arbitration Act (FAA)] does not apply to employment-related disputes between employers and employees in general, but also I would hold that compulsory arbitration conflicts with the congressional purpose animating the ADEA, in particular. As this Court previously has noted, authorizing the courts to issue broad injunctive relief is the cornerstone to eliminating discrimination in society. The ADEA, like Title VII of the Civil Rights Act of 1964, authorizes courts to award broad, class-based injunctive relief to achieve the purposes of the Act. Because commercial arbitration is typically limited to a specific dispute between the particular parties and because the available remedies in arbitral forums generally do not provide for class-wide injunctive relief, I would conclude that an essential purpose of the ADEA is frustrated by compulsory arbitration of employment discrimination claims. Moreover, as Chief Justice Burger explained:

Plainly, it would not comport with the congressional objectives behind a statute seeking to enforce civil rights protected by Title VII to allow the very forces that had practiced discrimination to contract away the right to enforce civil rights in the courts. For federal courts to defer to arbitral decisions reached by the same combination of forces that had long perpetuated invidious discrimination would have made the foxes guardians of the chickens.

*Id.* at 41–42 (Stevens, J., dissenting) (citations omitted) (quoting *Barrentine v. Ark.–Best Freight Sys., Inc.*, 450 U.S. 728, 750 (1981) (Burger, C.J., dissenting)).

42. STONE & COLVIN, *supra* note 21, at 15.

43. COLVIN, *supra* note 19, at 3; *see also id.* (“If an employment right protected by a federal or state statute has been violated and the affected worker has signed a mandatory arbitration agreement, that worker does not have access to the courts and instead must handle the claim through the arbitration procedure designated in the agreement.”).

44. Peter Feuille & Denise R. Chachere, *Looking Fair or Being Fair: Remedial Voice Procedures in Nonunion Workplaces*, 21 J. MGMT. 27, 36 (1995) (survey of grievance procedures found that only 4 of 107 responding firms provided for a decision by an outside arbitrator).

panded them. A Government Accountability Office survey estimated that by 1995, 6.7% of employers with no union workers had adopted mandatory arbitration.<sup>45</sup> A 2003 survey of the telecommunications industry found that 22.7% of that industry's nonunion workforce was subject to mandatory arbitration of employment-related disputes.<sup>46</sup>

In 2018, Professor and now-Dean of Cornell University's School of Industrial and Labor Relations, Alexander Colvin, conducted a "national survey of private-sector American business establishments" and found that 50.4% of responding employers reported that their employees were required to sign—usually at the time of hire—a "mandatory 'agreement or provision for arbitration of legal disputes with the company.'"<sup>47</sup> An additional 3.5% of responding employers reported that they adopted mandatory arbitration provisions "simply by announcing" to their existing workforce that these terms had been "incorporated into the organization's employment policies."<sup>48</sup> Thus, a total of 53.9% of responding employers indicated that they impose mandatory arbitration of employment-related disputes.<sup>49</sup>

Because employers imposing mandatory arbitration provisions tend to employ larger workforces,<sup>50</sup> the survey adjusted for workforce size to conclude that "overall 56.2 percent of employees in the establishments surveyed were subject to mandatory arbitration procedures."<sup>51</sup> Strikingly, the survey concluded that "[e]xtrapolating to the overall private-sector nonunion workforce, this corresponds to 60.1 million American workers who are now subject to mandatory employment arbitration procedures and no longer have the right to go to court to challenge violations of their employment rights."<sup>52</sup> Researchers expect the percentage of workers subject to mandatory employment arbitration provisions to grow significantly in response to recent Supreme Court rulings.<sup>53</sup>

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45. U.S. GOV'T ACCOUNTABILITY OFF., GAO/HEHS-95-150, EMPLOYMENT DISCRIMINATION: MOST PRIVATE-SECTOR EMPLOYERS USE ALTERNATIVE DISPUTE RESOLUTION 12 (1995); *see also id.* at 28 (reporting that 9.9% of businesses used arbitration, and of those, 47.1% had policies that made arbitration voluntary for all workers, 13.9% made it voluntary for some workers, and 39.0% made it mandatory for all workers).

46. Alexander J.S. Colvin, *Empirical Research on Employment Arbitration: Clarity Amidst the Sound and Fury?*, 11 EMP. RIGHTS & EMP. POL'Y J. 405, 410 (2007).

47. COLVIN, *supra* note 19, at 5. Professor Colvin's "survey was conducted from March 2017 to July 2017 and had a sample size of 627, yielding a margin of error at 95 percent confidence of plus or minus 3.9 percentage points." *Id.*

48. *Id.*

49. *Id.*

50. *See id.* at 6 ("Whereas 53.9 percent of all establishments had mandatory arbitration, among establishments that were part of companies with 1,000 or more employees, 65.1 percent had mandatory arbitration, which is a statistically significant difference (at the  $p < 0.05$  level) from the 50.5 percent of establishments with fewer than 1,000 workers that had mandatory arbitration. Breaking down employer size further . . . we see that it is the very largest employers who have the highest rates of adopting mandatory arbitration.").

51. *Id.* at 5.

52. *Id.*

53. *See, e.g., id.* at 5 (finding "substantial growth in the adoption of mandatory employment arbitration agreements" during the five-year period following Supreme Court's pro-employer ruling in *AT&T Mobility LLC v. Concepcion*, 563 U.S. 333 (2011)).

Requiring mandatory arbitration of employment-related legal disputes is not the only tool that employers use to reduce their legal and public-relations exposure. Increasingly, employers require their employees to waive class action rights as a condition of employment.<sup>54</sup> By virtue of signing a provision requiring that mandatory arbitration consist of individual suits, workers are prevented from engaging in collective action to challenge wage and hour violations, hostile workplaces, or other unlawful employment practices that harm multiple workers. Professor Colvin's survey found that

overall 41.1 percent of employees covered by mandatory arbitration procedures were also subject to class action waivers. Relative to the overall workforce, including both those covered and those not covered by mandatory arbitration, these estimates indicate that 23.1 percent of all private-sector nonunion employees are subject to class action waivers in mandatory arbitration procedures, corresponding to 24.7 million American workers.<sup>55</sup>

Again, researchers expect the percentage of workers subject to class action waivers to grow significantly in response to recent Supreme Court rulings.<sup>56</sup>

## B. HARMS

Mandatory arbitration provisions, class action waivers, and provisions prohibiting the disclosure of workplace disputes subject workers to wage and hour violations without remedy, perpetuate hostile work environments, and effectively nullify legal protections. While data on employment arbitration outcomes was initially sparse and hidden, it has now exposed how valuable mandatory arbitration provisions are to employers and how damaging they are to employees.

As mandatory arbitration provisions became more common, researchers initially faced challenges in gathering the data necessary to determine whether arbitration acted as a fair substitute for litigation or as a boon to employers.<sup>57</sup> Unlike court filings and orders, arbitration filings and reso-

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54. *See id.* at 11.

55. *Id.*

56. *See, e.g., id.* at 12 (projecting that if—as occurred recently in *Murphy Oil*—the Court “upholds the use of class action waivers in mandatory employment arbitration procedures, then we should expect a further increase in the use of these class action waivers and greater numbers of employers overall adopting mandatory arbitration”); *see also* CARLTON FIELDS, 2019 CARLTON FIELDS CLASS ACTION SURVEY: BEST PRACTICES IN REDUCING COST AND MANAGING RISK IN CLASS ACTION LITIGATION 3, 5 (2019), <https://classactionsurvey.com/pdf/2019-class-action-survey.pdf> [<https://perma.cc/6UG5-6X8Q>] (surveying general counsel and senior officers at Fortune 1000 and other large companies and finding that “[a]s expected, the use of arbitration clauses increased in 2018, and the percentage of companies that included class action waivers in their arbitration clauses increased to near 50 percent”).

57. *See, e.g.,* Samuel Estreicher, Michael Heise & David S. Sherwyn, *Evaluating Employment Arbitration: A Call for Better Empirical Research*, 70 RUTGERS U. L. REV. 375, 375–76 (2018) (“Since at least 1991, issues surrounding mandatory arbitration of employment and other disputes have intrigued, perplexed, angered, gratified, and confounded

lutions are private.<sup>58</sup> As Professor Cynthia Estlund describes in *The Black Hole of Mandatory Arbitration*, “the federal courts are exemplars of transparency compared to the world of arbitration.”<sup>59</sup> While researchers could access court filings and orders, they could not access arbitration filings or resolutions. Thus, comparisons were impossible. However, in 2002, California adopted a statute requiring certain private arbitration companies to “collect, publish at least quarterly, and make available to the public in a computer-searchable format” data about its arbitrations including party names; whether the dispute was employment related; whether parties were “repeat players” before the private arbitration company; the amount of claim; the amount of award; and whether other relief was granted.<sup>60</sup>

This data would expose that mandatory arbitration provisions and class action waivers act as “a virtual insurance policy,” effectively indemnifying employers “against employment claims” whether for wage and hour violations, sexual harassment, discriminatory practices, or other illegal activities—and one that is free, no less.”<sup>61</sup> To indemnify a person is to shield that person against legal liability for their actions. Mandatory arbitration provisions and class action waivers begin the indemnification process by causing workers to abandon claims of employer misconduct.

### 1. *Workers Abandon Claims Instead of Arbitrating*

In 2018, Professor Cynthia Estlund compared data on the federal and state lawsuits filed by the 44% of U.S. workers who are *not* bound by MAAs and class action waivers with the arbitrations initiated by the 56% of workers who are bound by these provisions.<sup>62</sup> She concluded that, as a general matter, the 44% of U.S. workers who are able to litigate their claims in open, public forums do so while the 56% of workers forced into private arbitration abandon their claims instead of participating in a rigged system.<sup>63</sup>

According to Professor Estlund’s study, in 2016 “approximately 31,000 federal lawsuits were filed in five categories of employment cases:” workers sought to enforce their rights under civil rights laws, the Americans with Disabilities Act, the Fair Labor Standards Act, the Employment Re-

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academics, politicians, lawyers, and others. Similar to many legal issues, the first wave of scholarly work centered on the law. As the law has pretty much settled, academics have turned to empirical work, focusing on how employment arbitration works, and how it compares to employment litigation. In part due to pressure from California legislation, the American Arbitration Association (“AAA”), the nation’s leading provider of arbitration services, opened access to its data base. Owing to inevitable data limitations, most analyses have focused on outcomes—comparisons between litigation verdicts/judgments and arbitration awards.” (footnotes omitted).

58. See *infra* note 109 and accompanying text.

59. Estlund, *supra* note 23, at 684.

60. 2002 Cal. Legis. Serv. ch. 1158 (A.B. 2656) (West) (codified as amended at CAL. CIV. PROC. CODE § 1281.96(a) (West, Westlaw through Ch. 372 of 2020 Reg. Sess.)).

61. Estlund, *supra* note 23, at 706.

62. See *id.* at 691.

63. See *id.* at 691, 698.

irement Income Security Act, and the Family and Medical Leave Act.<sup>64</sup> These workers also file an estimated “195,000 employment lawsuits per year in state courts of general jurisdiction.”<sup>65</sup> Many of the federal and state lawsuits these workers file are “class or collective actions, some of which might cover hundreds of employees or more.”<sup>66</sup> In short, workers with access to the justice system turn to that system to enforce their rights.

By stark contrast, workers with access only to mandatory arbitration do not turn to that system to enforce their rights. A “very large majority of aggrieved individuals who face the prospect of mandatory arbitration give up their claims before filing.”<sup>67</sup> Crunching the numbers, Estlund concludes that *if* workers bound by mandatory arbitration provisions sought resolution of their employment-related disputes as frequently as unbound workers do, “then we would expect to see between 320,000 and 727,000 employment claims in arbitration.”<sup>68</sup> Instead, the American Arbitration Association, the designated provider in about half of mandatory employment arbitration provisions, resolves “an average of about 940 cases per year.”<sup>69</sup> If filing rates are similar among other arbitration providers, “that yields an estimate of fewer than 2,000 employment arbitration cases terminated per year under MAAs.”<sup>70</sup>

Given these “jaw-dropping disparities in estimated filing rates between court and arbitration,”<sup>71</sup> Estlund concludes that “well under two percent of the employment claims that one would expect to find in some forum, but that are covered by MAAs, ever enter the arbitration process.”<sup>72</sup>

Estlund rightly emphasizes that “[t]he single most striking fact uncovered by the recent studies is the very small number of arbitration cases that enter the process.”<sup>73</sup> As she details, “the presence of a mandatory arbitration provision dramatically reduces an employee’s chance of securing legal representation, as well as her chance of any kind of recovery, any kind of hearing, or any formal complaint being filed on her behalf.”<sup>74</sup> Mandatory arbitration provisions simply erase the vast majority of potentially meritorious claims by employees against employers. “All in all, the available evidence suggests that the overwhelming majority of claims that

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64. *Id.* at 691. The cases were coded in such a way as to limit the count to civil rights claims and ADA claims brought within the employment context. *See id.* (counting federal cases coded “Civil rights: employment” and “ADA [Americans with Disabilities Act]/employment” (alteration in original)).

65. *Id.* at 693 (citing E-mail from Mark D. Gough, Assistant Professor, Penn State Coll. of Liberal Arts, to Cynthia Estlund, Professor, New York Univ. Sch. of L. (Nov. 30, 2017) (on file with the North Carolina Law Review)).

66. *Id.*

67. *Id.* at 699.

68. *Id.* at 696.

69. *Id.* at 689.

70. *Id.*

71. *Id.* at 698.

72. *Id.* at 696.

73. *Id.* at 689.

74. *Id.* at 703 (footnote omitted).

would have been litigated but for the presence of a[n] MAA are simply dropped without being filed in any forum at all.”<sup>75</sup>

A predictable consequence of erasing the overwhelming majority of potentially meritorious claims against employers is that unscrupulous employers will act in increasingly egregious and harmful ways. “If the imposition of mandatory arbitration means that the employer faces only a miniscule chance of ever confronting a formal legal claim in any forum regarding future legal misconduct against its employees, then such a provision virtually amounts to an ex ante exculpatory clause,”<sup>76</sup> preventing employers from ever being held liable if they violate wage and hour laws, fail to provide legally required accommodations for employees with disabilities, or engage in unlawful harassment or other discrimination against their workers. From the worker’s perspective, becoming subject to an employer-imposed MAA acts as an “ex ante waiver of substantive rights that the law declares non-waivable.”<sup>77</sup> Although statutes purport to protect workers’ rights, any avenue for effective enforcement has been waived.<sup>78</sup>

Professor Estlund’s findings that mandatory arbitration prevents the overwhelming majority of workers’ claims from ever being filed make less relevant how the few claims actually filed fare in arbitration: “For all the sound and fury about skewed outcomes, repeat player effects, biased arbitrators, limited discovery, and lack of adherence to or production of precedent in arbitration, it turns out that, except for a relative handful of cases, arbitration does not take place at all.”<sup>79</sup> Professor Estlund calls this “the black hole of mandatory arbitration.”<sup>80</sup>

Unfortunately, the few claims that workers actually advance in arbitration fare poorly. This is unsurprising because the rules applicable to employer-imposed arbitration proceedings are written by the employer. As Professors Katherine Stone and Alexander Colvin explain, arbitration is private, often relaxes the rules of evidence, often limits discovery, adjusts the “amount of due process provided to the participants,” and follows rules written by the drafter of the arbitration provision.<sup>81</sup> “The arbitration agreement itself is the primary source of the rules governing the arbitration process. The parties to this private agreement are generally allowed to write into the arbitration clause whatever rules they wish to govern how disputes will be resolved.”<sup>82</sup> While such a system seems to

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75. *Id.* at 698.

76. *Id.* at 703.

77. *Id.*

78. See, e.g., Judith Resnik, *Diffusing Disputes: The Public in the Private of Arbitration, the Private in Courts, and the Erasure of Rights*, 124 *YALE L.J.* 2804, 2936 (2015); Jean R. Sternlight, *Disarming Employees: How American Employers Are Using Mandatory Arbitration to Deprive Workers of Legal Protection*, 80 *BROOK. L. REV.* 1309, 1328–29 (2015); J. Maria Glover, *Disappearing Claims and the Erosion of Substantive Law*, 124 *YALE L.J.* 3052, 3091–92 (2015).

79. Estlund, *supra* note 23, at 699–700 (footnote omitted).

80. *Id.* at 700.

81. STONE & COLVIN, *supra* note 21, at 17.

82. *Id.*

uphold freedom of contract principles, “[i]n practice this means that the corporation that chooses to make arbitration mandatory for its workers . . . will write the rules of the procedure, and the worker . . . will have no choice but to assent if [the employer] want[s] to enter into an employment . . . transaction.”<sup>83</sup> Employers are legally empowered and incentivized to draft arbitration provisions that favor their own interests and disadvantage their employees.

Employers use many provisions in their unilaterally imposed MAAs to disadvantage their workers. For example, they include

provisions that would bar the claim altogether (like a very short limitations period or unaffordable arbitrator fees), or impede investigation (like very limited discovery), or sharply skew proceedings against the complainant (like a biased arbitrator pool or a skewed selection process), or curtail recovery even in the event of “success” (like provisions against attorney fee shifting or punitive damages, or damage limits).<sup>84</sup>

Provisions like these, which intentionally erode the safeguards provided to workers in the civil justice system, are sometimes enforced and occasionally voided. However, even when they are voided, they still threaten to mislead employees into underestimating their chances of success and advantage the employers who strategically include them in their mandatory arbitration provisions. Even the most egregious provisions “are likely to be struck or amended from an agreement rather than invalidating the agreement. As a result, firms get the benefit of the arbitration agreement despite any overreaching.”<sup>85</sup> The consequences are predictable. Existing law “tempts unscrupulous firms to ‘go for it’—to include knowingly unfair or invalid provisions that are likely to discourage many complainants and their attorneys from pursuing a case at all, with little or no downside risk in case the overreach is detected and corrected.”<sup>86</sup> Employers continue to use even unenforceable dispute resolution terms to chill employees who might otherwise bring meritorious claims. “Legally objectionable arbitration clauses and procedures, as well as vague and indeterminate ones, can deter both litigation and arbitration, especially by plaintiffs in relatively small-dollar cases.”<sup>87</sup> In sum, “companies have every incentive to draft their [mandatory arbitration] agreements to extract backdoor waivers of statutory rights.”<sup>88</sup>

Abstracting from particular terms, arbitration has many aspects that inherently favor employers: “[A]rbitration is a privately created, do-it-yourself tribunal, which rarely provides rights to discovery, compulsory process, cross examination, or other due process protections common to

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83. *Id.*

84. Estlund, *supra* note 23, at 700–01.

85. *Id.* at 701.

86. *Id.*

87. *Id.* at 702.

88. *Id.* at 704 (quoting *Am. Express Co. v. Italian Colors Rest.*, 570 U.S. 228, 244 (2013) (Kagan, J. dissenting)).

civil trials.”<sup>89</sup> Workers who advance claims of employer wrongdoing bear the burden of proving their claims and are impeded in that effort by not having discovery, compulsory process, cross-examination, or other fact-finding tools. Further, data indicates that arbitration favors repeat-player employers over one-time player employees, favors the employers who choose and compensate the arbitrator, and deprives employees of safeguards of the civil justice system.<sup>90</sup> These features create a vicious cycle wherein the few claims brought by workers in employer-imposed mandatory arbitration result in worker-unfavorable outcomes and cause even fewer claims to be brought in the future.<sup>91</sup>

Of critical importance for the purposes of this Article is Professor Estlund’s conclusion that mandatory arbitration provisions, class action waivers, and nondisclosure of dispute resolution provisions have become “a mechanism for employers’ unilateral dissolution of inalienable substantive rights.”<sup>92</sup> As she anticipates, “[a] skeptic might respond: If MAAs did represent a virtual insurance policy against employment claims—and one that is free, no less—then why wouldn’t all employers impose such agreements?”<sup>93</sup> And to this she responds, “I fear that may be exactly where we are headed, albeit more slowly than one might have expected. And the lag in adoption of MAAs might be traceable to the obscurity surrounding mandatory arbitration and the long quest for reliable empirical data on its impact.”<sup>94</sup> Employers are likely to impose mandatory arbitration provisions more frequently and more broadly than ever before. As employers increasingly obtain intangible assets that are akin to free insurance policies shielding them from their employees’ potentially meritorious claims, labor law has provided an insufficient check. Labor law’s potential to respond was further eroded by the Supreme Court’s ruling in *Epic Systems Corp. v. Lewis*.<sup>95</sup>

## 2. Workers Do Not Win Claims in Arbitration

In the rare instances in which employees proceed with arbitrations designed and imposed by their very employers instead of abandoning their

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89. Stone, *supra* note 31, at 1046.

90. See, e.g., Ronald Turner, *The FAA, the NLRA, and Epic Systems’ Epic Fail*, 98 TEX. L. REV. ONLINE 17, 18 (2019); *Forced Arbitration Hearings*, *supra* note 1, at 4 (statement of Deepak Gupta, Founding Principal, Gupta Wessler PLLC); *id.* at 2, 15 (statement of Myriam Gilles, Professor, Benjamin N. Cardozo School of Law).

91. For example, economically rational plaintiffs’ attorneys refuse to take these cases on a contingency-fee basis. See STONE & COLVIN, *supra* note 21, at 21 (“The mandatory arbitration–litigation outcome gap has a significant and pernicious effect on the ability [of employees] to obtain legal counsel under . . . contingency-fee arrangements. . . . [A]ttorneys decide whether to accept a case based on their judgment about the likely outcome. But as we have seen, the average outcome is substantially lower in mandatory arbitration than it is for litigation.”).

92. Estlund, *supra* note 23, at 705.

93. *Id.* at 706.

94. *Id.*

95. See 138 S. Ct. 1612, 1619 (2018).

claims, employees tend to lose.<sup>96</sup> Professor Alexander Colvin found that

[e]mployee win rates in mandatory arbitration are much lower than in either federal court or state court, with employees in mandatory arbitration winning only just about a fifth of the time (21.4 percent), which is 59 percent as often as in the federal courts and only 38 percent as often as in state courts.<sup>97</sup>

Employers write the rules of arbitration, and then they win.<sup>98</sup>

### 3. *When Workers Win, They Win Little*

In the rare arbitration that results in a worker winning, the worker wins little: “[T]he median or typical award [to a worker] in mandatory arbitration [is] only 21 percent of the median award in the federal courts and 43 percent of the median award in the state courts.”<sup>99</sup>

Taking lower win rates and lower damages together shows how disadvantageous arbitration is for workers.

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96. See, e.g., STONE & COLVIN, *supra* note 21, at 3 (“By delegating dispute resolution to arbitration, the Court now permits corporations to write the rules that will govern their relationships with their workers and customers and design the procedures used to interpret and apply those rules when disputes arise.”); Resnik, *supra* note 78, at 2808 (“To assume the result is ‘mass arbitration’ is to misunderstand how the provisions function; few who are cut off from using the courts and required (rather than choosing) to arbitrate do so, thereby erasing as well as diffusing disputes.”); Kathleen McCullough, Note, *Mandatory Arbitration and Sexual Harassment Claims: #MeToo-and Time’s Up-Inspired Action Against the Federal Arbitration Act*, 87 *FORDHAM L. REV.* 2653, 2658–59 (2019) (“Mandatory arbitration agreements can have major drawbacks for employees. Critics of mandatory arbitration suggest that employees are less likely to prevail in arbitration and, even if they do prevail, often recover less than they would through litigation. Mandatory arbitration may suppress meritorious claims and limit publicly accessible information due to nondisclosure agreements, which are often part of arbitration settlements.” (footnotes omitted)).

97. STONE & COLVIN, *supra* note 21, at 19.

98. Sternlight, *supra* note 30, at 188–89 (“Employment arbitrators are trying to make a living, which they do by being hired and rehired by disputants. They therefore may not want to write creative progressive decisions that present a greater risk of getting vacated. Such an outcome could annoy current disputants and discourage others from hiring that arbitrator in the future. More specifically, such an outcome could displease the *employer* disputant, to the detriment of the arbitrator. Employers, particularly large corporate employers, are repeat players who frequently hire arbitrators in multiple cases; individual employees may dispute only a single claim over the course of a lifetime and thus have less market influence.” (footnotes omitted)); McCullough, *supra* note 96, at 2659 (“Employers may have a significant advantage in the arbitration process because they often choose the applicable procedures and select the arbitrators. Employers also have a ‘repeat player’ advantage because they are familiar with the system and may deal with the same arbitrator multiple times, which also creates the potential for unconscious bias in their favor.” (footnote omitted)).

99. See STONE & COLVIN, *supra* note 21, at 19–20 (citing Alexander J.S. Colvin, *An Empirical Study of Employment Arbitration: Case Outcomes and Processes*, 8 *J. EMPIRICAL LEGAL STUD.* 1–23 at 5 (2011); Theodore Eisenberg & Elizabeth Hill, *Arbitration and Litigation of Employment Claims: An Empirical Comparison*, 58 *DISP. RESOL. J.* 44–55 (2004); Estlund, *supra* note 23, at 688–89 (“[E]mployees who did win something recovered much less in AAA arbitration than in litigation: The median award was \$36,500 in arbitration versus \$176,426 in federal discrimination cases, \$85,560 in state non-civil rights employment cases, and \$355,843 in California wrongful discharge cases.”).

The most comprehensive comparison comes when we look at the mean or average amount recovered in damages across all cases, including those in which the employee loses and zero damages are awarded. When we make this comparison, we find that the average outcome in mandatory arbitration is only 16 percent of that in the federal courts and 7 percent of that in state courts.<sup>100</sup>

In sum, “mandatory arbitration is massively less favorable to employees than are the courts.”<sup>101</sup> A study by the Economic Policy Institute similarly found that

plaintiffs’ overall economic outcomes are on average 6.1 times better in federal court than in mandatory arbitration (\$143,497 versus \$23,548) and 13.9 times better in state court than in mandatory arbitration (\$328,008 versus \$23,548). These are very large differences in outcomes, and attempts to explain away this gap have been largely unsuccessful.<sup>102</sup>

The available data shows that arbitration is good for employers and bad for employees.<sup>103</sup>

#### 4. *Labor Laws Go Unenforced by Any Tribunal*

Nearly twenty-five years ago—and well before the dramatic expansions of mandatory arbitration and class action waivers—Professor Katherine Stone warned of the harms of these provisions:

courts should not permit workers to waive their rights under state or federal employment statutes. That is, courts should not force parties to arbitrate statutory claims, should not presume that promises to arbitrate include promises to arbitrate statutory claims, and should not give arbitral rulings on statutory issues preclusive effect. To do otherwise threatens to nullify the past sixty years’ development of workers’ rights and will make it difficult to legislate effective worker protection in the future.<sup>104</sup>

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100. See STONE & COLVIN, *supra* note 21, at 19.

101. *Id.* The lower win rate and lower damage awards in arbitration do not appear to be explained by employees bringing weaker cases in arbitration, because summary judgment dismissal is less common in arbitration. See *id.* at 20 (“Looking at [a] subsample of cases in arbitration and litigation where there was no summary judgment motion, Colvin and Gough found that the win rate was 32 percent lower in mandatory arbitration than in litigation. This result indicates that the gap in outcomes cannot be explained away as an effect of greater use of summary judgment motions in litigation.” (citing ALEXANDER J.S. COLVIN & MARK D. GOUGH, *COMPARING MANDATORY ARBITRATION AND LITIGATION: ACCESS, PROCESS, AND OUTCOMES* (2014), <https://digitalcommons.ilr.cornell.edu/cgi/viewcontent.cgi?article=1059&context=reports> [<https://perma.cc/HQ3W-QTSW>])).

102. *Id.* at 21.

103. See *id.* (“The mandatory arbitration–litigation gap in outcomes has a direct effect on the ability of individual workers to recover compensation for the injuries they have suffered. The gap also reduces the liability exposure of corporations that adopt mandatory arbitration. However, equally important, the mandatory arbitration–litigation gap has a major impact on the ability of workers to make claims in the first place.”).

104. Stone, *supra* note 31, at 1020.

She warned that mandatory arbitration provisions would effectively strip workers of their statutory rights and thus harm workers who are subject to wage theft and unlawful discrimination particularly.<sup>105</sup>

Workers' rights organizations have similarly sounded the alarm:

[I]n a joint statement to the Commission on the Future of Worker-Management Relations, several organizations representing working women, including 9 to 5, the National Association of Working Women, the American Nurses Association, and the Coalition of Labor Union Women, decried the "alarming trend toward using mandatory arbitration to reduce employment-related litigation." These groups feared in particular that Alternative Dispute Resolution (ADR) was being used "as a means of eroding the hard-fought legal protections women have against inequitable treatment in the workplace . . . (especially) in the area of sexual harassment."<sup>106</sup>

These organizations objected to the manner in which employers imposed these terms, arguing that "employers should not be able to coerce individual workers, particularly women workers who are not protected by a union, at the onset of an employment relationship or at any time thereafter, to choose between their statutory rights to be free of discrimination and their jobs."<sup>107</sup>

Unfortunately, courts did not heed this warning. To the contrary, mandatory arbitration provisions and class action waivers have received ever stronger approval by courts.<sup>108</sup> Predictably, these terms have become far more common in response to this approval.

##### 5. *Labor Laws Go Unenforced by Sunlight*

Mandatory arbitration provisions protect employers who violate wage and hour laws, labor laws, sexual harassment laws, and discrimination laws from being exposed to prospective employees, business partners, customers, and the public. As Professor Katherine Van Wezel Stone explains, this is by design:

arbitral decisions are invisible documents—they do not receive media attention or public scrutiny and therefore engender no public debate. Arbitrators are not public officials, not accountable to a larger public, nor required to apply public law. And there is no legislative arena in which unpopular decisional trends can be challenged. Arbitration is a privatized forum, designed by the parties, and out of the public eye.<sup>109</sup>

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105. *See id.*

106. *Id.* at 1047 (second alteration in original) (footnote omitted) (quoting *Fact Finding Report: Hearing Before the Commission on the Future of Worker-Management Relations*, 102d Cong. 24–26 (1994) (statement of 9 to 5)).

107. *Id.* (quoting *Fact Finding Report: Hearing Before the Commission on the Future of Worker-Management Relations*, 102d Cong. 24–26 (1994) (statement of 9 to 5)).

108. *See Epic Sys. Corp. v. Lewis*, 138 S. Ct. 1612, 1619 (2018).

109. Stone, *supra* note 31, at 1046–47 (footnote omitted).

By shielding themselves from exposure to current and prospective employees, business contacts, and the public, employers gain significant advantage through the use of arbitration. Some employers highly value secrecy.

Unfortunately, while sunlight on employer wrongdoing can bring about change, darkness fosters growth. For example, the *New York Times* reported on long-standing and rampant sexual harassment at the employer Sterling Jewelers, which owns Kay Jewelers and Jared the Galleria of Jewelry.<sup>110</sup> The victims of harassment reported that their employer's mandatory arbitration provision prevented prospective employees, customers, and the public from responding to the offensive conduct by boycotting or otherwise pressuring change.<sup>111</sup> The provision also prevented victims from discovering that their experiences were part of a pattern of abuse and from proving that pattern to the arbitrator.<sup>112</sup> As employees who were victims of harassment explained,

all the employees had signed a mandatory arbitration agreement in the flood of paperwork that accompanied their hiring at Sterling—everyone did at the time. Arbitration meant that instead of being heard in a public court, they had to proceed privately in Sterling's in-house system, called Resolve. The first step of Resolve was an internal investigation. If the employee wasn't satisfied by the results of that investigation, he or she could ask to be heard by a panel of the employee's peers and an employment lawyer, all selected by Sterling. If the employee was still dissatisfied, the case was sent to arbitration. Sterling paid the arbitrator. The hearing's proceedings . . . were done in private, and their outcome was sealed. Afterward, if there was a settlement, the employee often had to sign a nondisclosure agreement that prohibited the employee from speaking about the case again.<sup>113</sup>

Sterling designed an arbitration process to benefit itself, and—as the article concludes—perhaps the most significant “benefit to the company was that” meritorious sexual harassment claims were “resolved in secret. The secrecy was the point.”<sup>114</sup>

Workers' rights advocates argue that if employers are not publicly exposed for their wrongdoing, the wrongdoing is perpetuated. Indeed, they argue that employers should be exposed and boycotted not just for harassment, discrimination, wage and hour violations, and other labor law violations but also for imposing mandatory arbitration terms on their employees because the harm of mandatory arbitration is so extreme.<sup>115</sup>

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110. Taffy Brodesser-Akner, *All That Glitters*, N.Y. TIMES MAG., Apr. 28, 2019, at 26.

111. *Id.*

112. *Id.*

113. *Id.*

114. *Id.*

115. See, e.g., Katherine V. Stone, *Signing Away Our Rights*, AM. PROSPECT (Mar. 5, 2011), <https://prospect.org/features/signing-away-rights/> [<https://perma.cc/2BE6-YR3H>] (“[W]ith a Republican majority, [federal legislative] reform is virtually dead for the foreseeable future. The other way to slow the arbitration express is for consumer and worker

## C. HARMS TO WORKERS GENERALLY

Individual suits for wage and hour violations are inefficient, which partially explains why coercive employment dispute resolution terms often bar class actions<sup>116</sup>: “The ban on class actions in particular makes it unlikely that many claims of corporate wrongdoing—particularly those that involve small sums for each in large groups of individuals—will ever be heard.”<sup>117</sup> Further, “[a]s Justice Breyer opined, ‘Only a lunatic or a fanatic sues for \$30.’”<sup>118</sup> Lack of an effective remedy makes wage theft easier, more common, and worse.<sup>119</sup>

Discrimination and sexual harassment suits often require proof of patterns of conduct, which partially explains why coercive employment dispute resolution terms often bar class actions and require confidentiality. An important component of justice for workers treated unlawfully is ex-

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groups to publicize the names of corporations that demand compulsory arbitration and class-action bans and to call upon the public to stop doing business with them. If Congress won’t act, this abuse cries out for collective citizen action.”); *see also, e.g., Coercive Contracts, supra* note 16 (exposing law firms who impose coercive employment terms on their employees).

116. *See* STONE & COLVIN, *supra* note 21, at 26–27; *see also* Sternlight, *supra* note 30, at 183–84 (“When vulnerable employees’ claims are weaker, . . . they will more likely be suppressed, because lawyers will not be eager to take the claims and because individual employees will hesitate to file them on their own. If the claims also cannot be brought in class actions, that augments the problem. So, when the claims of the most vulnerable employees are shunted to arbitration they become even more difficult to bring than would otherwise be the case.”).

117. STONE & COLVIN, *supra* note 21, at 26; *see also* Myriam Gilles & Gary Friedman, *After Class: Aggregate Litigation in the Wake of AT&T Mobility v Concepcion*, 79 U. CHI. L. REV. 623, 629–30 (2012) (“[M]ost class cases will not survive the impending tsunami of class action waivers. And as this great mass of . . . employment . . . and other cases is swept out to sea, the question arises: What or who can fill the resulting enforcement gap?”); Myriam Gilles, *Opting Out of Liability: The Forthcoming, Near-Total Demise of the Modern Class Action*, 104 MICH. L. REV. 373, 419–20 (2005) (“While arbitration of employment disputes is nothing new (and some scholars have staunchly defended the use [of] arbitration in the employment context) the potential for collective action waivers to curtail most, if not all, employment class actions seeking broad-scale changes in the U.S. workplace is a more recent phenomenon. Aggressive employers such as Circuit City have already used collective action waivers to avoid classwide exposure in the employment context. Brokerage houses, which have recently paid out high settlements to avoid jury trials in gender-discrimination cases, have long used arbitration clauses to shield themselves from classwide liability in employment claims; one would expect these entities to soon add collective action waivers to ensure their immunity. And the newfound ability of employers to notify employees of arbitration clauses via mass emails will make it far easier to impose these waivers.” (footnotes omitted)).

118. STONE & COLVIN, *supra* note 21, at 26 (quoting *AT&T Mobility LLC v. Concepcion*, 563 U.S. 333, 365 (2011) (Breyer, J., dissenting)).

119. *See id.* at 13 (“[T]he arbitration law trends may signal the destruction of the legal protection for collective action that has been at the heart of labor laws for over 60 years.”); Gilles, *supra* note 36, at 867 (“[I]ndividually risking so much for so little makes no sense. More important than costs are attorneys’ fees. Class actions happen because lawyers advance their time and fees, and they are not going to do that unless they can recover from sufficiently large numbers of people to make it worthwhile.” (footnote omitted)); Gilles, *supra* note 117, at 378 (“[S]ound public policy requires collective litigation be available for small-claim plaintiffs who would not have the incentive or resources to remedy harms or deter wrongdoing in one-on-one proceedings.”).

posure of the employer’s wrongdoing and a public judicial sanction.<sup>120</sup>

#### D. HARMS TO VULNERABLE WORKERS PARTICULARLY

One need only look at the laws that workers seek to enforce—wage and hour laws, sexual harassment laws, antidiscrimination laws, reasonable accommodation laws—to see that coercive employment dispute resolution terms disproportionately harm lower-paid, racial-minority, female, LGBTQIA+, physically impaired, and vulnerable workers.

Indeed, it is not just that vulnerable workers are more likely to have their potentially meritorious claims barred by mandatory arbitration provisions; they are also more likely to be subject to mandatory arbitration provisions in the first place.<sup>121</sup> In its survey on the use of mandatory arbitration provisions, the Economic Policy Institute considered that “[s]ince the proportion of female and racial and ethnic minority employees varies significantly across industries, we can also look at whether the rate of imposition of mandatory arbitration varies with the composition of the workforce in the industry.”<sup>122</sup> It did—and in troublingly predictable ways. For example, “[c]onstruction, an industry with a predominantly male workforce, has the lowest rate of imposition of mandatory arbitration, whereas education and health, industries with a more predominantly female workforce, have the highest rate of imposition of mandatory arbitration.”<sup>123</sup>

Similar industry-based comparisons indicate that African-American workers are more likely to be subject to mandatory arbitration than are their white peers.<sup>124</sup> Employer surveys indicate that “59.1 percent of African-American workers” while “55.6 percent of white, non-Hispanic workers . . . are subject to mandatory arbitration.”<sup>125</sup> Unfortunately, “overall, female workers (at 57.6 percent) and African-American workers (at 59.1 percent) are the most likely to be subject to mandatory arbitration.”<sup>126</sup>

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120. See, e.g., Stacy Perman, *#MeToo Law Restricts Use of Nondisclosure Agreements in Sexual Misconduct Cases*, L.A. TIMES (Dec. 31, 2018, 3:00 AM), <https://www.latimes.com/business/hollywood/la-fi-ct-nda-hollywood-20181231-story.html> [<https://perma.cc/C8M4-C6G3>] (“[O]nce investigations into [Harvey] Weinstein turned up claims of rape in October 2017, [his former assistant Zelda] Perkins was forced to reconsider the [settlement she had negotiated, which contained a nondisclosure provision forbidding her from discussing Weinstein’s sexual harassment of her]. ‘I was just so angry and frustrated, and I wasn’t allowed to speak to anybody about what happened,’ she told the Los Angeles Times. Although she faced crushing legal and financial repercussions if she went public, ‘I felt I had an absolute moral duty to break this agreement.’”).

121. See Sternlight, *supra* note 30, at 183 (“Compared to litigation, mandatory arbitration makes it harder for employees to secure legal representation, harder for employees to participate in class actions, and it remains hard for employees to bring or prevail on claims brought pro se. While these burdens affect all employees, they fall most heavily on the most vulnerable members of society.” (footnotes omitted)).

122. COLVIN, *supra* note 19, at 8.

123. *Id.*

124. *Id.* at 9.

125. *Id.*

126. *Id.*

Finally, lower-paid workers are more likely to be subject to mandatory arbitration provisions than are higher-paid workers. “It is the employers with the lowest-paid workforces that are most likely to impose mandatory arbitration on their employees. This is a concern from a policy perspective because low-paid employees are particularly vulnerable to infringements of their employment rights . . . [including] widespread violations of wage and hour laws.”<sup>127</sup>

#### E. HARMS TO THE SOCIETY AND THE RULE OF LAW

While some harms of mandatory arbitration and other coercive employment dispute resolution terms are borne primarily by employees—and particularly vulnerable employees—others are borne by society generally through the erosion of the rule of law, failure to enforce state and federal statutes, lack of transparency, and offense to fairness.

An amicus brief filed by several state attorneys general in the *Epic Systems* case explains that mandatory arbitration provisions impede enforcement of democratically enacted laws, like the Fair Labor Standards Act, thereby widening a gap in enforcement that states are already under-resourced to fill.<sup>128</sup> As these amici argued, state and federal laws are statements of shared community values, expressed through a democratic process.<sup>129</sup> The failure to enforce these laws is an offense to the rule of law and to the results of our democratic processes. As one arbitration scholar candidly asks, “If Congress passes laws that can’t be enforced in the real world, what good are those laws?”<sup>130</sup>

Additionally, mandatory arbitration provisions erode the strength and accuracy of our common law system. Just as taking data points out of a marketplace leads to a less efficient marketplace, taking court rulings out

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127. *Id.*

128. See Brief of Maryland et al. as Amici Curiae Supporting Respondents in Nos. 16-285 and 16-300 and Petitioner in No. 16-307 at 2–6, *Epic Sys. Corp. v. Lewis*, 138 S. Ct. 1612 (2018) (Nos. 16-285, 16-300, 16-307), 2017 WL 3588729, at \*2–6.

129. See *id.*

130. *Forced Arbitration Hearings*, *supra* note 1, at 2 (statement of Deepak Gupta, Founding Principal, Gupta Wessler PLLC). See generally G. Richard Shell, *ERISA and Other Federal Employment Statutes: When Is Commercial Arbitration an “Adequate Substitute” for the Courts?*, 68 TEX. L. REV. 509, 568 (1990) (“Title VII is not only a remedial statute, it is an attempt to address a systemic social ill—discrimination—that is deeply embedded in the cultural fabric. The adjudication of a Title VII claim is both an opportunity to reverse an instance of discrimination and an occasion for examining the institutions that made discrimination possible. The Court . . . recognized this aspect of Title VII when it stated that ‘the private litigant not only redresses his own injury but also vindicates the important congressional policy against discriminatory practices.’ Commercial arbitration is not well situated to serve this institutional goal because it is essentially transactional in focus.”) (footnote omitted) (quoting *Alexander v. Gardner-Denver Co.*, 415 U.S. 36, 45 (1974)); *id.* at 570 (“[A]dministrative hearing officers must render written opinions containing rulings of law, thus subjecting them to the sort of rigorous ‘legal discipline’ in their thinking that is missing from commercial arbitration decisional processes. . . . The institutions of commercial arbitration have demonstrated neither the historical ability nor the desire to resolve disputes [involving rights to personal dignity and equal protection] so close to the core of our Nation’s values.”).

of the common law system will lead to a less tried, less tested body of case law.<sup>131</sup>

Finally, the secrecy of mandatory arbitration prevents exposure of employer misconduct and makes society less safe. For example, “[s]ecret settlements in sexual assault and related cases can jeopardize the public—including other potential victims—and allow perpetrators to escape justice . . . . These secret settlements in workplace and other settings can ultimately endanger the public by hiding sexual predators from law enforcement and the public.”<sup>132</sup>

### III. EXISTING LAW DICTATES THAT COERCIVE EMPLOYMENT DISPUTE RESOLUTION TERMS BE UPHELD

Unfortunately, although mandatory arbitration and other coercive employment dispute resolution terms are extremely harmful, the U.S. Supreme Court sides with employers who impose them. In 2018, a 5–4 decision by the Court resolved a circuit split to hold that mandatory arbitration provisions, class action waivers, and nondisclosure provisions unilaterally imposed by employers on their employees do not violate the National Labor Relations Act (NLRA) and are enforceable.<sup>133</sup> This Part describes how *Epic Systems* reversed contrary rulings of the Seventh and Ninth Circuits to uphold coercive employment dispute resolution terms and pave the way for these terms to become even more common.

In *Lewis v. Epic Systems Corp.*, the Seventh Circuit held that coercive dispute resolution terms in employment contracts were unenforceable because they violate the NLRA’s protection of employees’ right to engage in concerted activities, including “collective, representative, or class legal

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131. See Gupta & Khan, *supra* note 35, at 499–500 (“Cases that previously would have been litigated and publicly recorded are now either diverted to a private arbitrator or not brought at all.”); Resnik, *supra* note 78, at 2855 (“[F]rom arbitration dockets . . . one employee cannot generally know if another succeeded on discrimination or on other claims of rights.”); Sternlight, *supra* note 30, at 181 (“Turning to the impact of mandatory arbitration on society more generally, critics have long worried that requiring employees to arbitrate rather than litigate claims will undermine the force of law not only by suppressing claims, but also by requiring claims to be heard privately and limiting easy access to precedent.”); *Forced Arbitration Hearings*, *supra* note 1, at 10 (statement of Myriam Gilles, Professor, Benjamin N. Cardozo School of Law) (“Class-banning forced arbitration clauses . . . undermine the principles central to the rule of law, such as stare decisis and the development of legal precedents.”); Owen M. Fiss, *Against Settlement*, 93 *YALE L.J.* 1073, 1085–87 (1984) (arguing that even when settlements are voluntarily agreed to go through a dispute resolution process that was mutually adopted after the dispute arose, settlement weakens the common law system by depriving it of data points and precedent). The weight of this harm should be viewed as far higher when the common law system is deprived of data points and precedent by arbitration outcomes that are dependent on a process that was not mutually agreed to but instead unilaterally imposed before the dispute even arose.

132. Michelle Kaminsky, *The Harvey Weinstein Effect: The End of Nondisclosure Agreements in Sexual Assault Cases?*, *FORBES* (Oct. 26, 2017, 1:00 PM), <https://www.forbes.com/sites/michellefabio/2017/10/26/the-harvey-weinstein-effect-the-end-of-nondisclosure-agreements-in-sexual-assault-cases/#21389a5a2c11> [https://perma.cc/SWR5-3FEF] (quoting California state senator Connie Leyva).

133. *Epic Sys. Corp. v. Lewis*, 138 S. Ct. 1612, 1632 (2018).

proceeding[s].”<sup>134</sup> Similarly, in *Ernst & Young LLP v. Morris*, the Ninth Circuit held that provisions requiring employees to arbitrate “only as individuals and in ‘separate proceedings’” signed as a condition of employment were unenforceable against employees initiating class-action wage and hour litigation because the NLRA protects employee engagement in collective action and makes its protections non-waivable.<sup>135</sup> On the other side of the split, the Fifth Circuit held in *Murphy Oil USA, Inc. v. NLRB* that mandatory arbitration provisions imposed by employers as a condition of employment were enforceable and protected by the Federal Arbitration Act.<sup>136</sup> The Supreme Court granted certiorari in each of these three cases<sup>137</sup> and consolidated them into *Epic Systems Corp. v. Lewis*.<sup>138</sup>

The way Epic Systems imposed its arbitration provision and class action waiver are illustrative. As the Seventh Circuit described,

On April 2, 2014, Epic Systems sent an email to some of its employees. The email contained an arbitration agreement mandating that wage-and-hour claims could be brought only through individual arbitration and that the employees waived “the right to participate in or receive money or any other relief from any class, collective, or representative proceeding.” The agreement . . . also said that employees were “deemed to have accepted this Agreement” if they “continue[d] to work at Epic.” Epic gave employees no option to decline

134. *Lewis v. Epic Sys. Corp.*, 823 F.3d 1147, 1155 (7th Cir. 2016) (“Epic’s clause [mandating individual arbitration of employment-related disputes] runs straight into the teeth of Section 7 [of the NLRA]. The [individual arbitration] provision prohibits any collective, representative, or class legal proceeding. Section 7 provides that ‘[e]mployees shall have the right to . . . engage in . . . concerted activities for the purpose of collective bargaining or other mutual aid or protection.’ A collective, representative, or class legal proceeding is just such a ‘concerted activit[y].’ Under Section 8, any employer action that ‘interfere[s] with, restrain[s], or coerce[s] employees in the exercise of the rights guaranteed in [Section 7]’ constitutes an ‘unfair labor practice.’ Contracts that stipulate away employees’ Section 7 rights or otherwise require actions unlawful under the NLRA are unenforceable.”) (fourth through ninth alterations in original) (citations omitted), *rev’d*, 138 S. Ct. 1612 (2018); *id.* at 1152 (“Contracts ‘stipulat[ing] . . . the renunciation by the employees of rights guaranteed by the [NLRA]’ are unlawful and may be declared to be unenforceable by the Board.”) (alterations in original)).

135. *Morris v. Ernst & Young, LLP*, 834 F.3d 975, 979 (9th Cir. 2016), *rev’d sub nom. Epic Sys. Corp. v. Lewis*, 138 S. Ct. 1612 (2018), *vacated*, 894 F.3d 1093 (9th Cir. 2018) (later reversed and vacated Ninth Circuit opinion finding unenforceable an arbitration provision requiring separate, individualized arbitration proceedings for wage and hour disputes); *id.* at 984 (“The Federal Arbitration Act (‘FAA’) does not dictate a contrary result. The ‘separate proceedings’ provision in this case appears in an agreement that directs employment-related disputes to arbitration. But the arbitration requirement is not the problem. The same provision in a contract that required court adjudication as the exclusive remedy would equally violate the NLRA. The NLRA obstacle is a ban on initiating, in any forum, concerted legal claims—not a ban on arbitration.”); *id.* at 986 (“The FAA does not mandate the enforcement of contract terms that waive substantive federal rights. Thus, when an arbitration contract professes the waiver of a substantive federal right, the FAA’s saving clause prevents a conflict between the statutes by causing the FAA’s enforcement mandate to yield.”).

136. *Murphy Oil USA, Inc. v. NLRB*, 808 F.3d 1013, 1015 (5th Cir. 2015), *aff’d sub nom. Epic Sys. Corp. v. Lewis*, 138 S. Ct. 1612 (2018).

137. 137 S. Ct. 809 (mem.) (granting certiorari in *Epic Systems*; *Ernst & Young, LLP*; and *Murphy Oil USA, Inc.*).

138. 138 S. Ct. 1612 (2018).

if they wanted to keep their jobs. The email requested that recipients review the agreement and acknowledge their agreement by clicking two buttons. The following day, Jacob Lewis, then a “technical writer” at Epic, followed those instructions for registering his agreement.<sup>139</sup>

Like many employers, Epic Systems imposed mandatory individual arbitration on its workforce to prevent employees from bringing their disputes collectively in an open, public forum without a meaningful opportunity for employees to opt out and without any assertion that employees were provided additional compensation or other consideration in exchange for the coercive employment term.<sup>140</sup> Employees were deemed to consent to mandatory arbitration, class action waiver, and nondisclosure of dispute resolution provisions simply by continuing to work after receiving notice of them.<sup>141</sup> Nonetheless, the Supreme Court held that Epic Systems’s individual arbitration provision was enforceable, as were the coercive employment dispute resolution terms imposed by the other employers in the consolidated cases *Ernst & Young* and *Murphy Oil*.<sup>142</sup>

The five-Justice majority in *Epic Systems* held that § 7 of the NLRA, which protects employee engagement in certain “concerted activities” like collective bargaining and union formation, does not protect class action or other litigation activities.<sup>143</sup> In its view, “Section 7 doesn’t speak to class and collective action procedures in the first place.”<sup>144</sup> Next, the majority held that if the Fair Labor Standards Act (FLSA) decides the matter instead of the NLRA, “this Court held decades ago that . . . [the

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139. *Lewis*, 823 F.3d at 1151 (second alteration in original).

140. *See Epic Sys. Corp.*, 138 S. Ct. at 1619–20 (“The agreement also specified individual arbitration, with claims ‘pertaining to different [e]mployees [to] be heard in separate proceedings.’” (alterations in original)). *See generally* *Morris v. Ernst & Young LLP*, No. C–12–04964 RMW, 2013 WL 3460052, at \*1 (N.D. Cal. July 9, 2013) (“McDaniel began her employment at EY on October 1, 2008. McDaniel’s signed offer letter included a copy of EY’s Arbitration Agreement, and provided therein that . . . all employment-related disputes would be subject to the Agreement’s mandatory mediation or arbitration provisions. In addition, McDaniel signed a confidentiality agreement that incorporated by reference the terms of the Arbitration Agreement. Morris began his employment at EY in January 2005. In March and April of 2006, EY sent an email to all employees attaching a copy of its ‘revised’ Arbitration Agreement, and stating therein that ‘An Employee indicates his or her agreement to the [Dispute Resolution] Program and is bound by its terms and conditions by beginning or continuing employment with the firm after May [25], 2006.’ EY asserts that the plaintiffs are bound by the Arbitration Agreement based on their express (McDaniel) or implied (Morris) acceptance of its terms.”) (alterations in original) (citations omitted), *rev’d*, 834 F.3d 975 (9th Cir. 2016), *rev’d sub nom. Epic Sys. Corp. v. Lewis*, 138 S. Ct. 1612 (2018).

141. *See Morris*, 2013 WL 3460052, at \*1 (establishing that employee Morris was bound by mandatory individual arbitration provision simply by “continuing employment” after receiving notice of the provision).

142. *Epic Sys. Corp.*, 138 S. Ct. at 1619–20.

143. 29 U.S.C. § 157; *Epic Sys. Corp.*, 138 S. Ct. at 1628 (“Nothing in our cases indicates that the NLRA guarantees class and collective action procedures, let alone for claims arising under different statutes despite the express (and entirely unmentioned) teachings of the Arbitration Act.”).

144. *Epic Sys. Corp.*, 138 S. Ct. at 1626; *see also id.* at 1625 (“[M]issing entirely from [the NLRA’s] careful regime is any hint about what rules should govern the adjudication of class or collective actions in court or arbitration.”).

FLSA] does *not* . . . prohibit individualized arbitration proceedings” of workplace disputes.<sup>145</sup> Finally, the majority noted that “Congress adopted the Arbitration Act in 1925 in response to a perception that courts were unduly hostile to arbitration,”<sup>146</sup> and that Congress thereby “require[d] courts ‘rigorously’ to ‘enforce arbitration agreements according to their terms, including . . . *the rules* under which that arbitration will be conducted.’”<sup>147</sup> In an argument that might compel when applied to parties exercising equal bargaining power, the majority concluded that “[t]he parties before us contracted for arbitration. They proceeded to specify the rules that would govern their arbitrations, indicating their intention to use individualized rather than class or collective action[s]” and that the Federal Arbitration Act requires that their contractually expressed intent be enforced.<sup>148</sup>

While the majority conceded that “the dissent [wa]s no doubt right that class actions can enhance enforcement by ‘spread[ing] the costs of litigation’”<sup>149</sup> and acknowledged that policy arguments about arbitration provisions and class action waivers are “debatable,”<sup>150</sup> it concluded that the “law is clear” that these provisions are enforceable.<sup>151</sup> Indeed, it ruled that the enforceability of mandatory arbitration provisions cannot be conditioned “on the availability of class-wide arbitration procedures.”<sup>152</sup> Thus, the majority upheld the mandatory arbitration provisions in the three consolidated cases before it, thereby reversing the contrary rulings in the Seventh and Ninth Circuits.<sup>153</sup> *Epic Systems* gives employers better reason than ever to be confident that the mandatory arbitration provisions, class action waivers, and nondisclosure clauses they impose on their employees will be enforced.

The four-Justice dissent in *Epic Systems* identified many of the harms that mandatory individual arbitration provisions impose on workers.<sup>154</sup> For example, the dissent stated that individual wage and hour “claims are small, scarcely of a size warranting the expense of seeking redress alone” and that employees could “gain effective redress for wage underpayment commonly experienced” only “by joining together with others similarly circumstanced.”<sup>155</sup> The dissent contextualized these harms as part of a

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145. *Id.* at 1626 (citing *Gilmer v. Interstate/Johnson Lane Corp.*, 500 U.S. 20, 32 (1991)); *see also id.* (“In fact, it turns out that [e]very circuit to consider the question’ has held that the FLSA allows agreements for individualized arbitration.” (alteration in original) (quoting *NLRB v. Alt. Ent., Inc.*, 858 F.3d 393, 413 (6th Cir. 2017) (Sutton, J., concurring in part and dissenting in part)).

146. *Id.* at 1621.

147. *Id.* (quoting *Am. Express Co. v. Italian Colors Rest.*, 570 U.S. 228, 233 (2013)).

148. *Id.*

149. *Id.* at 1632 (second alteration in original) (quoting *id.* at 1637 (Ginsburg, J., dissenting)).

150. *Id.*

151. *Id.*

152. *Id.* at 1631 (quoting *AT&T Mobility LLC v. Concepcion*, 563 U.S. 333, 336 (2011)).

153. *Id.* at 1632.

154. *See id.* at 1633–49 (Ginsburg, J., dissenting).

155. *Id.* at 1633.

broader “labor market imbalance” in which “[t]o block such concerted action, their employers require[ ] them to sign, as a condition of employment, arbitration agreements banning collective judicial and arbitral proceedings of any kind.”<sup>156</sup>

Similarly, the dissent asserted, existing labor laws recognize that employment terms are the products of unequal bargaining power and thus these laws aim to protect employees from enforcement of employment terms that would impede their collective action.<sup>157</sup> The dissent reasoned that the NLRA and its predecessor, the Norris–LaGuardia Act, recognize “that employees must have the capacity to act collectively in order to match their employers’ clout in setting terms and conditions of employment.”<sup>158</sup> These laws and the court decisions enforcing them do not view employment contract terms as the product of mutual intent; rather, they recognize that “workers often had to accept employment on whatever terms employers dictated.”<sup>159</sup> Thus, labor laws, including § 7 of the NLRA, “guarantee[ ] employees ‘the right . . . to engage in other concerted activities for the purpose of collective bargaining or other mutual aid or protection.’”<sup>160</sup> The dissent would have found that “[s]uits to enforce workplace rights collectively fit comfortably under the umbrella ‘concerted activities for the purpose of . . . mutual aid or protection.’”<sup>161</sup>

Further, while acknowledging that the Federal Arbitration Act promotes enforcement of arbitration agreements, the dissent argued that the Act’s legislative history “evidence[s] Congress’ aim to enable merchants of roughly equal bargaining power to enter into binding agreements to arbitrate *commercial* disputes” and “shows that Congress did not intend the statute to apply to arbitration provisions in employment contracts.”<sup>162</sup> Thus, the dissent would have refused to enforce employment terms in derogation of that right, including mandatory arbitration provisions, class action waivers, and nondisclosure provisions.<sup>163</sup>

The dissent took issue with the majority’s presentation of mandatory arbitration provisions as a freedom of contract matter.<sup>164</sup> Given the power imbalance, the “freedom to depart” from default dispute resolution processes “is entirely one sided.”<sup>165</sup> The dissent lamented that

[o]nce again, the Court ignores the reality that sparked the NLRA’s passage: Forced to face their employers without company, employees ordinarily are no match for the enterprise that hires them. Employees gain strength, however, if they can deal with their employers in numbers. That is the very reason why the NLRA secures against em-

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156. *Id.*

157. *Id.* at 1637–38.

158. *Id.* at 1634.

159. *Id.*

160. *Id.* at 1635 (emphasis omitted) (quoting 29 U.S.C. § 157).

161. *Id.* at 1637 (alteration in original) (quoting 29 U.S.C. § 157).

162. *Id.* at 1642–43.

163. *See id.* at 1648–49.

164. *Id.* at 1640.

165. *Id.*

ployer interference employees' right to act in concert for their "mutual aid or protection."<sup>166</sup>

The dissent urged Congress to correct "the Court's elevation of the [Federal Arbitration Act] over workers' rights to act in concert."<sup>167</sup> Unfortunately, it is unlikely that Congress will act.<sup>168</sup>

This author agrees with the dissent and would have found that the collective action protected by existing labor law includes class action litigation. However, this Article does not take up the labor law or statutory interpretation conclusions in the *Epic Systems* consolidated cases. This Article details these cases because they show how coercive employment dispute resolution terms are imposed, how they privilege employers over employees, how they are in tension with policy goals of existing labor law, and how their enforceability is scaffolded by recent Supreme Court interpretations of the Federal Arbitration Act.

Thus, taking the labor law defeat as given<sup>169</sup>—at least temporarily—this Article aims to expose the previously ignored tax consequences that should apply to employers who impose coercive employment dispute resolution terms on their workforces. It proposes a new check on mandatory arbitration, class action waiver, and nondisclosure of dispute provisions by arguing that when employers impose these terms on their workforces, they obtain a new and valuable intangible asset that should be subject to tax.

#### IV. CURRENT TAX TREATMENT OF COERCIVE EMPLOYMENT DISPUTE RESOLUTION TERMS

The current tax treatment of a coercive employment term depends on the context in which it is acquired. It turns on whether the coercive employment term is already in effect and acquired from a business seller as part of a business purchase or is newly imposed on an employee.

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166. *Id.* (quoting 29 U.S.C. §§ 151, 157, 158).

167. *Id.* at 1633.

168. *See, e.g.,* STONE & COLVIN, *supra* note 21, at 25 ("The Arbitration Fairness Act has been repeatedly introduced in Congress . . . . However, it has not received a vote, and passage in the current Congress appears unlikely."); Stone, *supra* note 115 ("In 2009, Rep. Hank Johnson of Georgia proposed the Arbitration Fairness Act which would ban mandatory pre-dispute arbitration for employment, consumer, franchise, and civil-rights claims, preserving access to the courts. But the bill didn't get the attention it deserved, even among Democrats, and now with a Republican majority, reform is virtually dead for the foreseeable future.").

169. Interestingly, however, the Fifth Circuit Court of Appeals declined to extend the holding in *Epic Systems* in a recent case outside of the employment context. *See* Henry v. Educ. Fin. Serv. (*In re* Henry), 944 F.3d 587, 590 (5th Cir. 2019) (per curiam) ("The bankruptcy court reasoned that Henry's claims did not 'arise under the loan agreement between the parties,' because Wells Fargo's 'obligation to comply with the Court's discharge order and the statutory injunction provided under 11 U.S.C. § 524 is not, and cannot be, part of a contractual negotiation between private parties.' The bankruptcy court found *Epic Systems* to be 'inapplicable to the instant case,' because 'Henry's claims do not arise out of an arbitrable contract between the parties,' and because 'the Supreme Court gave no indication in *Epic* that it intended its decision to reach' the Bankruptcy Code." (footnote omitted)).

Although the former context is not the primary focus of this Article, it is useful to consider how tax law treats existing coercive employment dispute resolution terms when they are acquired from a business seller because these rules contrast with how tax law currently treats the imposition of a coercive employment term by an employer on its own employees. This contrast reveals an unreasonable disparity: while tax law recognizes coercive employment dispute resolution terms as intangible assets with value to the employer in the business purchase context, it ignores these same intangible assets—and the value they provide to employers—in the business operations context when an employer newly imposes them on its workforce.<sup>170</sup> This inconsistency is unjustified and should be resolved by taxing employers on the value that they receive when they impose coercive employment dispute resolution terms on their employees.

When coercive employment dispute resolution terms are acquired as part of a business purchase—such as when a buyer acquires a workforce with contractual mandatory arbitration provisions, class action waiver provisions, or nondisclosure provisions—the value of these contractual terms is recognized and the buyer amortizes that value<sup>171</sup> over the fifteen years following the business purchase.<sup>172</sup>

When a taxpayer buys a business with coercive employment terms in place, tax law recognizes those terms as intangible assets that enrich the new employer.<sup>173</sup> In contrast, when a taxpayer imposes coercive employment terms on one or more of its employees, tax law fails to recognize those terms as intangible assets that enrich the existing employer. This Article argues that it should. By ignoring the value that an employer captures by imposing coercive employment dispute resolution terms, tax law violates its foundational principles and perversely subsidizes the imposition of these terms.

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170. See 26 U.S.C. § 197(c)(2), (d)(1)(C)(i).

171. See PHILIP F. POSTLEWATE, DAVID L. CAMERON & THOMAS KITTLE-KAMP, FEDERAL INCOME TAXATION OF INTELLECTUAL PROPERTIES AND INTANGIBLE ASSETS ¶ 11.01 (2019) (“The valuation of workforce in place depends on the level of experience, education, and training of the personnel of the business, *and the terms and conditions of their employment.*” (emphasis added)). Favorable employment terms cause a higher value on workforce in place, which, like other § 197 intangibles, is amortized over the fifteen years following the acquisition of the business. See *id.* Because the amortization period for all § 197 intangibles is fifteen years, the aggregate value of all § 197 intangibles is amortized over fifteen years and there is no need to establish separate values for coercive employment terms and other § 197 intangibles. See *id.* However, before § 197 was enacted, courts valued workforce in place and other aspects of going concern value in a variety of ways, including by characterizing the excess of the total purchase price for the business over the business’s tangible assets as going concern value or by capitalizing the excess of expected earnings from the business in excess of expected earnings attributable to its tangible assets as going concern value. See *id.* (describing these valuation methods and noting an example where the Tax Court established going concern value as approximately 10% of the total purchase price for the business).

172. See *id.*; 26 U.S.C. § 197(a), (d)(1)(C)(i).

173. 26 U.S.C. § 197(a), (d)(1)(C)(i).

V. COERCIVE EMPLOYMENT DISPUTE RESOLUTION  
TERMS ARE INCOME TO EMPLOYERS AND  
SHOULD BE TAXED

An employer who imposes a coercive employment dispute resolution term satisfies tax law's broad definition of gross income. The employer experiences an accession to wealth, causes a realization event at the imposition of the term, exercises control, and does not qualify for any recognized exception to gross income.<sup>174</sup> Thus, the employer should be taxed.

While taxing employer-imposed mandatory arbitration and other coercive employment dispute resolution terms is an incomplete solution that should be combined with efforts like the People's Parity Project and legislative efforts to ban employer-imposed mandatory arbitration, class action waiver, and nondisclosure provisions, taxing these terms is an incomplete solution with promise. Requiring employers to pay tax on the benefit they receive by imposing coercive employment dispute resolution terms would discourage the increasingly frequent and broad use of these terms. Additionally, it would raise revenue to fund enforcement of labor laws, antidiscrimination laws, and workplace accommodation laws.

A. IT IS A TAKING, NOT AN EXCHANGE

In a prior article, *Noncompetes as Tax Evasion*, I argue that the IRS should begin enforcing tax law on employers who use employment noncompete agreements and that by failing to do so, it perversely subsidizes these agreements.<sup>175</sup> Here, I argue that the IRS should begin en-

174. See 26 U.S.C. § 61(a) (“[G]ross income means all income from whatever source derived . . . .”); *Comm’r v. Glenshaw Glass Co.*, 348 U.S. 426, 431 (1955).

175. Rebecca N. Morrow, *Noncompetes as Tax Evasion*, 96 WASH. U. L. REV. 265 (2018) (addressing coercive employment terms that employers—at least by their own accounts—exchange for additional compensation). To the extent that noncompete provisions or other coercive employment terms (which primarily provide future benefits to the employer rather than benefits that are expended primarily within the year of payment) are exchanged for compensation, *Noncompetes as Tax Evasion* argues that employers should be prohibited from immediately deducting the employment compensation. *Id.* at 323. Instead, a portion of compensation attributable to the noncompete should be treated as an expenditure and amortized over the restricted period. *Id.* Delaying the deduction for compensation paid for a noncompete or other coercive employment term to match it to the period covered by that term would remove a tax subsidy that currently perversely incentivizes employment noncompetes and would better reflect foundational principles of tax law. See *id.* at 316–22. While focusing on a particularly common and particularly harmful form of restrictive employment covenant—the employment noncompete agreement—the arguments in *Noncompetes as Tax Evasion* apply similarly to other vertical restrictive covenants between employers and employees, many of which have been described by labor law expert Professor Orly Lobel, including provisions prohibiting employees from soliciting customers or co-workers after the employment relationship ends or penalizing employees for exiting the employment relationship. See Orly Lobel, *Gentlemen Prefer Bonds: How Employers Fix the Talent Market*, 59 SANTA CLARA L. REV. 663, 678 (2020) (“[B]eyond traditional non-competes, employers also regularly require their employees to sign a wide and constantly expanding variety of restrictive clauses designed to reduce the outside options of employees. These include non-solicitation of customers and co-workers, pre-innovation assignment agreements of all future patents, copyright—as well as non-patentable and non-copyrightable ideas, non-disclosure agreements that reach beyond what is defined as secret under trade secrecy laws, and exit penalties.”). Regardless of the particular type

forcing tax law on employers who impose mandatory arbitration, class action waiver, and nondisclosure of dispute terms and that by failing to do so, it perversely subsidizes these coercive employment dispute resolution provisions.<sup>176</sup> While the goals of these articles are similar—fidelity to tax law principles, hope for a freer labor market, desire to stop tax-incentivizing monopsony, and instinct to call attention to unexamined tax incentives—the approaches are different.

When an employer imposes a noncompete provision on an employee, the employer is legally required to provide compensation or other consideration in exchange for the imposition.<sup>177</sup> Thus, there is an exchange, and the proper tax treatment turns on when the employer can deduct what it pays in the exchange.<sup>178</sup> *Noncompetes as Tax Evasion* argues that the employer should not be permitted to deduct the compensation it pays for the noncompete until the period of time in which the employer receives the benefit of the noncompete.<sup>179</sup>

By contrast, when an employer imposes a coercive employment dispute resolution provision on an employee, the employer is *not* legally required to provide compensation or other consideration in exchange for the imposition.<sup>180</sup> Employers impose mandatory arbitration provisions, class action waivers, and nondisclosure provisions without even claiming to pay for them; courts enforce these provisions without even inquiring as to whether they are supported by consideration.<sup>181</sup> A mere change in employer policy can subject a workforce to coercive employment dispute resolution terms.<sup>182</sup> Or, an employer can impose these terms by notifying its workforce via a mass email.<sup>183</sup>

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of restriction imposed, whenever an employer can be seen as purchasing a lasting restrictive covenant through compensation (by which I mean a covenant that will benefit the employer beyond the tax year in which it is imposed), the employer should not be permitted to immediately deduct that compensation and instead should be required to amortize it over the period covered by the restrictive covenant. *See* Morrow, *supra*, at 323.

176. Furthering the work of *Noncompetes as Tax Evasion*, this Article addresses coercive employment dispute resolution terms between employers and employees that are not purchased through additional compensation (coercive employment dispute resolution terms).

177. Morrow, *supra* note 175, at 300.

178. *Id.* at 270–71.

179. *Id.* at 272. Of course, one might argue that the pretext of bilateral-imposition of noncompete terms should not control—that employer claims of adequate consideration are false—and that, therefore, all or many noncompete agreements should be treated as unilaterally imposed coercive employment terms. This author does not object to that view and is of the opinion that it would turn on the relative parity or lopsidedness of the bargaining power of the parties to the employment contract. However, *Noncompetes as Tax Evasion* argues that employers should not be allowed to claim that vertical restrictive covenants are supported by compensation consideration for purposes of contract law and then disclaim that they are supported by compensation consideration for purposes of tax law. *Id.* at 271.

180. *Cf. id.* at 300–01.

181. *Cf. id.*

182. *See supra* notes 141 and accompanying text.

183. *See supra* note 117.

Of course, coercive employment dispute resolution provisions—or at least mandatory arbitration provisions and nondisclosure of dispute provisions—involve an illusory exchange of benefit. It is not just the employee who is prevented from litigating; the employer is also prevented from litigating employment-related disputes. However, the data on arbitration of employment disputes exposes just how illusory this exchange is.<sup>184</sup> Mandatory arbitration provisions help employers by harming employees.<sup>185</sup> They prevent employees from bringing claims,<sup>186</sup> make it less likely that employees will win employment-related disputes,<sup>187</sup> and depress damages.<sup>188</sup> Mandatory arbitration provisions and nondisclosure of dispute provisions are stunningly effective at shielding employers from liability for violating wage and hour laws, antidiscrimination laws, sexual harassment laws, and more.<sup>189</sup> The data shows that coercive employment dispute resolution terms “function as a virtual death knell for most employment claims, including the many individual wrongful dismissal or harassment claims” and wage and hour claims.<sup>190</sup>

Furthermore, class action waivers do not involve even an illusory claim of mutual benefit. While it is common for many employees to share an employment-related legal claim against a single employer—for wage and hour violations or hostile work environment, for example—it is difficult to think of circumstances in which many employers would share an employment-related legal claim against a single employee. Class action waivers foreclose opportunities that are valuable to employees and irrelevant to employers.

Finally, if employment dispute resolution provisions were about mutual benefit—if they were primarily seeking to reduce the attorneys’ fees and time that each party spends to resolve a dispute—then we should see them executed after a particular dispute has arisen, when each side can

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184. See Sternlight, *supra* note 30, at 171–72; see also Sternlight, *supra* note 78, at 1312 (“Some arbitration commentators have urged that arbitration can be quicker, cheaper, and simpler than litigation, thus offering an accessible venue for employees who cannot litigate their claims in court. Yet available empirical evidence now shows that mandatory employment arbitration is bringing about the opposite result—eroding rather than boosting employees’ access to justice by suppressing employees’ ability to file claims. This evidence reveals that employees who are covered by mandatory arbitration provisions almost never file arbitration claims. The empirical evidence also provides important insights as to why so few employees file claims in arbitration: (1) employees win less often and win less money in arbitration than in litigation; (2) attorneys are less willing to take employee claims that are headed to arbitration rather than litigation; (3) arbitration is not a hospitable venue for pro se employees; and (4) arbitration is being used to eradicate the class actions, collective actions, and even group litigation that are essential to many employees.” (footnotes omitted)).

185. See *supra* note 159 and accompanying text; Sternlight, *supra* note 78, at 1311 (“Employers are using arbitration clauses to make it more difficult for employees to bring successful individual claims in any forum and also to eliminate the threat of class actions or even collective or group claims in both litigation and arbitration.” (footnote omitted)).

186. See *supra* Section II.B.1.

187. See *supra* Section II.B.2.

188. See *supra* Section II.B.3.

189. See Sternlight, *supra* note 78, at 1313–14.

190. Estlund, *supra* note 23, at 708.

best assess the relative benefits of litigation as compared to arbitration and class action as compared to individualized resolution.<sup>191</sup> This Article holds open the possibility that post-dispute arbitration provisions might constitute mutually beneficial exchanges. However, this is not when we tend to see employment dispute resolution terms imposed. On the contrary, employers in a 2018 survey responded that they impose dispute resolution terms before a dispute has arisen, as a condition of employment, and usually near the time when a new employee is hired.<sup>192</sup>

Consistent with the data, the American public recognizes that mandatory arbitration favors the employer at the expense of the employee. For example, in a 2019 survey of voters, 59% of respondents agreed that “arbitration requirements mainly benefit corporations,” compared to “just 7% [who indicated that] they mainly benefit . . . employees.”<sup>193</sup>

Put plainly, when an employer imposes a coercive dispute resolution provision, that employer receives a benefit without suffering a loss. It is a taking, not an exchange. This taking of benefit is made possible through the employer’s exertion of its superior bargaining power. Thus, proper tax treatment requires that the employer report the benefit received as gross income and pay tax on it.

#### B. WHEN AN EMPLOYER IMPOSES A COERCIVE EMPLOYMENT DISPUTE RESOLUTION TERM, THAT EMPLOYER REALIZES INCOME

The thesis of this Article is that coercive employment dispute resolution terms—including mandatory arbitration provisions, class action waivers, and nondisclosure provisions—result in gross income to the employer, on which the employer should be taxed. When an employer imposes such a term on its workforce, the employer has an accession to wealth (it obtains a new intangible asset in the form of the employment

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191. See Stuart H. Bompey, Michael Delikat & Lisa K. McClelland, *The Attack on Arbitration and Mediation of Employment Disputes*, 13 LAB. LAW. 21, 34–35 (1997) (“The principal advantages to employers of arbitration compared to civil litigation are time and money. Because of limited discovery and motion practice, as well as the informality of hearings, arbitration may cost far less than civil litigation.” (footnote omitted)).

192. See *supra* text accompanying notes 47–48.

193. Memorandum from Guy Molyneux & Geoff Garin, Hart Rsch. Assocs., to Interested Parties 1 (Feb. 28, 2019), <https://web.archive.org/web/20190802030527/https://www.justice.org/sites/default/files/2.28.19%20Hart%20poll%20memo.pdf> [https://perma.cc/PV3P-BDH8] (report accessible through archived web material). Similarly, polls of voters indicate that Republicans, Democrats, and Independents would support legislation to end mandatory arbitration. See *Forced Arbitration Hearings, supra* note 1, at 4 (statement of Deepak Gupta, Founding Principal, Gupta Wessler PLLC) (“Overwhelming majorities of Republicans, Democrats, and independents—80% or more of each—support federal legislation to end forced arbitration.”); CELINDA LAKE, DAVID MERMIN, LIESL NEWTON & CLAIRE REDEMER, LAKE RSCH. PARTNERS, FINDINGS FROM A NATIONAL SURVEY OF 1,000 LIKELY 2016 VOTERS 37 (2015), <https://ourfinancialsecurity.org/wp-content/uploads/2015/07/Toplines.AFRCL.public.070715.pdf> [https://perma.cc/X7Z4-ADDF] (polling likely voters in 2016 election and finding that 75% oppose forced arbitration imposed on bank customers).

dispute resolution term it prefers), causes a realization event, and exercises control. Of course, these three elements cause the employer to have gross income according to *Glenshaw Glass*.<sup>194</sup>

### 1. Tax Law Defines Gross Income Broadly

Tax law provides strong authority to construe gross income broadly. When Congress defined gross income in § 61 of the Internal Revenue Code as “all income from whatever source derived,”<sup>195</sup> it acted “to exert . . . the full measure of its taxing [authority]” as granted by the Sixteenth Amendment to the Constitution.<sup>196</sup> Courts have long held that gross income is broadly defined while exclusions from gross income are narrowly construed.<sup>197</sup>

An employer who imposes a coercive employment dispute resolution term has gross income as a result of that imposition, and the IRS should tax it. The imposition satisfies the three-element definition of gross income in *Glenshaw Glass*.<sup>198</sup> By imposing a coercive employment dispute resolution term, the employer has an accession to wealth, clearly realized, and in the taxpayer’s control.<sup>199</sup>

### 2. An Employer Who Imposes a Coercive Employment Dispute Resolution Term Has an Accession to Wealth

An employer enjoys a significant accession to wealth by imposing a coercive employment dispute resolution term. The employer is enriched by imposition because these terms make employees far less likely to bring legal claims against their employer,<sup>200</sup> less likely to win,<sup>201</sup> and less likely to win big.<sup>202</sup> “[B]y imposing mandatory arbitration on its employees, an employer can ensure that it will face only a miniscule chance of ever having to answer for future legal misconduct against employees.”<sup>203</sup> Similarly, by imposing a class action waiver on its employees, an employer can “curtail most, if not all, employment class actions seeking broad-scale changes in the U.S. workplace.”<sup>204</sup> Finally, by imposing a nondisclosure provision, an employer can hide its wrongdoing from current and prospective employees and from its customers.<sup>205</sup> Coercive employment dis-

194. See *Comm’r v. Glenshaw Glass Co.*, 348 U.S. 426, 431 (1955).

195. 26 U.S.C. § 61(a).

196. *Glenshaw*, 348 U.S. at 429 (quoting *Helvering v. Clifford*, 309 U.S. 331, 334 (1940)); see U.S. Const. amend. XVI (“The Congress shall have power to lay and collect taxes on incomes, from whatever source derived, without apportionment among the several States, and without regard to any census or enumeration.”).

197. See *Glenshaw*, 348 U.S. at 429–30.

198. See *id.* at 431 (“Here we have instances of undeniable accessions to wealth, clearly realized, and over which the taxpayers have complete dominion.”).

199. See *id.*

200. See *supra* Section II.B.1.

201. See *supra* Section II.B.2.

202. See *supra* Section II.B.2.

203. Estlund, *supra* note 23, at 707.

204. Gilles, *supra* note 117, at 419.

205. See Sternlight, *supra* note 30, at 181.

pute resolution terms do not just shield employers from justice; they predictably and measurably save employers money.

Intangible assets—and even some commercial dealings—that will save a taxpayer money are gross income. “There are plenty of other situations where what looks like ‘saving money’ to the taxpayer looks like ‘income’ to the law.”<sup>206</sup> For example, exchanges of labor that save a taxpayer from having to pay for the labor received cause gross income.<sup>207</sup> Cancellation of debt is gross income because it saves a taxpayer from having to repay the debt.<sup>208</sup> A third party’s payment of a legal obligation owed by a taxpayer is gross income because it saves the taxpayer from having to pay that legal obligation directly.<sup>209</sup> A corporation’s repurchase of its own bonds for below par value is gross income because it saves the corporation from having to pay a third-party bondholder at maturity.<sup>210</sup> When “assets previously offset” by anticipated obligations are made available for other uses, a taxpayer is enriched.<sup>211</sup> Coercive employment dispute resolution terms predictably and measurably save employers money. They make available for other uses money that employers otherwise would have paid as damages to their employees.

Similarly, the acquisition of a desired contract right is gross income. The acquisition of a contract right should be taxed like the acquisition of property because, as Professor Bryan Camp explains, a contract right is a form of property.<sup>212</sup> “Contracts themselves are a species of property called a ‘chose in action.’ . . . A chose in action is a species of intangible personalty that can be owned and transferred.”<sup>213</sup> A lease, for example, which tax law recognizes as a property right,<sup>214</sup> is a right born of contract

206. Bryan T. Camp, *The Play’s the Thing: A Theory of Taxing Virtual Worlds*, 59 *HASTINGS L.J.* 1, 41 (2007); see, e.g., *id.* (“For example, performing house-sitting services in exchange for free rent is also just ‘saving money,’ yet the value of the unpaid rent is unquestionably gross income.”).

207. See Rev. Rul. 79-24, 1979-1 C.B. 60 (“[T]he fair market value of the . . . services taken in payment must be included in [gross] income.”).

208. See 26 U.S.C. § 61(a)(11) (listing as an item of gross income “[i]ncome from discharge of indebtedness”).

209. See *Old Colony Tr. Co. v. Comm’r*, 279 U.S. 716, 729 (1929) (“The discharge by a third person of an obligation to [a taxpayer] is equivalent to receipt by the person taxed.”).

210. See *United States v. Kirby Lumber Co.*, 284 U.S. 1, 3 (1931).

211. *Id.*

212. See Camp, *supra* note 206, at 54–55.

213. *Id.* at 54. Because Camp finds that contract rights are property, he finds that even lines of computer code within *Second Life* and other “massively multiplayer online role-playing games” and player accounts are property of the player even if the underlying intellectual property remains owned by the game developer. See *id.* at 55–61.

214. See 26 U.S.C. § 178(a) (providing that the value of a lease is amortizable over the lease term including renewal options). Similarly, certain contracts with customers, potential business competitors, and suppliers are § 197 intangibles when acquired in connection with business acquisitions. *Id.* § 197(d)(1)(C)(iv) (listing as a 197 intangible “any customer-based intangible”); *id.* § 197(d)(2)(A)(iii) (defining customer-based intangible as including “any other value resulting from future provision of goods or services pursuant to relationships (contractual or otherwise) in the ordinary course of business with customers”); *id.* § 197(d)(1)(C)(v) (listing as a § 197 intangible “any supplier-based intangible”); *id.* § 197(d)(3) (defining supplier-based intangible as including “any value resulting from future acquisitions of goods or services pursuant to relationships (contractual or otherwise)

that gives the lessee the right to use the property for the lease term. Tax law recognizes this contract right as a valuable intangible asset.

When an employer imposes its desired employment dispute resolution term, it acquires a new mechanism to obtain dismissal of lawsuits brought by employees, prevent employees from bringing claims collectively, hide its misconduct from other employees and the public, and recover against an employee who discloses its unlawful activity in violation of a nondisclosure provision. These contract rights are valuable in that they significantly reduce employers' dispute resolution costs, the damages that employers would otherwise have paid to employees, and the costs of remedial measures that employers would otherwise have taken in order to avoid future lawsuits. Thus, tax law should recognize the contract rights that employers obtain by imposing coercive employment dispute resolution terms as valuable intangible assets, the acquisition of which is subject to tax.

Scholars equate coercive employment dispute resolution terms with free insurance policies,<sup>215</sup> *ex ante* exculpatory clauses,<sup>216</sup> and get-out-of-jail-free cards for employers.<sup>217</sup> They describe these terms as wealth transfers from employees to employers<sup>218</sup> and erasures of employee rights.<sup>219</sup> Each analogy shows why employers should be taxed when they impose coercive employment dispute resolution terms.

No one would doubt that a taxpayer who received free insurance coverage or a get-out-of-jail-free card (if such a card existed) had realized gross income upon that receipt. Nor should we doubt that an employer who receives the benefit of unilaterally imposing its preferred dispute resolution term on its workforce realizes gross income upon that imposition. Indeed, employers acknowledge that these terms are valuable to them in other contexts,<sup>220</sup> and tax law recognizes that favorable employment con-

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in the ordinary course of business with suppliers of goods or services to be used or sold by the taxpayer"); *id.* § 197(d)(1)(E) (listing as a § 197 intangible "any covenant not to compete (or other arrangement to the extent such arrangement has substantially the same effect as a covenant not to compete) entered into in connection with an acquisition (directly or indirectly) of an interest in a trade or business or substantial portion thereof").

215. *See supra* note 61 and accompanying text.

216. *See supra* text accompanying note 76.

217. STONE & COLVIN, *supra* note 21, at 26.

218. *See infra* note 313 and accompanying text.

219. *See supra* note 76 and accompanying text.

220. Chandrasekher & Horton, *supra* note 36, at 16 (noting that some companies find mandatory arbitration so valuable that, even when they unilaterally impose arbitration, they include in their mandatory arbitration provisions "rewards for plaintiffs to arbitrate those claims on an individual basis" and that "AT&T, Sallie Mae, and Verizon promised to pay a bounty of between \$5,000 and \$10,000 and up to double attorneys' fees to any consumer who won an award that exceeded the company's settlement offer" in an effort to increase the chances that a court would uphold their mandatory arbitration provision); Gilles, *supra* note 36, at 853-59 (describing various "[b]ounties, [p]remium [p]ayments, and '[b]ump-[u]ps'" that many companies including Clearwire, T-Mobile, Sallie Mae, Netflix, Verizon, Microsoft, and Sovereign Bank proffer to pay customers in the forced arbitration provisions they impose on their customers).

tract terms are intangible assets in the context of business purchases.<sup>221</sup> A coercive employment dispute resolution term is a valuable intangible asset to the employer who imposes it.

Finally, employers know that they experience an accession to wealth by imposing coercive employment dispute resolution terms. That is why they impose them. It is why they include them in employment handbooks, contracts of adhesion, and offer letters. It is why they email their existing employees, requiring them to consent to the terms as a condition of continued employment. It is why employers hire lawyers to draft these terms and to enforce them against workers who attempt to litigate—independently or through class action suits—workplace disputes. Employers are not ignorant of the value they receive by imposing these terms. To the contrary, “larger organizations with more sophisticated human resource policies and better legal counsel are *more* likely to adopt policies like mandatory arbitration that protect them against legal liability.”<sup>222</sup> Employers demonstrate the value that they place on coercive employment dispute resolution terms through their actions, and tax law should—at long last—recognize that value and tax it.

### 3. *Imposition of a Coercive Employment Dispute Resolution Term is a Realization Event*

The second element of gross income—realization—deserves the most attention. Often, a realization event is a sale or exchange.<sup>223</sup> The imposition of a coercive employment dispute resolution term is not a sale, and when one considers the realities of how these terms are implemented and how they function, their imposition is not an exchange.<sup>224</sup> Still, however, case law supports the conclusion that the imposition of a coercive employment dispute resolution term is a realization event.

Fundamentally, an employer’s imposition of a coercive employment dispute resolution term is a realization event because it results in the employer acquiring a new intangible asset that the employer did not have before. The receipt of a new asset is what distinguishes it from unrealized appreciation in a previously owned asset. Furthermore, while we are accustomed to thinking that new assets are acquired by purchase, by exchange, as compensation for labor, or as a return on investment, tax law provides many examples of when new assets are received by a taxpayer in exchange for nothing. When a taxpayer acquires something for nothing, it

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221. See 26 U.S.C. § 197(d)(1)(C)(i) (intangibles include “workforce in place including its composition and terms and conditions (contractual or otherwise) of its employment”); Treas. Reg. § 1.197-2(b)(3) (intangibles include “the terms and conditions of employment whether contractual or otherwise”); *supra* note 170 and accompanying text.

222. COLVIN, *supra* note 27, at 6 (emphasis added). Larger employers “could also become trendsetters over time if smaller employers copy these practices that larger employers have proven to be effective in protecting employers against legal actions.” *Id.*

223. See *Helvering v. Bruun*, 309 U.S. 461, 469 (1940).

224. See *supra* Section V.A.

is a realization event. Several of these examples involve a taxpayer who is able to acquire something for nothing by virtue of that taxpayer's status.

Take, for example, a taxpayer in *Glenshaw Glass*.<sup>225</sup> That taxpayer received compensatory damages and reported them as income.<sup>226</sup> However, in addition, that taxpayer received treble damages.<sup>227</sup> While the goal of the treble damages was to punish the offender (not to reward the taxpayer), it was the taxpayer who received the treble damages by virtue of the taxpayer's legal status as the prevailing plaintiff.<sup>228</sup> As is also true of punitive damages, which are paid to a prevailing plaintiff by virtue of its role as prevailing plaintiff, treble damages are not in exchange for property or in return for labor.<sup>229</sup> Rather, they are akin to a windfall received by the prevailing plaintiff by virtue of its status as such.<sup>230</sup> Although these receipts are available to a taxpayer by virtue of the taxpayer's status as prevailing plaintiff, they are taxable as gross income.<sup>231</sup> They enrich the taxpayer, are realized when obtained, and are within the taxpayer's control.<sup>232</sup>

Similarly, coercive employment dispute resolution terms are not received by employers following an exchange of value, nor are they a reward for labor or investment. Rather, they are available to an employer by virtue of its status as an employer—and by virtue of its superior bargaining power. These terms enrich the employer, are realized when the employer imposes them, and are within the employer's control.

Even if a reader is unconvinced that an employer's imposition of a coercive employment dispute resolution term is a taking, and instead sees it as an exchange, the value of the benefits that the employer receives should still be taxed to the employer. Such a position would require only that a worker also be taxed on the value of the benefits that the worker receives by virtue of the exchange. Because this author believes that workers lose value—instead of receiving it—through the imposition of coercive employment dispute resolution terms, this Article does not propose that the imposition of these terms should be treated as an exchange.

When a taxpayer acquires something for nothing, it is a realization event. *Glenshaw Glass* is not the only example of this principle. Take, for example, the landowner in *Helvering v. Bruun*,<sup>233</sup> or the finder of cash in *Cesarini v. United States*,<sup>234</sup> or the embezzler in *James v. United States*.<sup>235</sup> In each of these cases, the realization event was not a sale, exchange,

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225. *Comm'r v. Glenshaw Glass Co.*, 348 U.S. 429 (1955).

226. *Id.* at 428.

227. *Id.*

228. *Id.* at 431.

229. *See id.* at 429.

230. *See id.*

231. *Id.* at 431.

232. *Id.*

233. 309 U.S. 461 (1940).

234. 296 F. Supp. 3 (N.D. Ohio 1969).

235. 366 U.S. 213 (1961).

receipt of compensation for labor, or return on investment.<sup>236</sup> Rather, in each, the court found a realization event because a taxpayer received something for nothing.<sup>237</sup> The receipt of something new is the touchstone of a realization event, whether that something new is tangible or intangible, born of contract law or transferred by deed, earned or received by virtue of legal status,<sup>238</sup> lucked into,<sup>239</sup> taken from another, or outright stolen.<sup>240</sup> If coercive employment terms are—as this author argues, and as tax law recognizes in the context of business purchases—intangible assets that enrich the employer, then a realization event occurs when they are first obtained by the employer, which is to say when they are first imposed by the employer on an employee.

The unanimous Supreme Court decision in *Helvering v. Bruun*,<sup>241</sup> which was overruled by statute on its specific facts<sup>242</sup> but remains relevant for its treatment of realization of gross income, demonstrates why the imposition of a coercive employment dispute resolution term is a realization event for the employer. In that case, the taxpayer, Bruun, was a landlord who owned a parcel of land on which a building stood.<sup>243</sup> Bruun leased the property to a tenant for a term of ninety-nine years.<sup>244</sup> Since the tenant anticipated making use of the property for a long duration, it apparently made economic sense for the tenant to demolish the existing building and construct a new and more valuable one.<sup>245</sup> The tenant did so.<sup>246</sup> The terms of the lease provided that “[t]he lessee was to surrender the land, upon termination of the lease, with all buildings and improvements thereon.”<sup>247</sup> Unfortunately for the tenant, termination of the lease and surrender of the new, improved property came early.<sup>248</sup> The tenant had failed to pay rent, so Bruun terminated the lease and took possession of the new, improved property.<sup>249</sup> While Bruun treated the restoration of his possession of the property as irrelevant for tax purposes, the U.S. Supreme Court agreed with the IRS that Bruun had realized gross income equal to the fair market value of the tenant improvements when the lease terminated.<sup>250</sup>

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236. See *James*, 366 U.S. at 221; *Bruun*, 309 U.S. at 469; *Cesarini*, 296 F. Supp. at 8.

237. See *James*, 366 U.S. at 221; *Bruun*, 309 U.S. at 469; *Cesarini*, 296 F. Supp. at 8.

238. See *Bruun*, 309 U.S. at 469.

239. See *Cesarini*, 296 F. Supp. at 8.

240. See *James*, 366 U.S. at 221.

241. See *Bruun*, 309 U.S. at 469 (holding tenant’s improvement to land was taxable gain to the lessor).

242. See 26 U.S.C. § 109 (excluding the value of tenant improvements from the landlord’s gross income); 26 U.S.C. § 1019 (providing that the value of tenant improvements is not added to the landlord’s basis in her property and thereby reflecting no increase to basis since no tax cost was imposed).

243. *Bruun*, 309 U.S. at 462.

244. *Id.*

245. See *id.*

246. *Id.*

247. *Id.*

248. See *id.*

249. *Id.*

250. *Id.* at 467, 469.

Several things are notable about the *Bruun* holding. First, the landlord did not acquire income by virtue of his labor or capital investment.<sup>251</sup> Rather, he received something of a windfall, one that was available to him solely because of his legal status—that of landlord.<sup>252</sup>

Second, the landlord in some sense retook possession of a property that he owned all along.<sup>253</sup> At all times, the landlord owned the property, and for a period of time, it was merely leased to another.<sup>254</sup> However, a realization event was found because the value increase to that property was not the result of passive market appreciation (thus, not unrealized appreciation) or of his own labor (thus, not imputed income).<sup>255</sup> The value increase depended on the taxpayer taking something from another (the tenant) that he was lawfully allowed to take by virtue of his status as the landlord.<sup>256</sup>

Finally, the IRS and the U.S. Supreme Court both found that the landlord was required to report the increase in value as gross income in the year the lease terminated, even though doing so would require an appraisal to establish value (meaning that the rule likely would cause valuation disputes) and even though the taxpayer had not severed any value from or “cashed out” any portion of the asset (meaning that the rule might impose tax liabilities on taxpayers without liquid assets to pay them).<sup>257</sup> The Supreme Court expressly noted that “[i]t is not necessary to recognition of taxable gain that [a taxpayer] should be able to sever the improvement begetting the gain from his original capital.”<sup>258</sup> Rather, analogizing Bruun’s receipt of a new, valuable asset from another (notably, from another to whom Bruun provided nothing in return) to an exchange of property, the Court held that realization and recognition of income resulted from the taxpayer’s receipt of something new and valuable.<sup>259</sup>

*Bruun* found that the landlord realized income upon retaking possession of improved property because tax law defines gross income broadly, particularly in commercial contexts where a taxpayer acquires something new from another.<sup>260</sup> In Bruun’s case, the something new—the tenant improvement—was acquired by the taxpayer not via a fair, adequate exchange but via a windfall available to the taxpayer by virtue of his legal

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251. *See id.* at 462, 469.

252. *See id.* at 469.

253. *Id.* at 462.

254. *Id.*

255. *See id.* at 469.

256. *See id.* at 462, 469.

257. *See id.* at 469 (noting that the accession to wealth was not severed or cashed out from the taxpayer’s investment in the property, the Court held that “[i]t is not necessary to recognition of taxable gain that he should be able to sever the improvement begetting the gain from his original capital” because “[i]f that were necessary, no income could arise from the exchange of property; whereas such gain has always been recognized as realized taxable gain”).

258. *Id.*

259. *Id.*

260. *Id.* at 468–69.

status as a landlord.<sup>261</sup> The tenant's loss was the landlord's gain, and this gain was acquired without consideration paid by the landlord.<sup>262</sup> *Bruun* is an example that in the commercial context, receiving something for nothing is taxable.<sup>263</sup>

When employers impose coercive employment dispute resolution terms on their employees, they receive something new—an intangible asset born of contract law that bars their employees from bringing employment-related suits in the venues and with the procedures that our public system of civil litigation has established. They often prevent employees from engaging in collective or class-action-style dispute resolution that might otherwise facilitate resolution of smaller dollar claims, protect employees from fear or reality of retribution, or enable employees to establish patterns of unlawful behavior by the employer.<sup>264</sup> Each of these intangible assets is valuable to employers, and each is obtained at the expense of employees.

Most importantly—as in *Bruun*—when an employer subjects its workforce to a coercive employment dispute resolution term, the resulting accession to the employer's wealth, the new value captured, is not the result of passive market forces and not the result of the employer's own labor.<sup>265</sup> Nor is the new value obtained by a purchase or other fair, adequate exchange. Rather, it is something like a windfall (value that was not earned), or like a theft (value that should belong to another), or something that falls on the spectrum between a windfall and a theft. And it is available to the employer only by virtue of the employer's legal status as an employer.<sup>266</sup> Even if it is viewed as an exchange made possible by the employer's superior bargaining position, it is properly subject to tax. Parties to an exchange are taxed on the fair market value of what they *receive* in the exchange.

Employers impose coercive employment dispute resolution terms unilaterally because they can. Their status and superior bargaining position enable them to take something valuable from their employees and to appropriate that value as their own. When employers impose coercive employment dispute resolution terms, they convert their superior bargaining position into new and legally enforceable rights. Labor law has not yet prevented this. However, tax law should recognize the new, valuable intangible benefit captured by the employer and should tax it.

*Bruun* does not stand alone in its finding that a taxpayer who receives something for nothing has gross income. The tax treatment of found

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261. *See id.* at 462.

262. *See id.*

263. *See id.* at 469.

264. *See supra* Sections II.B, II.C.

265. *See Bruun*, 309 U.S. at 462.

266. In the analogous context of mandatory individual arbitration provisions in consumer contracts, Justice Kagan described the quasi-taking of imposing coercive terms by explaining that “[t]he monopolist gets to use its monopoly power to insist on a contract effectively depriving its victims of all legal recourse.” *Am. Express Co. v. Italian Colors Rest.*, 570 U.S. 228, 240 (2013) (Kagan, J., dissenting).

property and stolen property supports the conclusion that a taxpayer who receives something for nothing realizes gross income.<sup>267</sup> In *Cesarini v. United States*, the court held that when a taxpayer discovers found property and reduces it to his undisputed possession, that taxpayer realizes gross income equal to the fair market value that the taxpayer receives.<sup>268</sup> Found property is not acquired as compensation for labor, as investment returns, or by exchange; rather, it comes into the possession of the owner without being earned. Nonetheless, realization occurs at the moment of the find because the taxpayer acquires “current enjoyment rights” in a new asset.<sup>269</sup> Although a possible alternative rule might have found realization at the moment that lost or abandoned property came into the taxpayer’s possession,<sup>270</sup> the *Cesarini* court found realization at the moment the taxpayer discovered found property.<sup>271</sup> Thus, the court avoided the risk that the statute of limitations for inclusion in gross income might have passed before the taxpayer knew to include the income.<sup>272</sup> By setting the realization moment at the taxpayer’s discovery of the asset, the court minimized the risk that an accession to wealth might escape taxation entirely.<sup>273</sup>

Like tenant improvements acquired by a landlord upon termination of a lease or the finding of property, the taking or embezzlement of property from another is a realization event. In *James v. United States*, the Court held that when a taxpayer embezzles money, he realizes gross income equal to the amount embezzled.<sup>274</sup> In some sense, the Court recognized the embezzler does not have an unclouded accession to wealth because

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267. See *Cesarini v. United States*, F. Supp. 3, 5 (N.D. Ohio 1969).

268. *Id.*

269. Joseph M. Dodge, *Accessions to Wealth, Realization of Gross Income, and Dominion and Control: Applying the “Claim of Right Doctrine” to Found Objects, Including Record-Setting Baseballs*, 4 FLA. TAX REV. 685, 688 (2000). Dodge explains:

The realization-of-income area is an obscure and perhaps somewhat messy backwater of income tax doctrine, but it has potential application to windfall found objects due to the fact that the “finder” rarely obtains instant title. I argue that courts should restrict the “realization of income” doctrine to cases where current enjoyment rights (as opposed to “legal title”) in property received in-kind are significantly “contingent.” Lack of dominion and control translates into “nonrealization.”

*Id.* (emphasis omitted).

270. In *Cesarini*, this might have been found when the taxpayer took possession of the piano that contained old currency, which the taxpayer would later find. See *Cesarini*, 296 F. Supp. at 7–8.

271. *Id.* at 8.

272. *Id.*

273. See *id.* Indeed, *Cesarini* shows how strongly courts are guided by practical considerations in determining when income is recognized. The *Cesarini* court rejected the taxpayer’s contention that the found property was realized when the taxpayer took possession of the piano that contained old currency, which the taxpayer would later find, and instead ruled that it was realized upon the taxpayer’s discovery of it. *Id.* Tagging realization to discovery was likely motivated by practical considerations. The court likely worried that the taxpayer’s preferred rule would allow accessions to wealth to escape taxation by enabling owners to argue that the statute of limitations for taxing the find had passed even before the find was discovered.

274. *James v. United States*, 366 U.S. 213, 218 (1961).

he is always legally obligated to repay his victim.<sup>275</sup> However, practical considerations caused the Court to conclude that embezzled funds should be treated as recognized income.<sup>276</sup> In *James*, the practical considerations were that, for embezzlers, the obligation of repayment is illusory.<sup>277</sup> Since embezzlers have no intent to return the property to its lawful owner, the income must be recognized, lest the property escape taxation in the hands of the embezzler altogether.<sup>278</sup>

Whether a reader believes that a coercive employment dispute resolution term causes an employer to acquire value that is rightfully obtained (like found property is) or wrongfully obtained (like embezzled property is), the employer realizes income at the time the employer imposes the term. The employer obtains a new intangible asset by imposing the term, and if that value is not taxed at the time the term is imposed, then the employer's accession to wealth will escape taxation entirely. Courts consistently demonstrate that practical concerns—and primarily the concern that an accession to wealth might escape taxation entirely if not taxed at the right moment—justify the finding that a realization event has occurred.

#### 4. *Even Scholars Who Favor a Narrow Definition of Gross Income Describe Acquiring an Intangible Asset as a Realization Event*

Some tax scholars favor a narrower definition of gross income, including with respect to found property. Professors Lawrence Zelenak and Martin McMahon argue that although Treasury Regulation § 1.61-14 causes a taxpayer to realize income upon reducing a find to her undisputed possession, that regulation has rarely been applied, and never to a noncash find.<sup>279</sup> Indeed, they argue that the regulation is wrong and should be changed to tax noncash finds only upon disposition.<sup>280</sup>

In arguing that found property should not be taxed upon the find, Professors Zelenak and McMahon advance what they identify as a contrarian approach to defining gross income.<sup>281</sup> They do not define gross

275. *Id.* at 219.

276. *See id.* at 219–20.

277. *See id.*

278. *Id.* at 221.

279. Lawrence A. Zelenak & Martin J. McMahon, Jr., *Taxing Baseballs and Other Found Property*, 84 TAX NOTES 1299, 1301 (1999) (“[T]wo cases—one involving cash, and the other a brief aside on a hypothetical—constitute the entire judicial career of the treasure trove regulation. No court has ever relied on the regulation to include in gross income any non-cash found property. Nor has the treasure trove regulation received much attention in the rulings of the Internal Revenue Service.”); *see* Treas. Reg. § 1.61-14(a) (as amended in 1993) (“Treasure trove, to the extent of its value in United States currency, constitutes gross income for the taxable year in which it is reduced to undisputed possession.”).

280. Zelenak & McMahon, *supra* note 279, at 1300–01.

281. *Id.* at 1306. They are not alone in arguing that gross income should be defined more narrowly for reasons of administrability and ease of enforcement; they cite Edward A. Zelinsky's “powerful case for thinking of the definition of gross income as working outward from cash, rather than inward from Haig-Simons income.” *Id.* at 1304 n.52 (quot-

income using the “usual approach among tax theorists” by “start[ing] from the sweeping Haig-Simons definition of income as including all consumption and all increase[s] in asset values during a taxable period, and then . . . describ[ing] the ways in which section 61 retreats from that definition.”<sup>282</sup> Instead, building on the work of Edward Zelinsky, they

grab the other end of the stick, and start with the observation that basically what the income tax is about is the inclusion of the receipt of *cash* in gross income, [and it is from this starting point and goal that law should] then describe the ways in which section 61 extends beyond cash receipts. The logic here is that a cash-based tax system has the “attainable virtues” of ease of valuation and of liquidity, and that the only reason to extend the tax base beyond cash—to exchanges of property, to noncash compensation for services, and to barter generally—is to discourage tax-induced replacements of cash with in-kind transfers . . . to prevent wholesale tax avoidance . . .<sup>283</sup>

This author subscribes to the broader view of gross income that Professors Zelenak and McMahon describe as the usual approach among tax theorists. Nonetheless, it is helpful to note that, even as they argue against including found property in gross income upon the find, Professors Zelenak and McMahon describe the finding of property as a realization event.<sup>284</sup> Indeed, in their view, “[s]evering crops from land and then eating them is certainly dramatic enough to qualify as a realization event,” and having an animal kept as livestock give birth to “newborn livestock certainly seem[s] sufficiently severed from [its] source[ ] to be treated as realized.”<sup>285</sup>

Perhaps most importantly, Zelenak and McMahon describe “creating intangible assets out of nothing” as “sufficiently dramatic to constitute realizations” of income.<sup>286</sup> They use the example of self-created patents and copyrights, explaining that

patent and copyrights are intangible assets, separate and distinct from the paper or hard drive on which the information is recorded. They cannot be viewed as unrealized appreciation in a physical asset; they have the same *ex nihilo* quality as found property. If found property must be taxed because the finding is a realization event, self-created intangible assets must be taxed because the creation is a

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ing Edward A. Zelinsky, *For Realization: Income Taxation, Sectoral Accretionism, and the Virtue of Attainable Virtues*, 19 *CARDOZO L. REV.* 861 (1997)).

282. *Id.* at 1304.

283. *Id.* at 1304–05 (footnotes omitted) (citing Zelinsky, *supra* note 281, at 888, 890).

284. *See id.* at 1301 & n.21 (describing finding “stumbled-over and searched-for treasure trove” as realization events, noting that “searched-for treasure trove” that is found through one’s searching for one’s own benefit is excludible as imputed income, and arguing that there is not sufficient basis to impose “a tax difference between stumbled-over and searched-for treasure trove”).

285. *Id.* at 1306 & n.63. While these events are realization events, taxpayers who harvest crops or receive newborn livestock do not have gross income because crops and livestock raised by one’s self for one’s own consumption are imputed income. *See id.* at 1306.

286. *Id.*

realization event.<sup>287</sup>

Zelenak and McMahon consistently treat “getting something when a moment before one had nothing” as a realization event.<sup>288</sup> With helpful precision, they state “[t]o use the standard tools of analysis, the key to the nontaxation of self-created property is imputed income, not unrealized appreciation.”<sup>289</sup>

For purposes of this Article, the distinction between doctrinal bases is helpful, as is the articulation of the rule that “getting something when a moment before one had nothing” is a realization event.<sup>290</sup> Like obtaining a patent or copyright, an employer’s imposition of a coercive employment dispute resolution term involves the acquisition of a set of enforceable legal rights and entitlements that one did not have before.<sup>291</sup> Thus, when an employer imposes a coercive employment dispute resolution term, the employer causes a realization event.

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287. *Id.* This quote is followed with a statement that despite a realization event, “there should still be no tax because there has been no transaction.” *Id.* This author confesses that she trips over the word *transaction*. If acquisition of a new asset is sufficient to constitute a transaction, then acquisition of crops, newborn livestock, and self-created intangibles are all circumstances in which there has been a transaction, and there is no tax. Thus, it seems likely that *transaction* refers to exchange, sale, or other disposition. If this is the case, then the reason that tax waits until a later exchange, sale, or other disposition is that it is unknown whether the crop, newborn livestock, or self-created intangible will be consumed by the person who labored to create it (thus imputed income and not subject to tax) or exchanged away or sold (thus subject to tax).

288. *Id.*

289. *Id.*; see also *id.* (“Given the universal understanding that self-created property is not taxable unless and until it is sold, why would anyone think that the tax treatment of self-found [property] should be any different?”).

290. *Id.*

291. The regulations requiring taxpayers to capitalize certain amounts paid to acquire or create intangibles define the term “separate and distinct intangible asset” as

a property interest of ascertainable and measurable value in money’s worth that is subject to protection under applicable State, Federal or foreign law and the possession and control of which is intrinsically capable of being sold, transferred or pledged (ignoring any restrictions imposed on assignability) separate and apart from a trade or business.

Treas. Reg. § 1.263(a)-4(b)(3)(i). It is not clear whether a coercive employment term is capable of being sold, transferred, or pledged separate and apart from a trade or business. However, this author advocates against a rule that would find gross income only upon a taxpayer’s acquisition of a separately sellable intangible asset. Such a rule would be inconsistent with *Glenshaw Glass* and the extensive case law calling for gross income to be broadly construed. Furthermore, even the regulation defining a “separate and distinct intangible asset” provides a parallel rule for certain future benefits that do not meet this definition. See *id.* § 1.263(a)-4(b)(2) (“Any published guidance identifying a future benefit as an intangible for which capitalization is required under paragraph (b)(1)(iv) of this section applies only to amounts paid on or after the date of publication of the guidance.”); *id.* § 1.263(a)-4(b)(1)(iii) (requiring capitalization of amounts “paid to create or enhance a separate and distinct intangible asset”); *id.* § 1.263(a)-4(b)(1)(iv) (requiring capitalization of amounts “paid to create or enhance a future benefit identified in published guidance in the Federal Register or in the Internal Revenue Bulletin (see § 601.601(d)(2)(ii) of this chapter) as an intangible for which capitalization is required under this section”).

5. *Employers Exercise Control When They Impose Coercive Employment Dispute Resolution Terms*

An employer who imposes a coercive dispute resolution term exercises control through that imposition.<sup>292</sup> Employers write these terms,<sup>293</sup> usually without engaging in any bargaining<sup>294</sup> and with largely unchecked incentives to write them in favor of their own interests.<sup>295</sup> As Justice Ginsburg writes in her dissent in *Epic Systems*, the “freedom to depart” from default dispute resolution processes “is entirely one sided.”<sup>296</sup> Employers alone are able to depart from our open, public system of litigation to instead impose the closed, private dispute resolution processes they prefer.

By employers’ own reporting, they typically choose to impose coercive dispute resolution terms either at the beginning of the employment relationship<sup>297</sup> or after an employee has accepted and begun employment.<sup>298</sup> Employers require their employees to “acquiesce”—“consent” seems like the wrong word—to these terms as a condition of employment.<sup>299</sup>

Employees understand that they do not have a meaningful opportunity to negotiate or decline.<sup>300</sup> Indeed, the law does not even require an employee’s signature on the coercive dispute resolution term that binds her:

Generally, . . . so-called “agreements” to arbitrate are unilaterally imposed by employers on employees who likely are not aware the terms exist, and, in any case, have little choice but to accept the provision if they want to get or keep their jobs. While the Federal Arbitration Act does require arbitration agreements to be “written,” they need not be signed, and courts have upheld “agreements” formed in a variety of ways. Mandatory arbitration “agreements” are often imposed in the fine print of employment or related applications, employee handbooks, envelope stuffers, computer click-throughs, or e-mails.<sup>301</sup>

In sum, an employer who imposes a coercive dispute resolution term exercises control far in excess of the control required to find gross income.

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292. This Article does not address cases when employer control is not exercised. For example, if after a dispute has arisen, an employer and employee agree to arbitration, that agreement might be viewed as a mutual exercise of control and an exchange of values. Similarly, this Article does not address a term that is agreed to by a union or prospective employee with power equivalent to that of the employer. Such terms would likely involve back-and-forth negotiation and mark ups as opposed to the terms of adhesion that employers include in employee handbooks and mass emails to their employees.

293. *See supra* text accompanying note 83.

294. *See supra* note 38 and accompanying text.

295. *See supra* notes 84–88 and accompanying text.

296. *Epic Sys. Corp. v. Lewis*, 138 S. Ct. 1612, 1640 (2018) (Ginsburg, J., dissenting).

297. *See supra* text accompanying note 47.

298. *See supra* text accompanying note 48.

299. *See supra* text accompanying note 42.

300. *See supra* text accompanying notes 12 and 83.

301. Sternlight, *supra* note 30, at 171–72 (footnotes omitted); *e.g.*, *supra* notes 31 and 139 and accompanying text.

## 6. No Exclusion from Gross Income Applies

While some increases to wealth—including imputed income,<sup>302</sup> unrealized appreciation in asset value,<sup>303</sup> and informal pooling of familial or other noncommercial labor<sup>304</sup>—are not subject to tax, realized increases in wealth from commercial activities are subject to tax.<sup>305</sup>

Some tax scholars add an additional “exception[ ] to what taxpayers must include as ‘gross income’” beyond the conventional list of imputed income, unrealized appreciation, and pooled noncommercial labor.<sup>306</sup> Professor Bryan Camp describes this exception as “‘priceless’ income for which there is no ascertainable fair market value.”<sup>307</sup> This author worries about the use of the term *priceless*, particularly if applied to difficult-to-value commercial intangibles as opposed to personal intangibles that are insusceptible to valuation—like health and love. If applied to difficult-to-value commercial intangibles, the exclusion of items deemed to be priceless would create tax subsidies for the creation of intangibles that are neither worthless nor harmless. It would even create incentives for taxpayers to make intangibles difficult to value.

Coercive employment dispute resolution terms should not be excluded from an employer’s gross income on the basis that they are priceless for three main reasons. First, these terms can be reduced to a value that can be included on an employer’s tax return for the year of imposition, even

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302. Douglas A. Kahn, *Exclusion from Income of Compensation for Services and Pooling of Labor Occurring in a Noncommercial Setting*, 11 FLA. TAX REV. 683, 688 (2011) (“While there is no statutory provision excluding imputed income from taxation, it is excluded under the common law.”).

303. Zelenak & McMahon, *supra* note 279, at 1304. As Zelenak & McMahon explain: The two most important retreats [from section 61’s broad definition of gross income] are the failures to tax unrealized appreciation and imputed income. Congress has never found it necessary to provide explicit statutory authority for either of these departures from Haig-Simons income. It is clear, nevertheless, that gross income includes neither mere increases in value of property, nor any of the various forms of imputed income—the value of self-performed services, self-created property, and the use value of one’s own property.

*Id.* at 1304 (footnote omitted). Further, “[d]espite the absence of a statutory exclusion for imputed income, the ‘congressional silence on the subject is clearly tantamount to an affirmative grant of immunity.’” *Id.* at 1304 n.50 (quoting BORIS I. BITTKER & MARTIN J. MCMAHON, JR., FEDERAL INCOME TAXATION OF INDIVIDUALS ¶ 3.3[1] (2d ed. 1995)).

304. Kahn, *supra* note 302, at 697 (“The thrust of the income tax system is to tax income earned from commercial activity. There are good reasons not to tax income generated from noncommercial activities, and generally taxes have not been applied in that situation even though no specific exception for noncommercial income has ever been articulated. As a corollary to the proposed rule excluding income from noncommercial activity, the combining of the labor of several persons to reach a common noncommercial goal should be regarded as noncommercial and so should not be taxed as an exchange of services.”).

305. See 26 U.S.C. § 61 (defining gross income as “all income from whatever source derived, including . . . [g]ains derived from dealings in property”); *Comm’r v. Glenshaw Glass Co.*, 348 U.S. 426, 431 (1955) (holding that an accession to wealth, clearly realized, and in the taxpayer’s complete dominion is gross income); *Helvering v. Bruun*, 309 U.S. 461, 469 (1940) (listing exchanges as realization events).

306. Camp, *supra* note 206, at 25.

307. *Id.*

if that value is imperfect or even rough. In Section V.C., this Article will propose a starting method for valuing these intangible assets.

Second, valuation challenges do not justify ignoring the benefit that employers obtain by imposing these terms. To ignore their value is to tax-incentivize their imposition. As Professor Joseph Dodge persuasively argues, neither ease of valuation nor the likelihood of precise valuation is an element of gross income.<sup>308</sup> Accessions to wealth that are realized and are in the taxpayer's control should, under the fundamental principles of tax law, be included in the recipient's gross income.<sup>309</sup> "Mere nonliquidity, difficulty of valuation, or [even] a possibility of forfeiture should not be a bar to current realization. . . . Institutionally, immediate realization should be the judicial norm, barring extreme circumstances, and exceptions should be left to Congress."<sup>310</sup> Failure to tax the income that employers capture by imposing coercive dispute resolution terms on their workforces encourages employers to impose these terms more frequently and more broadly. Further, it encourages taxpayers to engage in further takings from others, provided that whatever they take is difficult to value.

Finally, recognized exclusions from gross income—such as imputed income, unrealized appreciation, and noncommercial pooling of labor—are recognized because they are viewed as "necessary . . . [to] prevent[ ] government over-reach . . . or . . . intolerable government intrusion into individual lives."<sup>311</sup> An employer's imposition of a coercive employment dispute resolution term on its workforce is not a private matter.<sup>312</sup>

Unfortunately, the IRS has not enforced existing tax law consistently. Instead, the IRS ignores the imposition of coercive employment dispute resolution terms, a category of commercial activity that increases the wealth of employers and significantly harms workers.<sup>313</sup> An employer who imposes a coercive employment dispute resolution term has "income from whatever source derived"<sup>314</sup> that is not imputed income, unrealized appreciation, or noncommercial pooling; thus, foundational principles of tax law require that it be taxed.

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308. See Dodge, *supra* note 269, at 688.

309. See *Glenshaw*, 348 U.S. at 431.

310. Dodge, *supra* note 269, at 688.

311. Camp, *supra* note 206, at 25.

312. See *supra* Section II.C (an employer's imposition of a coercive employment dispute resolution term harms workers generally); *supra* Section II.D (vulnerably workers suffer disproportionate harms); *supra* Section II.E (and these terms harm society generally and undermine the rule of law).

313. Indeed, in *Arbitration as Wealth Transfer* Deepak Gupta and Lina Khan encourage readers to view forced arbitration as a wealth transfer, arguing that "the rise and prevalence of forced arbitration clauses should be understood as both an outcome of and a contributor to economic inequality," meaning that "the national conversation about economic inequality should therefore include the debate over forced arbitration." Gupta & Khan, *supra* note 131, at 502.

314. 26 U.S.C. § 61(a).

### 7. Failure to Tax Violates Burden of Proof Rules

Courts consistently hold that gross income is broadly construed, exclusions are narrowly construed, and the party seeking to exclude has the burden of proof.<sup>315</sup> If tax law's burden of proof rules were properly applied to coercive employment dispute resolution terms, then these terms would be taxed unless the employer who imposed them met its burden to establish a basis for exclusion.

#### C. COERCIVE EMPLOYMENT DISPUTE RESOLUTION TERMS HAVE A VALUE TO EMPLOYERS THAT CAN BE APPRAISED, EVEN IF IMPERFECTLY

Although tax law's long-standing definition of gross income requires the inclusion of new intangible assets when they are acquired by the taxpayer, for practical purposes it must answer the question of *what amount* should be included in gross income. The amount included in gross income is the fair market value of the asset,<sup>316</sup> defined by reference to a hypothetical market transaction.<sup>317</sup> Fair market value, says tax law, is the price that would be agreed to by a hypothetical willing buyer and a hypothetical willing seller if each had "reasonable knowledge of [all] relevant facts" and if neither were "under any compulsion" to transact.<sup>318</sup>

Although a hypothetical market transaction is referenced, tax law often values assets that are rarely or never exchanged on the market.<sup>319</sup> In these cases, it often values an asset based on the projected, uncertain financial benefits that the asset is anticipated to produce. For example, in *Newark Morning Ledger v. United States*, the U.S. Supreme Court found that existing subscriber relationships are an intangible asset to newspapers and valued this intangible asset based on an estimate of future profits that the newspapers reasonably anticipate receiving from identified subscribers.<sup>320</sup> Of course, estimated future profits were uncertain, and this made the valuation somewhat speculative.<sup>321</sup> Still, however, the Court reviewed competing expert testimony and weighed assumptions about the likelihood that subscribers in various categories would continue

315. See, e.g., *Comm'r v. Glenshaw Glass Co.*, 348 U.S. 426, 429–30 (1955) ("This Court has frequently stated that this language ['all income from whatever source derived'] was used by Congress to exert in this field 'the full measure of its taxing power.' . . . Congress applied no limitations as to the source of taxable receipts, nor restrictive labels as to their nature. And the Court has given a liberal construction to this broad phraseology in recognition of the intention of Congress to tax all gains except those specifically exempted." (citations omitted)).

316. See *Helvering v. Bruun*, 309 U.S. 461, 464–65 (1940).

317. See *United States v. Cartwright*, 411 U.S. 546, 550–51 (1973).

318. *Id.* at 551 (quoting Treas. Reg. § 20.2031-1(b) (as amended in 1965)); see also *id.* ("The willing buyer-willing seller test of fair market value is nearly as old as the federal income, estate, and gifts taxes themselves . . .").

319. See, e.g., *Phila. Park Amusement Co. v. United States*, 126 F. Supp. 184, 187 (Ct. Cl. 1954) (valuing a ten-year railway franchise received by the taxpayer from a governmental entity).

320. See *Newark Morning Ledger v. United States*, 507 U.S. 546, 570 (1993).

321. See *id.* at 570.

their subscriptions (and if so, for how long).<sup>322</sup> Based on imperfect assumptions, the Court reached a conclusion as to the value to a newspaper of an existing population of subscribers.<sup>323</sup> Courts recognize that even imperfect valuation, which depends on speculation and estimations, is better than nothing.<sup>324</sup>

This Article will propose a starting valuation methodology based on the projected financial benefits that coercive employment dispute resolution terms are likely to produce for the employers who impose them.

## VI. HOW TO IMPLEMENT A TAX ON EMPLOYERS FOR IMPOSING COERCIVE EMPLOYMENT DISPUTE RESOLUTION TERMS

An employer who imposes a coercive employment dispute resolution term on an employee realizes gross income as a result of that imposition and should be taxed. This Part proposes how to implement such a tax.

### A. REQUIRE AN EMPLOYER WHO IMPOSES A COERCIVE EMPLOYMENT DISPUTE RESOLUTION TERM TO REPORT THE GROSS INCOME

When an employer imposes a coercive employment dispute resolution term on an employee, tax law should recognize that the employer has obtained a new and valuable intangible asset.

The IRS should require the employer to establish the value it receives from imposing the coercive employment dispute resolution term.<sup>325</sup> As it

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322. *Id.* at 551.

323. *See id.* at 570.

324. *See generally* Treas. Reg. § 1.61-2(d)(1) (taxing, and thus requiring taxpayers to value non-cash compensation, including services “paid for in exchange for other services”); *id.* § 1.61-2(d)(3) (taxing, and thus requiring taxpayers to value “living quarters or meals which an employee receives in addition to his salary . . . unless they . . . meet the conditions specified in section 119”); *id.* (taxing, and thus requiring taxpayers to approximate the “rental value of parsonages” except to the extent excluded by section 107); *id.* § 1.61-21(a)(1) (taxing, and thus requiring taxpayers to value fringe benefits, including “an employer-provided automobile [and chauffeur services], a flight on an employer-provided aircraft, an employer-provided free or discounted commercial airline flight, an employer-provided vacation, an employer-provided discount on property or services, an employer-provided membership in a country club or other social club, and an employer-provided ticket to an entertainment or sporting event” except to the extent excluded by section 132 and other sections); *id.* § 1.132-6(e)(2) (“Examples of fringe benefits that are not excludable from gross income as de minimis fringes are: season tickets to sporting or theatrical events; the commuting use of an employer-provided automobile or other vehicle more than one day a month; membership in a private country club or athletic facility, regardless of the frequency with which the employee uses the facility; employer-provided group-term life insurance on the life of the spouse or child of an employee; and use of employer-owned or leased facilities (such as an apartment, hunting lodge, boat, etc.) for a weekend.”); S. REP. NO. 93-768, at 157 (1974) (valuing several unique assets that are not exchanged on any market, including use by family members of government aircraft); *id.* at 178 (concluding that valuation is appropriate even though “[b]y their very nature, the calculations of benefits of this type and the allocations required cannot be made with precision”).

325. Even if a law is enacted that makes the coercive employment term unenforceable, it generally should still be deemed to have value to the employer based on its ability to discourage employees from initiating meritorious litigation.

does when taxpayers acquire other valuable assets, the IRS should require employers to support their appraisals with competent evidence of the value of the coercive employment dispute resolution terms that they impose. This evidence likely will be difficult, but not impossible, to obtain. It will often depend on expert reports. The need to acquire this evidence will also discourage employers from engaging in excessive use of coercive employment dispute resolution terms. Further, this evidence will help inform employees and the public—who may underestimate the impact of coercive employment dispute resolution terms—about how valuable these terms are to employers and how correspondingly costly they are to employees.

Finally, when an employer realizes gross income by imposing a coercive employment dispute resolution term, the IRS should tax that income just as it would tax any other realization of income.

Following this imposition of tax, the coercive employment term would have a tax cost basis. If an employer met its burden of proving, consistent with Treas. Reg. § 1.167-3(a), that the coercive employment term “is known from experience or other factors to be of use in the business or in the production of income for only a limited period, the length of which can be estimated with reasonable accuracy,” then that employer should be permitted to amortize the tax cost basis over that limited and determinable useful life.<sup>326</sup> However, if an employer did not meet its burden of proving a limited and determinable useful life, then the tax cost basis of a coercive employment dispute resolution term should be recoverable only upon revocation of that coercive employment dispute term or upon the sale or termination of the business. As existing law helpfully cautions, “[a]n intangible asset, the useful life of which is not limited, is not subject to the allowance for depreciation. No allowance will be permitted merely because, in the unsupported opinion of the taxpayer, the intangible asset has a limited useful life.”<sup>327</sup> It is difficult to imagine how an employer could impose an infinite or indefinite coercive employment dispute resolution term on its workforce and then establish that the coercive employment dispute resolution term has a limited and determinable useful life. Taxing employers when they impose coercive employment dispute resolution terms and then allowing employers to recover tax cost basis when they revoke these terms would discourage employers from adopting or continuing to use these terms.

#### B. GIVE NOTICE OF THE NEW ENFORCEMENT APPROACH THROUGH A TREASURY REGULATION

As Part IV argues, this more aggressive tax treatment of coercive employment dispute resolution terms is consistent with foundational principles of tax law. Implementing this treatment would not require changes

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326. Treas. Reg. § 1.167(a)-3(a).

327. *Id.*

to the Internal Revenue Code. Arguably, it would not require changes to Treasury regulations either. However, in an effort to provide fair notice to taxpayers of a significant change to the IRS's enforcement approach, the Treasury should adopt a regulation under § 61. If it were the next-adopted provision under § 61, it would be numbered Treasury Regulation § 1.61-23. It should provide:

An employer who imposes a mandatory arbitration provision, class action waiver, or nondisclosure of dispute resolution provision on any employee is in receipt of gross income, for federal income tax purposes, to the extent of its value in United States currency. An employer realizes gross income in each taxable year in which that employer first imposes such a provision on any employee.

This language parallels the language of the treasure trove regulation.<sup>328</sup> It allows valuation methodologies for coercive employment dispute resolution terms to evolve and incorporate additional data. And it gives employers notice that they will be taxed for imposing these terms.

### C. APPRAISE BASED ON DATA-DRIVEN DAMAGE MULTIPLIERS

For employers who impose coercive dispute resolution terms on their employees, there are three main financial benefits: insurance against paying damages, reduced transaction costs, and public relations protections. Each of these benefits is susceptible to valuation.

This Article will not propose a valuation methodology that accounts for each of these benefits. It invites further development of its proposed valuation methodology to account for the reduced transaction costs and public relations benefits that employers enjoy when they force employment disputes to be resolved via private arbitration and often with non-disclosure provisions. For example, employers value avoiding the employee strikes and consumer boycotts that they might suffer if their illegal activity were disclosed through open litigation. Until the valuation methodology accounts for all these benefits, it will understate the value of coercive employment dispute resolution terms. However, even an incomplete valuation methodology comes closer to the value of these terms than does our current tax treatment. Further, even an incomplete valuation methodology would better discourage the use of these terms.

As an offer of proof as to the susceptibility of these benefits to valuation, this Article will suggest a starting method to value the first benefit that employers receive by imposing coercive employment dispute resolution terms: insurance against paying damages. Employers who impose coercive employment dispute resolution terms can anticipate a dramatic reduction in the damages that they will be required to pay to employees who are the victims of their wrongdoing. Thus, this Article proposes a starting valuation methodology that accounts for the lower claim rates,

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328. See Treas. Reg. § 1.61-14(a) (as amended in 1993) ("Treasure trove, to the extent of its value in United States currency, constitutes gross income for the taxable year in which it is reduced to undisputed possession.").

lower win rates, and lower damage amounts experienced by employers who shield themselves from liability through coercive employment dispute resolution terms as compared to employers whose employees retain access to the civil justice system.

The data shows several ways in which arbitration slashes the damages that employers owe to their employees. First, Professor Estlund concludes that “well under two percent of the employment claims that one would expect to find in some forum, but that are covered by MAAs, ever enter the arbitration process.”<sup>329</sup> Thus, for every two arbitrations initiated against an employer, we would expect to see one hundred lawsuits initiated. Accordingly, an appraisal should presume that for every arbitration initiated against an employer, fifty lawsuits would have been initiated.<sup>330</sup> Additional data could help refine this number by, for example, establishing that arbitrations combined with class action waivers should be presumed to replace more court actions. Nonetheless, the assumption that, for every one arbitration initiated against an employer, we would have expected to see fifty court actions initiated is a sufficiently precise datapoint to begin appraising the value to employers of mandatory arbitration provisions. It captures the greatest benefit of mandatory arbitration to employers, which is the extinguishment of claims against them.

Second, Professors Stone and Colvin compared employee win rates and damages in arbitration versus litigation and found that employees in mandatory arbitration win “59 percent as often as in the federal courts and only 38 percent as often as in state courts.”<sup>331</sup> Similarly, “the median . . . award in mandatory arbitration [is] only 21 percent of the median award in the federal courts and 43 percent of the median award in the state courts.”<sup>332</sup> Combining the effects of arbitration’s lower employee win rates and lower damage awards, the data establishes “that the average outcome in mandatory arbitration is only 16 percent of that in the federal courts and 7 percent of that in state courts.”<sup>333</sup> Thus, for every dollar of damages an employer is forced to pay in arbitration, it would be reasonable for an appraisal to assume that the employer would have had to pay \$6.25 in damages<sup>334</sup> had the same issue been litigated in federal court or \$14.29<sup>335</sup> had the same issue been litigated in state court instead of being arbitrated.

Finally, and most importantly, combining Professors Stone and Colvin’s findings that employees win less frequently and are awarded lower

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329. Estlund, *supra* note 23, at 696.

330. Observe that  $2\% = 2/100 = 1/50$ .

331. STONE & COLVIN, *supra* note 21, at 19.

332. *Id.*

333. *Id.*

334.  $\$1$  arbitration damages  $\div$   $\$6.25$  federal court damages = 16%, for a simple representation of “the average outcome in mandatory arbitration is only 16 percent of that in the federal courts.” *Id.*

335.  $\$1$  arbitration damages  $\div$   $\$14.29$  state court damages = 7% for a simple representation of “the average outcome in mandatory arbitration is only . . . 7 percent of that in state courts.” *Id.*

damages in arbitration with Professor Estlund's findings that instead of arbitrating, employees abandon 98% of claims that they would have litigated, the multipliers increase.<sup>336</sup> For every dollar of damages an employer is forced to pay in arbitration, an appraisal should presume that the employer would have had to pay \$312.50 in damages<sup>337</sup> had employees litigated claims in federal court or \$714.50 in damages<sup>338</sup> had employees litigated claims in state court instead of either arbitrating *or predictably abandoning their claims in the face of arbitration*. In other words, the multipliers—that \$1 of damages in arbitration would be associated with \$312.50 of damages in federal court or \$714.50 of damages in state court—account for the far greater rate at which employees abandon claims that they would have litigated instead of arbitrating them.

Let's take an example (Example 1) of how this approach might work if an employer who previously allowed its employees to litigate disputes newly imposes a mandatory arbitration provision on its entire workforce. Imagine that the employer has one hundred total employees and each year, on average, pays \$10,000 in total damages for wage and hour law violations that its employees litigate in state court.<sup>339</sup> This employer has no history of paying damages in federal court and no history of violations of other laws like antidiscrimination laws or reasonable accommodation laws. After imposing the mandatory arbitration provision, this employer should expect to pay less than \$14 in total annual damages. The data shows that only 2% of claims that would have been litigated are arbitrated,<sup>340</sup> which reduces this employer's annual anticipated damages from \$10,000 to \$200. Given employees' lower win rates and stingier damage awards, their average award in mandatory arbitration is only 7% of that in state courts,<sup>341</sup> which reduces this employer's annual anticipated damages from \$200 to \$14. If we further assume that the average employee will work for three years after the mandatory arbitration provision is imposed and that a 5% discount rate properly accounts for the time value of money, then this employer's imposition of a mandatory arbitration provision results in \$27,194.35<sup>342</sup> of gross income on which the employer should pay tax.<sup>343</sup>

336. *See id.*; Estlund, *supra* note 23, at 696 (“[W]ell under two percent of the employment claims that one would expect to find in some forum, but that are covered by MMAs, ever enter the arbitration process.”).

337.  $\$6.25 \times 50$  (for the fifty court cases brought for each arbitration brought) = \$312.50.

338.  $\$14.29 \times 50$  (for the fifty court cases brought for each arbitration brought) = \$714.50.

339. This might occur because the employer paid \$30,000 three years ago and nothing for the last two years or because the employer paid \$10,000 each in each of the last three years.

340. *See* Estlund, *supra* note 23, at 696.

341. STONE & COLVIN, *supra* note 21, at 19.

342. The net present value of \$10,000 each over three years assuming a 5% discount rate is \$27,232.48. The net present value of \$14 each over three years assuming a 5% discount rate is \$38.13. The accession to wealth of paying \$38.13 in arbitration damages to save \$27,232.48 in litigation damages is \$27,194.35.

343. This value would likely be higher if the mandatory arbitration provision were combined with a class action waiver. *See* Estlund, *supra* note 23, at 706–07.

It is an advantage of this method that a less scrupulous employer—say one who each year, on average, pays \$100,000 in damages for violations of wage and hour laws—would instead pay tax on \$271,943.55<sup>344</sup> of gross income for imposing the same mandatory arbitration provision on a workforce of the same size. The method reflects that such a provision is more valuable to an unscrupulous employer.

Of course, these multipliers also work in reverse, which is helpful for valuing an employer's imposition of an existing coercive employment dispute resolution term on a new employee. In such a case, an appraisal should begin by looking at average annual arbitration damages paid by that employer to its existing employees on a per-employee basis. Arbitration damages for violations of federal law should be multiplied by \$312.50.<sup>345</sup> Arbitration damages for violations of state law should be multiplied by \$714.50.<sup>346</sup> If average annual per-employee arbitration awards are multiplied by the appropriate multiplier, the result is a reasonable estimate of the damages that the employer will annually save by imposing its coercive dispute resolution term on each additional employee.<sup>347</sup>

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344. The net present value of \$100,000 each over three years assuming a 5% discount rate is \$272,324.80. The net present value of \$140 each over three years assuming a 5% discount rate is \$381.25. The accession to wealth of paying \$381.25 in arbitration damages to save \$272,324.80 in litigation damages is \$271,943.55.

345. This multiplier reflects that employees arbitrate 2% of the claims that they would have litigated, *see supra* notes 329–330 and accompanying text, and receive average arbitration damages that are 16% of what they would have received in federal courts. *See supra* text accompanying note 333. Alternatively,  $\$312.50 \times 2\% = \$6.25$ , and  $\$6.25 \times 16\% = \$1$ .

346. Notice that  $\$14 \text{ arbitration damages} \times 714.50 = \$10,003$  litigation damages in state court is consistent with Example 1. This multiplier reflects that employees arbitrate 2% of the claims that they would have litigated, *see supra* notes 329–30 and accompanying text, and receive average arbitration damages that are 7% of what they would have received in state courts. *See supra* text accompanying note 333. Alternatively,  $\$714.50 \times 2\% = \$14.29$ , and  $\$14.29 \times 7\% = \$1$ .

347. A reader might argue that valuing a difficult-to-value intangible asset (here, the coercive employment dispute resolution term) so that it can be taxed at acquisition is not worth the effort, particularly since a coercive employment dispute resolution term will cause an employer to have increased net profits over time and thus increased tax liability over time. This might lead a reader to think that, if the value due to a coercive employment term is taxed in the end, why go to the effort and difficulty of taxing it in the beginning? This argument was raised in briefing in *Bruun* and failed to persuade the Court, which required inclusion in gross income upon the tenant improvements being acquired by the landlord at lease termination. *See Helvering v. Bruun*, 309 U.S. 461, 467 (1940). It should similarly fail to persuade here. In tax law, a substantial number of tax benefits come in the form of *delaying* the imposition of tax on accessions to wealth. Nonrecognition treatment available to like-kind exchanges, transfer of property at divorce, and certain corporate and partnership formations differ from recognition treatment in that the tax on income is delayed. *See* 26 U.S.C. §§ 1031, 1036, 1041. Similarly, immediate expensing of outlays differs from gradual depreciation only on the basis of the timing of the tax benefit, not the amount of tax benefit. *Compare id.* § 168(a)–(c) (providing depreciation deductions of property over specified recovery period), *with id.* § 168(k) (providing a 100% depreciation deduction in year property is placed in service). The same can be said of the fundamental distinction between immediately deductible expenses and gradually depreciable or even non-depreciable expenditures. The timing of tax liabilities and tax benefits is the bulk of tax planning and is a big-money issue for taxpayers and the Treasury. Waiting to tax for when an increased net profit stream becomes subject to tax over time would provide an important and highly valuable subsidy to coercive employment dispute resolution terms. *See Morrow, supra* note 175, at 335. This author opposes such a subsidy and notes that it

Let's take an example (Example 2) of how this approach might work if an employer who previously imposed a mandatory arbitration provision on its entire workforce hired a new employee subject to that provision. Imagine that prior to hiring the new employee, the employer had 100 total employees and each year, on average, pays \$200 in arbitration damages for violations that would otherwise have been litigated in state court plus \$100 for violations that would otherwise have been litigated in federal court. This breaks down to \$2 and \$1 on an annual, per-employee basis. However, if these same employees were able to pursue their claims in state courts and federal courts, data establishes that they would pursue their claims far more frequently, win far more often, and win bigger.<sup>348</sup> Thus, we would expect them to receive damage awards of \$1,429 in state court<sup>349</sup> plus \$312.50 in federal court<sup>350</sup> on an annual, per employee basis. If we further assume that the average employee will work for three years after being hired and that a 5% discount rate properly accounts for the time value of money, then each time the employer imposes its mandatory arbitration provision on a newly hired employee, it results in \$4,734.37<sup>351</sup> gross income on which the employer should pay tax. Again, this number would be higher if the employer were less scrupulous or if the coercive employment term were broader.

Of course, any particular employer might argue that these multipliers are inaccurate in their particular case, and the burden of proof would be on that employer to establish better-tailored multipliers. Employers anticipating valuation disputes might engage in desired actions like limiting their use of arbitration provisions, decoupling them from class action waivers, or lifting the veil of secrecy on arbitration outcomes.

Similarly, the IRS might argue that comparisons of filing rates, win rates, and damages fail to sufficiently account for selection effects. Employers who impose coercive employment dispute resolution terms on their employees might have higher rates of misconduct against their employees than do employers who do not limit the dispute resolution opportunities of their employees. All of this is to say that valuation is not

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would encourage employers to impose more and broader coercive employment dispute resolution terms. A taxpayer who acquires a new business entity has an accession to wealth at the moment of acquisition even though acquiring a new business entity will cause the taxpayer to receive increased profits over time and even though those increased profits will cause the taxpayer to have increased tax liability over time. A taxpayer who acquires a new rental property has an accession to wealth at the moment of acquisition even though acquiring a new rental property will cause the taxpayer to receive increased rents over time and even though those increase rents will cause the taxpayer to have increased tax liability over time. The anticipation of future tax on an increased income stream does not negate that the acquisition of an income-producing property constitutes an immediate realization of income. *See Bruun*, 309 U.S. at 467.

348. *See supra* text accompanying notes 329–35.

349.  $\$2 \times 714.50 = \$1,429$ .

350.  $\$1 \times 312.50 = \$312.50$ .

351. The net present value of \$1,741.50 (reflecting \$1,429 + \$312.50) each over three years assuming a 5% discount rate is \$4,742.54. The net present value of \$3 each over three years assuming a 5% discount rate is \$8.17. The accession to wealth of paying \$8.17 in arbitration damages to save \$4,742.54 in litigation damages is \$4,734.37.

perfect and will evolve with additional information. Nonetheless, these multipliers offer a reasonable starting point to value the benefit that employers capture by imposing coercive employment dispute resolution terms. Each time an employer imposes such a term on a new employee, the employer should be taxed.

## VII. CONCLUSION

When an employer imposes a coercive employment dispute resolution term on a worker, that employer obtains a new and valuable intangible asset. Thus, according to foundational principles of tax law, the employer should be taxed. The IRS's failure to tax employers who impose these terms has effectively created a tax subsidy for coercive employment dispute resolution terms that will cause an ever-increasing number of American workers to become subject to them. This subsidy should end.

