

ENFORCEABILITY OF ARBITRATION FEE ALLOCATION CLAUSES IN EMPLOYMENT-RELATED DISPUTES

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I. INTRODUCTION

Within the last decade, corporations have placed an increasing emphasis on reducing costs that provide negative impact on profit margin, commonly referred to as non-value added costs.¹ Corporate litigation has not been immune to this trend. Although corporations have designated employment-related litigation as a necessary part of conducting business, increasingly they have sought to reduce their financial burden in this area. In the quest to meet cost reduction requirements, some corporations have turned away from the courts to settle employment disputes because of the total financial responsibility associated with the defense of a dispute. Instead, corporations have turned to agreements with employees to refer some or all disputes to arbitration.

Arbitration is a form of Alternative Dispute Resolution that includes an adjudicative approach.² In arbitration, parties to a dispute agree to submit their dispute to an impartial third party, known as an arbitrator, for resolution.³ Arbitration often provides a corporation with an opportunity to shift the entire financial burden of litigation, or a portion thereof, to the employee. However, corporations often risk having

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¹ Thane Peterson, *Can Corporate America Get Out from Under Its Overhead?*, BUSINESS WEEK, May 18, 1992, at 102.

² Carolyn Chalmers and Laura Cooper, *Alternative Dispute Resolution: An Introduction* 18 (1997).

³ *Id.*

these arbitration agreements declared unenforceable by a court because of the fee percentage allocated to the employee.

This article examines whether an employer can enforce fee allocation clauses in arbitration agreements that require an employee to pay 50% of arbitration costs. Part II provides an overview of the Federal Arbitration Act and arbitration fees. Part III explores the emergence of arbitration agreements in resolving disputes arising in the employment arena. Part IV reviews the analysis methods used in various circuits to determine the enforceability of fee allocation clauses in arbitration agreements. Part V offers further analysis and proposes federal government subsidization as the best option for developing a bright line test for fee allocation clause enforceability.

II. FEDERAL ARBITRATION ACT

A. Overview

Congress passed the Federal Arbitration Act (“FAA”) in 1925.⁴ The Act was initially aimed at maritime and other contractual commercial transactions. It stated that, “a written provision in any maritime transaction or a contract evidencing a transaction involving commerce to settle by arbitration a controversy thereafter arising out of such contract . . . shall be valid, irrevocable, and enforceable except where revocation is permissible under law or equity.”⁵ The congressional intent behind the FAA was to eliminate the long held animosity toward arbitration agreements.⁶ Enacting the FAA

⁴ Federal Arbitration Act, 9 U.S.C. §§ 1-16 (2003) (original version at 88 Stat. 883 (1925)).

⁵ 9 U.S.C. § 2.

⁶ *Gilmer v. Interstate/Johnson Lane Corp.*, 500 U.S. 20, 24 (1991).

gave arbitration agreements the same legal weight as any other contract.⁷ It also required courts to refer a dispute to arbitration when parties previously agreed to arbitrate.⁸

B. Fees

Arbitration, like litigation, costs money. The American Arbitration Association (“AAA”) sets guidelines for fees related to arbitration. Some of the fees assessed to the parties in the dispute include the cost of the courtroom and a court reporter.⁹ Among the chief fees incurred by the parties are filing fees that can range from \$500 to \$2000 depending on the amount of damages sought by the claimant,¹⁰ and the arbiter’s daily fee that can range from \$750 to \$5000.¹¹ Typically, employment arbitration can last between fifteen and forty hours¹² and can cost more than \$1000 per day.¹³ In 2000, the AAA processed over 198,000 arbitration claims and had revenues in excess of \$80,000,000.¹⁴

III. ARBITRATION AGREEMENTS EMERGENCE IN EMPLOYMENT SETTINGS

A. History

Arbitration has become the preferred way of resolving disputes between labor and management.¹⁵ From a database of 4000 collective bargaining agreements, a sampling of

⁷ *Id.*

⁸ 9 U.S.C. § 3.

⁹ DeGroff v. MascoTech Forming Technologies-Fort Wayne, Inc., 179 F. Supp. 2d 896, 912 n.16 (N.D. Ind. 2001).

¹⁰ Melissa G. Lamm, *Who Pays Arbitration Fees?: The Unanswered Question in Circuit City Stores, Inc. v. Adams*, 24 Campbell L. Rev. 93, 108 (2001).

¹¹ Phillips v. Associates Home Equity Services, Inc., 179 F. Supp. 2d 840, 846 (N.D. Ill. 2001).

¹² Shankle v. B-G Maint. Mgmt. of Colo., Inc., 163 F.3d 1230, 1235 n.5 (10th Cir. 1999).

¹³ Richard M. Alderman, *Pre-Dispute Mandatory Arbitration in Consumer Contracts: A Call for Reform*, 38 Hous. L. Rev. 1237, 1250 (2001).

¹⁴ *Id.* at 1256.

¹⁵ Chalmers, *supra* note 2, at 19.

400 revealed that only 1% did not include a clause for the arbitration of grievances.¹⁶ Non-unionized sectors of corporate America eventually noticed the overall effective use of arbitration between unions and corporations and incorporated arbitration clauses into their collective bargaining agreements.¹⁷ For example, arbitration has become the method used for resolving employment disputes for entities as widely-known as the New York Stock Exchange.¹⁸ Within the last decade, at-will employers have increasingly placed mandatory arbitration agreements into employment contracts.¹⁹ Employers have introduced arbitration into the workplace through revisions to employee handbooks²⁰ and clauses placed in employment applications²¹ to affect how future employment disputes would be resolved.

Arbitration has gained popularity in the employment arena because it is seen as a way of avoiding lengthy and costly employment dispute litigation.²² In a unionized setting, arbitration is used as a form of dispute resolution when a dispute cannot be resolved via grievance procedures.²³

B. Claims of Duress and Lack of Procedural Access

In light of the increasing implementation of arbitration clauses in collective bargaining agreements, employees soon began to challenge their enforceability. Such

¹⁶ *Id.* at 3, n.2.

¹⁷ See David Masud, *Management Criticisms of NLRB Power*, 2001 L. Rev. M.S.U.-D.C.L. 1069, 1075.

¹⁸ Chalmers, *supra* note 2, at 20.

¹⁹ Sidney Charlotte Reynolds, *Closing a Discrimination Loophole: Using Title VII's Anti-Retaliation Provision to Prevent Employers from Requiring Unlawful Arbitration Agreements as Conditions of Continued Employment*, 76 Wash. L. Rev. 957, 959 (2001).

²⁰ See Blair v. Scott Specialty Gases, 283 F.3d 595, 598 (2002).

²¹ See John Taylor, *Helping Those Who Help Themselves: The Fourth Circuit's Treatment of Agreements to Arbitrate Statutory Employment Discrimination Claims in Brown v. ABF Freight Systems, Inc. and EEOC v. Waffle House, Inc.*, 79 N.C.L. Rev. 239, 246 (2000).

²² Lamm, *supra* note 10, at 95.

²³ STEVEN L. WILLBORN ET AL., *EMPLOYMENT LAW CASES AND MATERIALS* 47 (3rd ed. 2002).

challenges center on a belief that arbitration agreements written into employment applications and/or contracts are unenforceable and violative of the FAA based on the duress potentially placed upon an applicant or incumbent employee.²⁴ In addition, the National Labor Relations Board (“NLRB”) maintains that arbitration agreements can constitute unfair labor practice when mandatory arbitration agreements preclude employees from filing an NLRB charge against their employers.²⁵

C. Supreme Court Guidance

Supreme Court decisions in the cases of *Williams v. Cigna Financial Advisors, Inc.*²⁶ and later *Circuit City Stores, Inc. v. Adams*²⁷ upheld enforcement of arbitration agreements in the employment setting. In *Gilmer v. Interstate/Johnson Lane Corp.*, Robert Gilmer, an employee of a securities firm signed an agreement to arbitrate any employment dispute under rules established by a co-operative of which his employer was a member.²⁸ Gilmer was fired at age sixty-two and filed a claim under the Age Discrimination in Employment Act with the Equal Employment Opportunity Commission (“EEOC”).²⁹ Upon Gilmer’s subsequent suit in U.S. district court, the employer sought dismissal of the complaint and requested enforcement of the arbitration agreement.³⁰

²⁴ See *Gilmer v. Interstate/Johnson Lane Corp.*, 500 U.S. 20, 33 (1991).

²⁵ *Cole v. Burns Int’l Sec. Services*, 105 F.3d 1465, 1479 n.6 (D.C. Cir. 1997).

²⁶ *Williams v. Cigna Fin. Advisors, Inc.*, 197 F.3d 752 (5th Cir. 1999).

²⁷ *Circuit City Stores, Inc. v. Adams*, 121 S.Ct. 1302 (2001).

²⁸ *Gilmer*, 500 U.S. at 23-4.

²⁹ *Id.* at 23.

³⁰ *Id.* at 23-4.

The Supreme Court upheld the enforcement of the agreement to arbitrate Gilmer's dispute.³¹ The Court ruled that absent fraud or overwhelming economic bargaining power, arbitration agreements that are in line with the FAA in terms of contractual revocation rules should be enforced.³² This ruling legitimized arbitration agreements in the employment arena as well as the disputing parties' right to enforce them.

D. Fee Allocation Clauses

Although the Gilmer decision provided a legal avenue for enforcement of arbitration agreements, questions remain unresolved in relation to enforcement of specific terms in arbitration agreements. One term that has been the subject of recent debate in the legal community concerns fee allocation clauses and their effect on arbitration agreement enforceability. Such debate, however, has not stopped the growing popularity of employers' use of arbitration agreements as an alternative to litigation.

A reason for the emergence of arbitration in the employment setting lies in the fact that the disputing parties can, through contract, elect to proportionately share the costs associated with arbitration. It is how those fees are allocated that has led to litigation on the issue of contract enforceability. The Supreme Court has not ruled on arbitration agreement fee allocation clauses.³³ All federal courts of appeals agree that if a fee allocation clause in an arbitration agreement becomes so cost prohibitive as to constructively deny an employee access to the arbitration system, the arbitration agreement can be found unenforceable.³⁴ In addition, courts have placed on the

³¹ *Id.* at 23.

³² *Id.* at 33.

³³ Lamm, *supra* note 10, at 104.

³⁴ Manuel v. Honda R&D Americas, Inc., 175 F. Supp. 2d 987, 993 (S.D. Ohio 2001).

employee the burden of proving financial hardship as a reason not to enforce an arbitration agreement.³⁵ The courts, though, are divided on whether the presence of a fee allocation clause per se makes the arbitration agreement unenforceable.³⁶

The United States courts of appeals and some district courts have used four methods of analysis in determining whether a fee allocation clause in an arbitration agreement renders the agreement unenforceable.³⁷ Those methods are (1) a case-by-case analysis of a party's capacity to pay the fee, (2) an analysis determining per se invalidity, (3) an analysis to determine that the employer must pay all costs unique to the arbitration, and (4) an analysis to determine whether the agreement provides for fee splitting between the disputing parties.³⁸ Most circuits use either a case-by-case or a per se analysis as their primary analytical method.³⁹ Section four explores the preferred analyses of various circuits.

IV. ANALYSIS METHODS BY CIRCUITS

A. Case-by-Case Analysis

1. Fifth Circuit

The Fifth Circuit endorsed a case-by-case analysis in *Williams v. Cigna*.⁴⁰ In this case, Arthur Williams, 58, was hired by Cigna to be an agent.⁴¹ Williams had to register with the National Association of Securities Dealers as a condition of his employment.⁴²

³⁵ Jean Hellwege, *Arbitration Agreement Is Unenforceable If Costs Are Too High, Court Says*, 37-Nov Trial 16 (2001).

³⁶ *Manuel*, 175 F. Supp. 2d at 993.

³⁷ Lamm, *supra* note 10, at 104.

³⁸ *Id.*

³⁹ *Manuel*, 175 F. Supp. 2d at 993.

⁴⁰ *See Williams v. Cigna Fin. Advisors, Inc.*, 197 F.3d 752 (5th Cir. 1999).

⁴¹ *Id.* at 755.

⁴² *Id.*

The registration process required Williams to sign a form stating he would arbitrate any claim or dispute between himself and Cigna,⁴³ and pay 50% of any arbitration costs.⁴⁴ Cigna fired Williams for unsatisfactory performance.⁴⁵ He filed age discrimination charges with the EEOC and later filed a retaliation claim, all of which were moved to arbitration after Cigna was granted a motion by a district court to proceed with arbitration.⁴⁶

The Fifth Circuit Court of Appeals ruled that a fee allocation clause requiring an employee to pay 50% of the arbitration costs did not preclude Williams from having an opportunity to present his claims.⁴⁷ In reaching its decision, the court did not put forth a bright line test for finding a fee allocation clause unenforceable.⁴⁸ Instead the court chose to focus on the specifics of the case.⁴⁹ The court concluded that an employee's ability to pay arbitration fees was a dispositive factor in finding the arbitration clause enforceable.⁵⁰ The court based this decision on the fact that Williams' income at the time exceeded \$100,000.⁵¹

2. Seventh Circuit

While the Fifth Circuit in *Williams* seemed to endorse a case-by-case analysis, the Seventh Circuit stated unequivocally in *Phillips v. Associates Home Equity Services, Inc.*, that case-by-case analysis is the correct method for determining enforceability of fee

⁴³ *Id.*

⁴⁴ *Id.* at 763.

⁴⁵ *Id.* at 755-6.

⁴⁶ *Id.* at 756-7.

⁴⁷ *Id.* at 764.

⁴⁸ *See Id.*

⁴⁹ *Id.* at 764-5.

⁵⁰ *Id.*

⁵¹ *Id.*

allocation clauses.⁵² In *Phillips*, the Plaintiff obtained a residential mortgage from Associates Home Equity.⁵³ The parties signed an arbitration agreement stipulating that all disputes would be resolved via arbitration according to AAA rules.⁵⁴ The agreement provided that if Phillips were unable to pay her percentage of the fees and the AAA was unwilling to reduce its fee schedule, the fee allocation schedule would be determined by the arbitrator.⁵⁵ Prior to arbitration, Phillips estimated her fees according to information provided by the AAA.⁵⁶ She estimated that the fees would amount to more than \$4000.⁵⁷ Phillips claimed, and Associates conceded, that she was unable to pay her portion of the arbitration fees.⁵⁸

In finding the fee allocation clause unenforceable, the court turned to a case-by-case analysis of an employee's ability to pay arbitration fees.⁵⁹ The court concluded that Phillips had made a good faith effort to estimate her fees based on the fee information that she obtained from the AAA.⁶⁰ In addition, the court found that the fees in this case, in excess of \$4000, were cost prohibitive given Phillips' economic status.⁶¹ The court held that the fees precluded her from pursuing her claim in an arbitral forum.⁶² Associates was admonished by the court for its unwillingness to bear any responsibility for Phillips' fees in light of her financial hardship.⁶³ This case is significant for employees because case-by-case analysis requires a showing of good faith for the court to

⁵² *Phillips v. Associates Home Equity Services, Inc.*, 179 F. Supp. 2d 840, 847 (N.D. Ill. 2001).

⁵³ *Id.* at 842.

⁵⁴ *Id.* at 843.

⁵⁵ *Id.*

⁵⁶ *Id.* at 846.

⁵⁷ *Id.*

⁵⁸ *Id.*

⁵⁹ *Id.* at 846-7.

⁶⁰ *Id.* at 847.

⁶¹ *Id.*

⁶² *Id.*

⁶³ *Id.* at 846-7.

find a fee clause unenforceable based on an employee's inability to pay arbitration fees. The court's measure of good faith will be the same used in the employee's claim of financial hardship.

3. Fourth Circuit

In *Bradford v. Rockwell Semiconductor Systems, Inc.*, the Fourth Circuit held that a cost prohibitive fee allocation clause can make an arbitration agreement unenforceable.⁶⁴ In *Bradford*, the Plaintiff was employed by Brooktree Corporation, which was being acquired by Rockwell Semiconductor Systems.⁶⁵ Bradford was offered continued employment by Rockwell after the acquisition on the condition that he sign an agreement to arbitrate all disputes with Rockwell and pay half of the arbitration costs.⁶⁶ The day prior to the closing of the Rockwell acquisition, Bradford was told that he was being terminated.⁶⁷ He, in turn, filed an age discrimination suit in district court against Rockwell.⁶⁸ In addition, Bradford claimed the fee allocation clause was unenforceable because it had the chilling effect of deterring employees from seeking redress for their claims.⁶⁹ The district court granted a motion by Rockwell to compel arbitration of Bradford's claim.⁷⁰ The court ruled that an arbitration agreement requiring the splitting of arbitration fees did not, in and of itself, render the agreement unenforceable.⁷¹ In

⁶⁴ *Bradford v. Rockwell Semiconductor Systems, Inc.*, 238 F.3d 549, 554 (4th Cir. 2001).

⁶⁵ *Id.* at 551.

⁶⁶ *Id.*

⁶⁷ *Id.*

⁶⁸ *Id.* at 551-2.

⁶⁹ *Id.*

⁷⁰ *Id.*

⁷¹ *Id.* at 558.

upholding enforcement of a fee allocation clause, the court of appeals held that the issue should be determined on a case-by-case basis.⁷²

The significance of this decision lies in the fact that the Fourth Circuit provided clarity on what factors should be considered when determining whether a fee allocation clause is unenforceably cost prohibitive. The dispositive factors include: (a) the employee's projection of his share of the arbitration costs, (b) the employee's ability to pay arbitration costs, (c) the employee's ability to pay for court litigation, and (d) upon determination that the fees the employee pays make arbitration cost prohibitive, whether the fee allocation clause provides for shifting the employee's fees to the employer.⁷³ In affirming the district court's opinion, the court of appeals applied to its analysis the factor of Bradford's ability to pay fees.⁷⁴ The court held that Bradford failed (1) to provide evidence of an inability to pay arbitration costs and (2) to demonstrate the fee clause had a chilling effect on him or others in pursuit of any claims through arbitration.⁷⁵ Despite this holding, the court provided a working model for case-by-case analysis when it suggested that if Bradford's salary at the time of his discharge had not been \$115,000 and had not averaged \$53,000 for the past three years,⁷⁶ it might have made a different finding based on relative salary versus the arbitration costs.⁷⁷

⁷² *Id.* at 556.

⁷³ *Id.* at 556 n.5.

⁷⁴ *Id.* at 558.

⁷⁵ *Id.*

⁷⁶ *Id.* at 559.

⁷⁷ *Id.*

4. Sixth Circuit

In *Manuel v. Honda R&D Americas, Inc.*, the Sixth Circuit decided to adopt a case-by-case analysis.⁷⁸ In *Manuel*, Michael Manuel was initially hired by Honda of Los Angeles where he worked from 1989 to 1995.⁷⁹ He resigned and then filed a discrimination suit against Honda that was resolved through a legal settlement.⁸⁰ In the settlement, Manuel agreed to arbitrate any future claim against Honda and agreed that the losing party in any arbitration would bear all costs.⁸¹ Manuel was later hired as a design engineer by a company that received a majority of its business contracts from Honda.⁸² Manuel's new employer assigned him to a Honda plant in Ohio that employed some of his former Honda co-workers.⁸³ One day, Honda escorted Manuel from the plant and informed his new employer that it no longer wanted him on its property because of alleged workplace violence during his period of employment with Honda.⁸⁴ The contractor terminated Manuel, and in turn Manuel filed suit against Honda.⁸⁵

Manuel argued that the arbitration clause in the settlement agreement with Honda was unconscionable, per se invalid, and therefore unenforceable.⁸⁶ The court of appeals rejected the claim that the presence of such a fee allocation clause automatically makes the clause invalid and unenforceable.⁸⁷ Instead, the court stated that it was adopting the case-by-case analysis used by the Fourth Circuit.⁸⁸ This court's use of a case-by-case

⁷⁸ *Manuel v. Honda R&D Americas, Inc.*, 175 F. Supp. 2d 987, 994 (S.D. Ohio 2001).

⁷⁹ *Id.* at 988.

⁸⁰ *Id.*

⁸¹ *Id.* at 991.

⁸² *Id.* at 988.

⁸³ *Id.*

⁸⁴ *Id.* at 988-9.

⁸⁵ *Id.* at 989.

⁸⁶ *Id.* at 991.

⁸⁷ *Id.* at 994.

⁸⁸ *Id.*

analysis is evidenced by use of the same factors outlined in *Bradford*.⁸⁹ In *Manuel*, the court considered the factors of total arbitration costs and Manuel's ability to bear his share of the fees to be dispositive.⁹⁰ The court found Manuel had failed to provide any evidentiary basis for a finding of clause unenforceability.⁹¹ Specifically, the court pointed to Manuel's failure (1) to provide the court with any indication of total arbitration cost and (2) to provide the court with any evidence of a financial hardship if the clause were enforced.⁹² In addition, this court amplified the endorsement of case-by-case analysis by stating that the rule of per se invalidation of an arbitration agreement due to inclusion of a fee allocation clause contradicts Supreme Court precedent.⁹³ The court relied on interpretation of Supreme Court reasoning that one who seeks to invalidate an arbitration agreement because of a fee allocation clause bears the burden to show that in one's specific case, the fee allocation costs make arbitration cost prohibitive.⁹⁴

5. Third Circuit

In the Third and Eighth Circuits, cases involving claims of employer violations of the Fair Labor Standards Act ("FLSA") evidenced endorsement of a case-by-case analysis in determining enforceability of fee allocation clauses in arbitration agreements.⁹⁵ The Third Circuit rejected per se analysis and implicitly adopted the case-

⁸⁹ Compare *Bradford v. Rockwell Semiconductor Systems, Inc.*, 238 F.3d 549, 556 (4th Cir. 2001), with *Manuel v. Honda R&D Americas, Inc.*, 175 F. Supp. 2d 987, 995 (S.D. Ohio 2001).

⁹⁰ *Manuel*, 175 F. Supp. 2d at 995.

⁹¹ *Id.*

⁹² *Id.*

⁹³ *Id.* at 994.

⁹⁴ *Manuel*, 175 F. Supp. 2d at 994.

⁹⁵ See *Giordano v. Pep Boys--Manny, Moe & Jack, Inc.*, 2001 WL 484360 (E.D. Pa. March 29, 2001) and *Bailey v. Ameriquest Mortg. Co.*, 2002 WL 100391 (D. Minn., Jan. 23, 2002).

by-case method in *Giordano v. Pep Boys--Manny, Moe & Jack, Inc.*⁹⁶ In *Giordano*, Peter Giordano claimed that Pep Boys failed to pay him his total wages and terminated him in retaliation for claiming it violated the FLSA.⁹⁷ Giordano claimed the arbitration agreement he signed upon being rehired by Pep Boys was unenforceable because it required him to pay 50% of the arbitrator's fee, which was cost prohibitive and precluded him from having his claim adjudicated.⁹⁸ Giordano's rationale was based on the fact that his wages were \$400 per week when he was terminated,⁹⁹ compared to the arbitrator's fee, which ranged from \$600 to \$900 per day.¹⁰⁰ The district court declared the fee allocation clause unenforceable.¹⁰¹

In reaching the decision to strike the fee clause, the court used an employee's ability to pay as a factor in its case-by-case analysis, which was also used in Third Circuit cases *Goodman v. ESPE America, Inc.*¹⁰² and *Zumpano v. Omnipoint Communications*.¹⁰³ In using ability to pay fees as a dispositive factor, the court quickly determined that the disparity between Giordano's weekly wage and even one day of arbitration proceedings effectively precluded him from access to the arbitral forum.¹⁰⁴ The significance of this opinion, however, is not that it embraced the use of a case-by-case analysis, but that the court openly expressed a view increasingly popular among the circuits that the case-by-

⁹⁶ *Giordano*, 2001 WL 484360, at 5.

⁹⁷ *Id.* at 1.

⁹⁸ *Id.* at 4.

⁹⁹ *Id.* at 6.

¹⁰⁰ *Id.*

¹⁰¹ *Id.* at 7.

¹⁰² *Goodman v. ESPE Am., Inc.*, 2001 U.S. Dist. Lexis 433, at 4 (E.D. Pa. January 19, 2001) (District court upholds arbitration agreement signed by a former company president requiring neither prior payment of fees, nor fee splitting at the end of arbitration).

¹⁰³ *Zumpano v. Omnipoint Communications*, 2001 WL 43781, at 7 (E.D. Pa. Jan. 18, 2001) (District court upholds arbitration agreement signed by employee with a \$120,000 annual base salary despite ambiguity in terms of fee allocation).

¹⁰⁴ *Giordano*, 2001 WL 484360, at 6.

case method is the appropriate method of analysis, and also that the per se method's future viability is in doubt.¹⁰⁵

6. Eighth Circuit

The Eighth Circuit adopted a case-by-case analysis in *Bailey v. Ameriquest Mortgage Co.*¹⁰⁶ Here, the Plaintiffs claimed that by not paying overtime, Ameriquest Mortgage Co. had violated the FLSA.¹⁰⁷ The arbitration agreement signed by the employees upon being hired stated that employees would pay 50% of the arbitrator's fees, and that the arbitrator reserved the right to provide the winning party reasonable fees.¹⁰⁸

The court found that the fee allocation clause discouraged employees from pursuing claims through arbitration, and was therefore unenforceable.¹⁰⁹ The court ruled that decisions involving claims that could preclude a plaintiff from pursuing his arbitral claim and make an agreement unenforceable such as venue, collective action, and fee allocation, should be decided on a case-by-case basis.¹¹⁰

7. First Circuit

The First Circuit endorsed a case-by-case analysis in *Rosenberg v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*¹¹¹ In *Rosenberg*, Susan Rosenberg was hired by Merrill

¹⁰⁵ *Id.* at 5.

¹⁰⁶ *Bailey v. Ameriquest Mortg. Co.*, 2002 WL 100391, 7 (D. Minn., Jan. 23, 2002).

¹⁰⁷ *Id.* at 1.

¹⁰⁸ *Id.* at 5.

¹⁰⁹ *Id.* at 6.

¹¹⁰ *Id.* at 6-7.

¹¹¹ *Rosenberg v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 170 F.3d 1, 17 (1st Cir. 1999).

Lynch as a financial consultant.¹¹² Merrill Lynch terminated her for poor performance, after which she filed tort and discrimination suits in state court.¹¹³ Merrill Lynch was granted a motion to arbitrate Rosenberg's claims in accordance with a pre-existing agreement.¹¹⁴

While the main issue was whether an arbitration clause in a securities industry registration form created an adhesion contract,¹¹⁵ the court also ruled that a person who signed an arbitration agreement could have opted out with evidence showing that any procedure pertaining to the arbitration agreement was biased.¹¹⁶ The court's rationale is analogous to case-by-case analysis because it requests that plaintiffs produce reasonable evidence in good faith related to the arbitration agreement that is unique to their circumstances. The evidence must be of a level that would lead a court to conclude that the plaintiffs are procedurally precluded from the arbitral forum.

The case-by-case analysis shares acceptance among the courts in the circuits that use it not only in terms of fee allocation clauses, but also in relation to any term in an arbitration agreement. The courts in the case-by-case analysis circuits agree with the notion that even what may appear to be cost prohibitive in terms of arbitration does not always lead to striking down of the agreement. The rationale is that arbitration is much less expensive than court litigation for both sides.¹¹⁷

¹¹² *Id.* at 4.

¹¹³ *Id.* at 5.

¹¹⁴ *Id.*

¹¹⁵ *Id.* at 17.

¹¹⁶ *Id.* at 16.

¹¹⁷ *Id.*

B. Per Se Invalid Analysis

The second approach that circuits prefer is a per se analysis. If an arbitration agreement contains any type of fee allocation clause making the employee responsible for any portion of arbitration costs, then under a per se analysis that clause is deemed automatically invalid.¹¹⁸

1. Tenth Circuit

The Tenth Circuit endorsed a per se rule in reviewing fee allocation clauses in *Shankle v. B-G Maintenance Management of Colorado, Inc.*¹¹⁹ In *Shankle*, Matthew Shankle had been employed by B-G for several years at the time he signed an arbitration agreement where fees were to be shared equally by each party.¹²⁰ The agreement contained language stating that if an employee were unable to pay half of the fees at the time arbitration commenced, the employer would pay the employee's share of the fees.¹²¹ The agreement stipulated that the employee would then become liable to the employer for fee reimbursement.¹²²

The court held that a fee allocation clause requiring each party to pay half of the fees was per se unenforceable.¹²³ The court stated that the fee allocation clause put Shankle “between the proverbial rock and a hard place”¹²⁴ in terms of seeking redress. In addition, the court found the clause made arbitration automatically cost prohibitive and in

¹¹⁸ See *Fuller v. Pep Boy--Manny, Moe & Jack of Del., Inc.*, 88 F. Supp. 2d 1158, 1162 (Colo. 2000).

¹¹⁹ *Shankle v. B-G Maint. Mgmt. of Colo., Inc.*, 163 F.3d 1230, 1235 (10th Cir. 1999).

¹²⁰ *Id.* at 1232.

¹²¹ *Id.*

¹²² *Id.*

¹²³ *Id.* at 1233.

¹²⁴ *Id.* at 1235.

effect denied him access to the arbitral forum.¹²⁵ The court also rejected B-G's alternative argument that fee allocation clauses that split costs evenly promote neutrality among arbitrators.¹²⁶ The court found that even if the clause effectively promoted arbitrator neutrality, the denial of employee access to the arbitral forum due to the requirement to pay half of the fees outweighed any benefit from fee splitting.¹²⁷

2. Eleventh Circuit

The Eleventh Circuit embraced a *per se* rule in determining the enforceability of arbitration fee allocation clauses in *Perez v. Globe Airport Security Services, Inc.*¹²⁸ In *Perez*, Damiana Perez signed an agreement to arbitrate all disputes as a condition of employment.¹²⁹ The agreement also provided that in the event of arbitration, regardless of any governing arbitration rules stipulating that the prevailing party is awarded fees, each party was to pay 50% of all arbitration costs.¹³⁰ After ending her employment with Globe, Perez claimed that Globe had violated Title VII, and she filed a gender discrimination suit.¹³¹ Globe moved to compel Perez to resolve her dispute through arbitration in accordance with the arbitration agreement.¹³² The district court denied the motion on the basis that the fee allocation clause was cost prohibitive and therefore precluded Perez from asserting her Title VII rights.¹³³

¹²⁵ *Id.*

¹²⁶ *Id.*

¹²⁷ *Id.*

¹²⁸ *Perez v. Globe Airport Sec. Services, Inc.*, 253 F.3d 1280, 1287 (11th Cir. 2001), *vacated by* 2002 US App Lexis 12334.

¹²⁹ *Id.* at 1282.

¹³⁰ *Id.*

¹³¹ *Id.* at 1283.

¹³² *Id.*

¹³³ *Id.*

In affirming the district court's decision, the court of appeals ruled that an agreement requiring an employee to pay 50% of all fees usurped the authority of the arbitrator to impose his own fee allocation schedule in accordance with Title VII dispute resolution.¹³⁴ This usurpation of Perez's Title VII remedial rights rendered the arbitration agreement unenforceable.¹³⁵ The court held that the denial of any arbitration remedial rights granted by congressional action renders an arbitration agreement unenforceable.¹³⁶

V. ANALYSIS

A. Employer/Employee Bargaining Power Equalized

A majority of the nation's circuits have offered progressive jurisprudence on the topic of arbitration agreement fee allocation clauses by rejecting a per se analysis and endorsing a case-by-case analysis. Despite the fact that the Tenth and Eleventh Circuits continue to use per se analysis, the majority of circuits follow the Supreme Court's reasoning that fee allocation clauses do not make arbitration agreements per se invalid.¹³⁷ Thus, majority opinion holds that arbitration agreements are not per se invalid despite the unequal bargaining power that can be exerted by an employer upon an employee to enter into an arbitration agreement with fee allocation clauses as a condition of employment.

Those circuits endorsing case-by-case analysis address the unequal bargaining power aspect by allowing the employee the opportunity to show that the financial hardship unique to his circumstances warrants, at a minimum, re-examination of the fee allocation clause and, in some cases, renders the entire arbitration agreement

¹³⁴ *Id.* at 1285.

¹³⁵ *Id.* at 1287.

¹³⁶ *Id.* at 1286.

¹³⁷ Lamm, *supra* note 10, at 107.

unenforceable. These circuits reach the conclusion that this method of analysis resolves all issues regarding the viability of employee responsibility in terms of arbitration fee allocation clauses. Alternatively, the next section examines how case-by-case jurisdictions leave unresolved the possibility of a hidden cost that can potentially result in arbitration becoming cost prohibitive for both the employer and the employee.

B. The Hidden Costs of Case-by-Case Analysis

There is a hidden expense in case-by-case analysis, which can escalate costs to the point that the fee allocation clause makes arbitration cost prohibitive for both the employee and the employer. The cost is borne out of the employee's right to pursue a litigation claim over the fee allocation clause prior to commencing arbitration, regardless of whether the claim is valid.

This can be resolved by having an employer contractually agree to pay all arbitration expenses upon proof of employee financial hardship. While this approach appears to be a novel, enlightened method of fostering positive employer/employee relationships, it does nothing to reduce the potential for litigation costs associated with fee allocation clauses. Under any type of employee financial hardship clause, the employer will likely determine what constitutes hardship. If the employer determines hardship, employees rejected for hardship status will claim bias on the part of the employer because of the employer's financial interest in shifting a portion of the fees to the employee. Consequently, employees in case-by-case jurisdictions will seek to litigate the employer's hardship determination based on the rationale that case-by-case analysis

inherently creates fluid standards based on the specifics of an employee's claim. Therefore, an employee faces a greater likelihood of a ruling that grants hardship status.

C. Legislation as a Resolution Alternative

Given that case-by-case analysis is the emerging standard for review of fee allocation clause causes of action, employers who seek to resolve the issue of hidden costs associated with litigating an arbitration agreement, or the issue of clearly defining an enforceable fee allocation clause, are unlikely to find a sympathetic audience in the courts. This lack of understanding and lack of acknowledgement of the issue of hidden costs by the case-by-case circuits will ultimately result in employers seeking changes in the area of fee allocation clauses in the arena of congressional change to the FAA. The next section provides a proposal designed to resolve these issues in a manner equitable to both parties in an arbitration agreement.

D. Proposal

In jurisdictions that use case-by-case analysis, employers are faced with the two unresolved issues of (1) the constant uncertainty of having their fee allocation clauses declared unenforceable and (2) the constant threat of litigation concerning what constitutes financial hardship in cases where the employer agrees to shift fees based on such determination. Employers are seeking a bright line test for fee allocation clauses that would serve as an employer guide for constructing enforceable clauses, as well as eliminate litigation on the hardship issue. Without consistent rationale from the circuit courts of appeals, and the Supreme Court yet to rule on clause enforceability, employers

should turn to the legislative branch of government in an effort to create a bright line test for these matters. These legislative changes could create equitable fee allocation conditions for both the employer and the employee if they include (1) employers contributing to a national fund designed to spread the risk of arbitration costs and (2) requiring employees to pay a portion of arbitration costs based on means testing. The next section explores criticism and praise of these proposed changes.

1. Employer Arbitration National Fund

While large employers are usually able to absorb arbitration costs, an arbitration agreement where the employer agrees to pay for all costs can make arbitration cost prohibitive for small to moderate sized employers. The amount of contribution required from each employer would be based on a percentage of its prior year's gross income. To minimize the criticism from larger employers that they are subsidizing arbitration for smaller employers, the federal government would provide a subsidy in the form of matching funds to all employers for every dollar contributed to the fund. By legislatively directing all employers to contribute to a national fund, from which the costs of arbitration would be dispersed, arbitration costs would be equalized for all employers.

2. Employee Fee Structure

The premise behind the FAA was to place arbitration on equal footing with civil court litigation.¹³⁸ Civil court litigation requires that each party be financially responsible for some or all of the costs associated with this form of dispute resolution. It is a logical conclusion that if court litigation and arbitration are on the same level, then employees as

¹³⁸ See *Gilmer v. Interstate/Johnson Lane Corp.*, 500 U.S. 20, 24 (1991).

well as employers should be financially responsible for the process. Despite this rationale, any method that requires employees to be financially responsible for arbitration costs must ensure that arbitration does not become cost prohibitive. Legislation could be enacted requiring employees to pay a portion of arbitration costs. The amount the employee would pay would be based on a means test. This means test would determine the employee lower gross income limit in which an employee would not be required to contribute to arbitration costs. As a component of this test, the costs of arbitration assigned to the employee could be based on a percentage range of the employee's gross income. This range would be capped at 15% for those with incomes greater than \$200,000. As with the costs associated with the employer, the federal government could pay the remaining portion of the employee's costs through subsidies. This proposal would be amenable to both employers and employees. For employers, it sends a signal that employees, just like employers, will have financial responsibility in the arbitration process. For employees, paying a relatively small percentage of the costs of arbitration based on their income removes cost as a barrier to the arbitral forum.

3. Criticisms to Proposed Changes

The group most likely to be critical of the outlined proposed changes will be those who see the federal government subsidizing the costs of arbitration as unnecessary government intrusion. Criticism from this group would stem from the theory that the federal government should operate in a manner based on the ideology that government should have a reduced role in regulating processes associated with the private sector. Another criticism of the proposal might come from those who believe that government

has the right to become involved in this process, and should; but that changes to the arbitration process should be left to the individual states. This rationale is based on the belief that having the federal government subsidize the arbitration process represents another manner in which the federal government can impose its will on states by threatening to remove the proposed subsidies if a state fails to adhere to federal government demands. As an example, this group may use the threat by the federal government, resulting from the Arab oil embargo of the 1970s, to cut off federal funds to those states that refused to impose a fifty-five mile per hour speed limit on their highways.¹³⁹

4. Subsidies Create A Bright Line Enforcement Test

The Supreme Court has stated that the FAA will continue to satisfy its remedial purpose provided that a party has the chance to plead its case in an arbitral forum.¹⁴⁰ However, if fees associated with an arbitration agreement preclude a potential litigant from pleading a claim in an arbitral forum, the arbitration agreement is unenforceable.¹⁴¹ The majority of cases reviewed in this article involve clauses in which the employee could be required to pay half of the arbitration costs. Having the employee financially responsible for the arbitral process with the help of government subsidies eliminates litigation on the issue of an employee's ability to pay under fee allocation clauses. In addition, the proposed changes benefit the employer in the quest to reduce litigation costs associated with fee allocation clauses due to the emergence of a bright line test.

¹³⁹ Marks v. Mobil Oil Corp., 562 F. Supp. 759, 771 (D.C. Pa. 1983).

¹⁴⁰ Gilmer v. Interstate/Johnson Lane Corp., 500 U.S. 20, 28 (1991) (quoting Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc., 473 U.S. 614, 617 (1985)).

¹⁴¹ Etokie v. Carmax Auto Superstores, Inc., 133 F. Supp. 2d 390, 392 (D. Md. 2000).

VI. CONCLUSION

To reduce court litigation costs, employers have increasingly utilized arbitration and arbitration agreements with clauses stipulating that employees will be responsible for 50% of arbitration fees. In an attempt to resolve clause enforceability questions, most courts use either the per se or case-by-case method of analysis. Per se analysis, used by a minority of circuits, finds that any arbitration agreement that contains a fee allocation clause requiring an employee to pay arbitration fees is automatically unenforceable. Circuits using this method have determined that forcing an employee to pay a part of the cost of arbitration automatically makes arbitration financially inaccessible as a forum of dispute resolution for the employee. By contrast, the majority of circuits uses a case-by-case analysis to determine fee allocation clause enforceability. Circuits using this method look at each employee's financial circumstances in relation to arbitration costs to determine clause enforceability. Those circuits using case-by-case analysis create a constantly changing standard for determining fee allocation clause enforceability. Employers who wish to avoid court litigation over a fee clause may offer to pay an employee's costs upon a determination of financial hardship. Still, such action does not resolve the issue of reducing court litigation costs because employees who are not granted hardship status can seek redress in court over the issue of what constitutes hardship.

The federal government should resolve the issue of enforceable fee allocation clauses through legislation. The proposed legislation would require an employee to pay a capped percentage of arbitration costs and create a national fund to defray some employer

arbitration fees. In addition, the federal government would subsidize the costs of arbitration on behalf of both the employer and the employee. Adopting this proposal would create a bright line test for enforcing fee allocation clauses in employment arbitration agreements.