Arbitration of Employment Disputes:
Can It Be Required?

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I. INTRODUCTION

Prior to the Supreme Court’s decision in Gilmer v. Interstate/Johnson Lane Corp., the leading case on whether employers could mandate arbitration of discrimination claims was the Court’s 1974 decision in Alexander v. Gardner-Denver. That case was generally considered a prohibition of pre-dispute agreements to arbitrate employment claims. In Gilmer, however, the Supreme Court ruled that an employer and employee can enter into a private agreement – mandated by the employer – to arbitrate such claims.

Since the Gilmer decision, many employers have initiated policies requiring employees to arbitrate all disputes arising out of the employment relationship as a condition of employment or continued employment. Employees signing such agreements have responded with an array of challenges to attempts to enforce them. They have argued that Gilmer only applies to the security industry, that the agreement lacked consideration, that the agreement was so one-sided as to be unconscionable, or that the agreement unlawfully deprived them of statutory rights. They have argued that such agreements violate public policy and are therefore unenforceable. They have argued that such agreements cannot be enforced unless entry into the agreement was “knowing and voluntary.” Some administrative agencies, the Equal Employment Opportunity Commission (“EEOC”) foremost among them, have been openly hostile to employment arbitration agreements. After a decade of litigation, however, it is now clear that employers can generally mandate arbitration of all employment disputes – if the agreements provide certain basic rights to the employee. Following are some of the key cases in this rapidly evolving area of the law.

II. FROM GILMER TO WAFFLE HOUSE WITH A STOP AT CIRCUIT CITY

In Gilmer, the Supreme Court announced: “Although all statutory claims may not be appropriate for arbitration, ‘[h]aving made the bargain to arbitrate, the party should be held to it unless Congress itself has evinced an intention to preclude a waiver of judicial remedies for the statutory rights at issue.’” The statute at issue in Gilmer was the Age Discrimination in Employment Act (“ADEA”). The Court looked to the text and the legislative history of the statute and determined that nothing therein explicitly precluded non-judicial resolution of ADEA claims and that there was no conflict between arbitration and the ADEA’s statutory goals. Following Gilmer, most courts addressing the issue determined that the Supreme Court’s reasoning also applied to Title VII of the Civil Rights Act of 1964 (“Title VII”).
Shortly after *Gilmer* was decided, Congress enacted the Civil Rights Act of 1991 ("1991 CRA"). The 1991 CRA includes a provision which states:

> [w]here appropriate and to the extent authorized by law, the use of alternative means of dispute resolution, including . . . arbitration, is encouraged to resolve disputes arising under the Acts or provisions of Federal law amended by this title.10

Curiously, one Federal Court of appeals concluded that this language demonstrated the intent of Congress to preclude arbitration of Title VII claims.11 Most courts to address the issue, however, have reached the opposite conclusion, holding that this language evinces congressional intent to encourage arbitration of claims under the laws amended by the 1991 CRA (including the Americans with Disabilities Act ("ADA"), the ADEA, and Title VII).12 And at least one court attempted to reach a middle ground, concluding that the phrase “authorized by law” was intended to encourage arbitration of claims where the agreement to arbitrate is enforceable under the FAA, but construing the phrase “appropriate” to deny arbitration of an age discrimination claim where the information provided to the employee did not clearly explain that all employment claims would be arbitrated.13

But the ongoing question of whether arbitration of discrimination claims could be mandated was resolved by the U.S. Supreme Court on March 21,2001, in *Circuit City Stores, Inc. v. Adams*.14

In *Circuit City*, the company’s employment application included a paragraph agreeing to arbitrate all employment disputes between the employer and employee. Following his termination, the employee filed a state law employment discrimination suit against Circuit City. Circuit City sued in federal court to enjoin the employee’s action and to compel arbitration pursuant to the agreement in the employment application. The District Court entered judgment in favor of Circuit City. The Ninth Circuit reversed, stating that the Federal Arbitration Act’s ("FAA") provision excluding coverage for “contracts of employment of seamen, railroad employees, or any other class of workers engaged in foreign or interstate commerce” was intended to prevent enforceability of all arbitration agreements in contracts of employment. But the Supreme Court overruled the Ninth Circuit, holding by a 5 – 4 margin that Section 1 of the FAA only prohibited the enforcement of arbitration agreements in contracts of employment involving transportation workers. Therefore, it is now clear that the FAA allows enforcement of agreements mandating arbitration of employment discrimination claims.15

Even though the Supreme Court has authorized mandatory pre-dispute agreements to arbitrate statutory discrimination claims, the Court has also found that such agreements do not strip the EEOC of its right to pursue litigation on behalf of an employee who is contractually bound to the arbitration process. *Equal Employment Opportunity Commission v. Waffle House*.16 In *Waffle House*, the employee had agreed at the time of hire to a clause stating that all disputes would be settled through a binding arbitration process. Sixteen days after beginning his job, he suffered a seizure and was subsequently discharged. The employee did not seek to initiate arbitration procedures; instead, he filed a charge with the EEOC alleging violations of the
American with Disabilities Act ("ADA"). The EEOC filed a complaint seeking injunctive and make whole relief on behalf of the employee. Waffle House filed a petition seeking to compel arbitration pursuant to the employee’s contractual agreement. The Court determined that the EEOC’s mandate to vindicate the public interest superseded the employee’s waiver of his right to go to court. Consequently, whether or not an employee agrees to arbitrate all employment disputes, the EEOC retains its right to pursue remedies against the employer without regard to the charging party’s arbitration agreement.

A. CHALLENGES BASED ON CONTRACT PRINCIPLES

Agreements to arbitrate employments disputes are simply contracts in which the parties agree to have their disputes resolved by an arbitrator as an alternative to having the same disputes resolved by the courts. When analyzing such agreements, the courts apply ordinary contract principles to determine whether the employee in question has entered into a legally binding agreement to submit the claims at issue to arbitration. In determining whether a valid agreement arose between the parties, courts look to the state law governing the formation of contracts under the specific circumstances.17

1. Consideration

Arbitration agreements are frequently attacked as lacking consideration. In employment arbitration agreements, the consideration from the employee is the promise to take disputes arising out of the employment to an arbitrator rather than a court. However, some consideration must be provided by each party to form a legally binding agreement. Accordingly, the contractual analysis often focuses on whether the employer has provided consideration for the agreement.

Mutual promises may provide consideration for each other. The consideration provided by the employer often takes the form of the employer’s mutual promise to arbitrate disputes arising out of the employment relationship. This is a detriment to the employer because the employer no longer has the option to take the employee to court regarding claims arising from the employment. In some states, mutuality is arguably the required form of consideration before an arbitration agreement will be enforced.18

When determining whether mutuality exists, courts look to the specific language of the agreement to determine whether the employer intended to be bound by an agreement to arbitrate its employment claims.19 In Gibson v. Neighborhood Health Clinics,20 the arbitration agreement at issue was contained in a “New Associate Understanding.” Because the Understanding was phrased in terms such as “I agree”, “I understand”, and “I am waiving”, the court held that it could not provide the consideration necessary for the agreement.21 This is to be contrasted with the case of Michalski v. Circuit City Stores, where the arbitration agreement was contained in a section of an employee handbook which stated: “In arbitration, you and the company agree to submit a legal dispute to an arbitrator who...renders a final, binding decision to your legal claim.”22 The court held that this language bound both parties and constituted sufficient consideration for the agreement.
The circumstances surrounding entry into the arbitration agreement will also be reviewed to determine whether the employer intended to be bound by an agreement to arbitrate claims. In *Gibson*, plaintiff was given a stack of papers to sign, including an employee manual and the “Understanding.” The Understanding, which the plaintiff signed, contained an agreement to abide by the arbitration procedures contained in the manual. The manual — which the plaintiff never signed — was not provided to the plaintiff until after the Understanding had been executed and returned. Unlike the Understanding, the manual was drafted to indicate that both the employer and the employee would be bound to arbitrate claims arising out of the employee’s employment. However, because the employee did not know the contents of the manual when she signed the Understanding, the court concluded that the employee could not have agreed to arbitrate her claims in exchange for the employer’s mutual obligation to do the same. Because consideration must be a “bargained for exchange,” the court ruled that the mutual obligations expressed in the manual could not constitute consideration for the employee’s promise to arbitrate.23

*Patterson v. Tenet Healthcare, Inc.*24 was another case where the circumstances surrounding the issuance of the arbitration agreement were critical to the outcome. In *Patterson*, the arbitration agreement was included in an employee handbook which specified that it was not a contract and could be amended, supplemented or rescinded by the employer unilaterally at any time.25 However, the arbitration clause was set forth on a separate page of the handbook which was to be signed, removed from the handbook and returned to the employer to be stored in the employees’ personnel files. Also, the language and tone of that provision was markedly different from that of the rest of the handbook, containing language such as “I agree”, “I agree to abide by and accept”, “condition of employment”, “final decision” and “ultimate resolution”. Based on these factors, the court enforced the arbitration agreement, concluding that the arbitration provision was distinct from the rest of the handbook and therefore not subject to the disclaimer language.26

Arbitration agreements contained in employee handbooks are at greater risk of being held unenforceable for lack of consideration than stand-alone arbitration agreements. This is because a clear objective of drafting employee handbooks is to prevent the document from being interpreted as a contract. Employers frequently put disclaimers in their handbooks stating that nothing in the handbook is to be interpreted as a contract or as creating any contractual rights.27 Also common in handbooks is language that the employer reserves the right to amend, alter, modify or terminate any policy in the handbook, usually without any notice to employees being required.28 An arbitration agreement, in contrast, must be a contract in order to be found enforceable and therefore cannot be subject to unilateral modification or rescission by either party.

This problem is clearly illustrated in the case of *Heurtebise v. Reliable Business Computers*.29 In *Heurtebise*, the employee handbook contained an arbitration clause and a provision allowing the employer to unilaterally modify the terms of the handbook.30 The handbook also had a disclaimer which stated: “the Policies specified herein do not create any employment or personal contract, express or implied.”31 The court refused to enforce the
arbitration provision, in part because the employer “did not intend to be bound to any provision contained in the handbook.”32 Because an employer’s intent to avoid creating contractual rights in an employee handbook conflicts with the goal of creating an enforceable contract to arbitrate discrimination claims, placing the “agreement” in the employee handbook makes enforcement more difficult.

In addition to (or as an alternative to) providing consideration in the form of mutuality of obligations, employers may also obtain employee agreements to arbitrate in exchange for offers of employment or continued employment.33 This is consideration because it is a benefit to the employee. However, courts will look carefully at the circumstances of the case and will not find consideration unless the offer of employment or continued employment was actually exchanged for the employee’s promise to arbitrate employment claims.

Establishing that the employment was exchanged for the promise to arbitrate is more difficult than it initially appears. Where an offer of initial employment is not made explicitly conditional upon the employee’s agreement to arbitrate, courts will refuse to enforce the agreement for lack of consideration based upon the absence of the requisite bargained for exchange.34 Employers can establish that an exchange of continued at-will employment was bargained for by communicating to the employee when tendering the arbitration agreement that they may continue to work if they sign the agreement, but that their future is uncertain if they refuse.35 However, even an offer of initial employment will be held ineffective consideration if the employee was already hired at the time the agreement was signed, again because of the lack of any bargained for exchange.36 Employers using offers of employment or continued employment as consideration for employment arbitration agreements must tender such agreements to employees in a manner that makes clear to all concerned that the employment offer is conditioned upon the employee’s agreement to arbitrate.

2. **Unconscionability**

Unconscionability is an established defense to the enforcement of a contract, and has been applied to invalidate arbitration agreements. Unconscionability is generally defined as the absence of a meaningful choice for one party plus contract terms that are unreasonably one-sided. The concept includes both procedural and substantive elements.37 The procedural element concerns the manner in which the contract was negotiated and the circumstances of the parties at that time. It involves oppression arising from an inequality of bargaining power which results in an absence of meaningful choice or surprise due to the hidden nature of the offensive terms. The procedural aspect often arises in connection with an adhesion contract, but an adhesion contract is not a prerequisite to a finding of unconscionability. The substantive element focuses on the terms of the agreement and whether they are unjustifiably one-sided and unreasonably harsh. The two elements work together in a sliding scale relationship. The greater the degree of substantive unconscionability, the lesser the degree of procedural unconscionability required to nullify the contract or clause. However, the law has long imposed a heavy burden upon those who challenge arbitration agreements as unconscionable.38
Most courts to address the issue have found that employment arbitration agreements are contracts of adhesion, but are nevertheless not unconscionable. In Kovelskie v. SBC Capital Markets, Inc., the court held that a mandatory arbitration agreement was not unconscionable where a securities trader challenged the enforceability of the Form U-4 she signed as a condition of her employment. The plaintiff claimed that the arbitration procedures in the securities industry were substantively unconscionable because the arbitrators were not explicitly required to follow the law, they did not always award attorneys’ fees to prevailing plaintiffs, and the scope of judicial review was too limited. The court disagreed, finding that arbitrators’ decisions may be overturned on review if they do not follow the law, that arbitration is often more affordable to plaintiffs and defendants than litigating a claim in court, and that review of arbitration awards was sufficient to protect employees’ statutory rights. The court recognized that the arbitration agreement was a “contract of adhesion” — a “take-it-or-leave-it deal” — but refused to invalidate the contract solely because of the unequal bargaining power between the parties where the procedures agreed to were not oppressive. Thus, where there has been no showing of fraud, oppressive conduct or wrongdoing on the part of the employer, arbitration agreements will generally not be found unconscionable.

A few courts, however, have concluded that agreements to arbitrate employment claims are unconscionable by their very nature where employees are required to enter into them as a condition of employment. The Michigan case of Heurtebise is noteworthy for its broad anti-arbitration language, even though this language was adopted by only half of the court. In Heurtebise, three of six justices of the Michigan Supreme Court agreed that pre-dispute arbitration agreements are unenforceable as a matter of law, stating:

> [a]n aggrieved individual’s access to a judicial forum to remedy violations of his nonnegotiable, constitutionally guaranteed, and legislatively articulated civil rights, is also a nonnegotiable state right. Accordingly . . . the people of the state of Michigan and the Legislature intended to preclude prospective waivers of judicial remedies.

Because unconscionability is a creature of state contract law and states differ in the application of this theory to mandatory, pre-dispute employment arbitration agreements, this issue will need to be reviewed on a state-by-state, if not case-by-case, basis.

Courts which allow mandatory, pre-dispute employment arbitration agreements but analyze them to determine whether they are unconscionable generally look to the substance of the agreements to determine whether they should be enforced. For example, one California court found an agreement substantively unconscionable based on lesser evidentiary discovery, a lack of procedural safeguards protecting the privacy of sexual harassment victims, the fact that arbitral awards were not generally subject to appellate review, and the agreement’s restrictions on punitive damages and attorney’s fees. Other courts have disagreed on whether such an agreement can be enforced if it requires the employee to pay all or part of the arbitrators’ fees or the other parties’ legal fees. The EEOC has filed briefs challenging arbitration agreements
which imposed filing deadlines shorter than those provided by the statute, limited statutory remedies (including attorneys’ fees and punitive or liquidated damages), limited discovery, or required employees to bear all or part of the costs of arbitration.46

B. CLAIMS THAT WAIVER MUST BE “KNOWING AND VOLUNTARY”

In the wake of *Gilmer*, the U.S. Court of Appeals for the Ninth Circuit adopted a requirement that waivers of the right to a judicial forum for employment claims must be “knowing and voluntary”.47 Federal agencies such as the EEOC and the NLRB then took the position that they would require any waiver of rights under either Title VII or the National Labor Relations Act to be knowing and voluntary, and further concluded that pre-dispute agreements to waive such statutory rights cannot meet this standard.48 Other courts have rejected this “knowing and voluntary” standard.49 Nevertheless, some employers will want to draft arbitration agreements which meet even the most stringent “knowing and voluntary” requirements.

In *Prudential Ins. Co. of Am. v. Lai*, the Ninth Circuit ruled that, “a Title VII plaintiff may only be forced to forego her statutory remedies and arbitrate her claims if she has knowingly and voluntarily agreed to submit such disputes to arbitration.”50 In *Lai*, the plaintiff employees who signed an agreement to arbitrate were ignorant of the rights they were waiving. In invalidating the arbitration agreement, the court, relying on a single statement in the legislative history (by Senator Dole) concluded: “Congress intended there to be at least a knowing agreement to arbitrate employment disputes before an employee may be deemed to have waived the comprehensive statutory rights, remedies, and procedural protections prescribed in Title VII.”51 Several courts have criticized the *Lai* decision for its citation to inadequate legislative history and over-reliance on *Alexander v. Gardner-Denver Co.*52 the pre-*Gilmer* case dealing primarily with arbitration under collective bargaining agreements.53

Despite criticism, the Ninth Circuit continues to adhere to the requirement of “knowing and voluntary” assent to employment arbitration agreements. In *Nelson v. Cyprus Bagdad Copper Corp.*, the court held that an employee had not knowingly assented to an arbitration clause included in an employee handbook. The employee had not specifically agreed to arbitrate, but had rather only signed a form acknowledging his receipt of the employee handbook.55 The acknowledgment signed by the employee did not notify him that “the Handbook contained an arbitration clause or that his acceptance of the Handbook constituted a waiver of his right to a judicial forum in which to resolve claims.”56 The employee’s signing of the form therefore “did not in any way constitute a ‘knowing agreement to arbitrate.’”57

Employers desiring to draft and implement employment arbitration agreements immune to such a challenge need to know how to meet the “knowing and voluntary” standard. Federal courts use a “knowing and voluntary” standard in reviewing the validity of releases of substantive rights under Title VII and other federal statutes.58 Cases addressing such releases provide guidance for drafting and implementing arbitration agreements which are “knowing and voluntary”.

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One such case is the decision of the Seventh Circuit in Pierce v. Atchison, Topeka and Santa Fe Railway Company. In Pierce, the court looked to the “totality of circumstances” to determine whether an employee’s assent to a release was “knowing and voluntary.” The court analyzed the following eight factors to make this determination: (1) the employee’s education and business experience; (2) the employee’s input in negotiating the terms; (3) the clarity of the agreement; (4) the amount of time the employee had for deliberation before signing the release; (5) whether the employee actually read the release and considered its terms before signing it; (6) whether the employee was represented by counsel or consulted with an attorney; (7) whether the consideration given in exchange for the waiver exceeded the benefits to which the employee was already entitled by contract or law; and (8) whether the employee’s release was induced by improper conduct on the defendant’s part. Each of these factors should be taken into account by employers seeking to meet the “knowing and voluntary” standard when drafting and implementing an employment arbitration program.

III. CONCLUSION

The law is now clear that employers can use agreements that require employees to submit all employment disputes to arbitration, including statutory claims. But the law is still muddy as to what procedural and substantive safeguards must be in place in order to enforce such an agreement. At present, this still necessitates a state-by-state or Circuit-by-Circuit analysis.

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3 See Prudential Ins. Co. of America v. Lai, 42 F.3d 1299, 1303 (9th Cir. 1994).
4 Applying the Federal Arbitration Act (FAA), 9 U.S.C. § 1 et seq., the Court held that agreements to arbitrate statutory claims of discrimination were not unenforceable as a matter of law. Instead, the Court held that the right to a judicial forum for trial of a statutory discrimination claim may be waived by the employee.
5 See e.g., EEOC v. Frank’s Nursery & Crafts, Inc., 177 F.3d 448 (6th Cir. 1999).
6 Gilmer, 500 U.S. at 26 (citing Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc., 473 U.S. 614 (1985)).
7 29 U.S.C. §621 et seq.
8 Gilmer, 500 U.S. at 27-29.
11 See Duffield v. Robertson Stephens & Co., 144 F.3d 1182, 1199 (9th Cir. 1998).
12 See e.g., Bercovitch v. Baldwin School, Inc., 133 F.3d 141 (1st Cir. 1998)(ADA claims); Patterson v. Tenet Healthcare, Inc., 113 F.3d 832, 837 (8th Cir. 1997)(Title VII claims).
15 On remand, however, the Ninth Circuit held the Circuit City arbitration agreement was unconscionable, primarily because of the parties’ unequal bargaining power. 279 F.3d 889, 893 (9th Cir. 2002). Apparently anticipating such a result, Circuit City revised its policy to allow an applicant to opt out of the mandatory arbitration
provision, and so the company was recently successful in enforcing the mandatory arbitration provision against an employee who filed suit solely under the California Fair Employment and Housing Act. *Circuit City Stores, Inc. v. Najd*, 2002 U.S.App. Lexis 12360 (9th Cir., June 24, 2002).


17 *See Gibson v. Neighborhood Health Clinics, Inc.*, 121 F.3d at 1130; *Michalski v. Circuit City Stores, Inc.*, 177 F.3d 634 (7th Cir. 1999).

18 *See Hull v. Norcom, Inc.*, 750 F.2d 1547, 1550 (11th Cir. 1985)(holding that the consideration exchanged for one party’s promise to arbitrate must be the other party’s promise to arbitrate at least some specified class of claims); *cf. Design Benefit Plans, Inc. v. Enright*, 940 F.Supp. 200, 205 (N.D.Ill. 1996)(“The court is unable to reconcile *Hull* with current New York law, and for that matter, Illinois law”).

19 This is not always as easy as it sounds. At least three Circuits have differed on the mutuality of the arbitration commitment used by one restaurant chain. *Cf. Penn v. Ryan’s Family Steak Houses, Inc.*, 269 F.3d 753 (7th Cir. 2001) with *Lyster v. Ryan’s Family Steak Houses, Inc.*, 239 F.3d 943 (8th Cir. 2001) and *Floss v. Ryan’s Family Steak Houses, Inc.*, 211 F.3d 306 (6th Cir. 2000).


21 *Id.* at 1131.

22 *Michalski v. Circuit City Stores, Inc.*, 177 F.3d at 637.

23 *Gibson*, 121 F.3d at 1131.

24 *Patterson v. Tenet Healthcare, Inc.*, 113 F.3d 832 (8th Cir. 1997).

25 *Id.* at 834-35.

26 *Id.* at 835.


28 *Id.*


30 *Id.* at 247. *See also, Snow v. BE&K Construction Co.*, 126 F.Supp. 5 (D. Me. 2001) (six-page “Employee Solutions Program” unenforceable because employer reserved right to modify or discontinue the program at any time).

31 *Id.*

32 *Id.*

33 *See Gibson v. Neighborhood Health Clinics, Ltd.*, 121 F.3d at 1131-32.

34 *See e.g., Gibson*, 121 F.3d at 1131-32.

35 *Id.*

36 *See Gibson*, 121 F.3d at 1132.


38 *See Rosenberg v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 170 F.3d at 17.

39 167 F.3d 361 (7th Cir. 1999).

40 *Id.* at 366.

41 *Id.* at 366, citing *Gilmer*, 500 U.S. at 33.

42 *Id.; See also Rosenberg*,170 F.3d at 17; *Seuss v. John Nuveen & Co., Inc.*, 146 F.3d at 184.

43 550 N.W.2d at 257.


45 *Compare Cole v. Burns Int’l Security Svcs.*, 105 F.3d 1465, 1468 (D.C.Cir. 1997), *Shankle v. B-G Maintenance Management Etc.*, 163 F.3d 1230, 1234-35 (10th Cir. 1999), and *Paladino v. Avnet Computer Technologies, Inc.*, 134 F.3d at 1062 (Tjoflat, specially concurring) with *Koveleski*, 167 F.3d at 366, and *Rosenberg*, 163 F.3d at 68. *See also Green Tree Financial Corp. v. Randolph*, 531 U.S. 79 (2000) (non-employment case in which Court held that a party who seeks to invalidate an arbitration agreement as being prohibitively expensive must show the likelihood of such costs); *Bradford v. Rockwell Semiconductor Systems, Inc.* 238 F.3d 549 (4th Cir. 2001) (mandatory arbitration agreement enforced because employee failed to show fee splitting clause would result in prohibitive costs); *McCaskill v. SCI Management Corporation*, 285 F.3d 623 (7th Cir. 2002) (voiding arbitration agreement requiring each party to pay its own costs; but decision vacated and rehearing granted, 2002 U.S.App.

46 See EEOC Policy Statement on Mandatory Arbitration, at fn. 18.
50 Prudential Ins. Co. v. Lai, 42 F.3d at 1305.
51 Id. at 1304.
54 119 F.3d 756 (9th Cir. 1997).
55 Id.
56 Id.
57 Id.
58 Wagner v. Nutrasweet Co., 95 F.3d 527, 532 (7th Cir. 1996); See also Pierce v. Atchison, Topeka and Santa Fe Railway Co., 65 F.3d 562 (7th Cir. 1995).
59 65 F.3d 562 (7th Cir. 1995).
60 Id. at 570.
61 Id. at 571.