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# To Sever or to Destroy: The Eighth Circuit Allows Invalid Provisions to Be Served from Otherwise Enforceable Arbitration Agreements

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# To Sever or to Destroy?: The Eighth Circuit Allows Invalid Provisions to be Severed from Otherwise Enforceable Arbitration Agreements

*Gannon v. Circuit City Stores, Inc.*[1]

## I. INTRODUCTION

The Federal Arbitration Act ("FAA") allows for arbitration to be a medium by which parties may settle disputes more expeditiously than litigation. The FAA declares specifically that written agreements to resolve disputes through arbitration are "valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract."[2]

This language clearly places arbitration agreements upon the same footing as other contracts. However, a profound circuit split has developed on the issue of whether a written agreement between an employee and employer to settle all employment-related disputes exclusively through binding arbitration remains enforceable after a provision within the agreement is found invalid. Some circuits have taken the position that inclusion of an invalid provision renders the entire arbitration agreement unenforceable. Other circuits, however, have adopted the contrary position, and have allowed an invalid provision to be severed from the overall agreement, thereby allowing the remaining provisions of the arbitration agreement to be enforced. This Note explores the split among the circuits on this issue. In *Gannon v. Circuit City Stores, Inc.*, the Eighth Circuit addressed this issue, and held that an invalid provision could be severed from an arbitration agreement, effectively allowing the rest of the agreement to be enforceable.

## II. FACTS AND HOLDING

In May 1998, Marken Gannon applied for employment with Circuit City Stores at its store in Ellisville, Missouri.[3] As part of Gannon's application for employment with Circuit City, she executed the Circuit City Dispute Resolution Agreement (the "Agreement") along with Circuit City.[4] By executing the Agreement, Gannon agreed that all employment-related claims against Circuit City would be resolved exclusively through binding arbitration.[5] The Agreement explicitly advised Gannon to familiarize herself with the rules and procedures under the Agreement prior to signing.[6] Within the agreement, there were terms in bold type indicating to Gannon

1. 262 F.3d 677 (8th Cir. 2001).
2. 9 U.S.C. § 2 (1994).
3. *Gannon*, 262 F.3d at 679.
4. *Id.*
5. *Id.*
6. *Id.*

that the Agreement did affect her legal rights, and that she may wish to consider seeking legal advice before signing.[7] Moreover, the Agreement stated that Gannon could withdraw her consent up to three days after signing the Agreement, and also outlined procedures for how Gannon could effectuate such a withdrawal.[8] Upon Gannon's signing of the Agreement, Circuit City hired her.[9]

Gannon was terminated by Circuit City after approximately one year of employment.[10] Gannon filed charges with both the Equal Employment Opportunity Commission ("EEOC") and the Missouri Commission on Human Rights, and Gannon received right-to-sue letters from both agencies.[11] Upon receiving the letters, Gannon brought suit in federal court, asserting claims under Title VII and the Missouri Human Rights Act ("MHRA").[12] These claims were based on allegations of sexual harrassment, a hostile work environment, sex discrimination, and retaliation.[13]

Based on the arbitration agreement Gannon had signed, Circuit City responded by filing a motion to dismiss the case and to compel arbitration.[14] The district court denied Circuit City's motion to compel arbitration, finding that the Agreement was unenforceable because of a punitive damages limitation.[15] Circuit City subsequently filed a motion for reconsideration, asserting that it no longer enforced the punitive damages limitation, and that another separate provision in the Agreement served to automatically strike terms judicially determined to be unenforceable.[16] The district court denied this motion, and Circuit City filed an interlocutory appeal, resulting in the instant case.[17]

Relying on general contract principles, the intent of the parties, statutory law, and the public policy underlying the FAA, the Eighth Circuit reversed the judgment of the district court and held the invalid punitive damages provision to be severable from the rest of the arbitration agreement, which did not affect the validity of the remaining provisions of the arbitration agreement.[18]

## III. LEGAL BACKGROUND

It is well-settled that Congress enacted the FAA "to reverse a longstanding judicial hostility to arbitration agreements . . . and to place arbitration agreements on

7. *Id.*
8. *Id.*
9. *Id.*
10. *Id.*
11. *Id.*
12. *Id.* Title VII is codified at 42 U.S.C.§ 2000e *et seq.*, and the MHRA at § 213.010 *et seq.* of the Missouri Revised Statutes.
13. *Id.*
14. *Id.*
15. *Id.* The punitive damages limitation in question limited recoverable punitive damages to five thousand dollars. *Id.*
16. *Id.*
17. *Id.* Such an interlocutory appeal is allowed under the Federal Arbitration Act (9 U.S.C.§ 16 (1994)). *Id.*
18. *Id.* at 683.

the same footing as other contracts."[19] Subsequent court interpretations have developed a liberal federal policy in favor of arbitration agreements.[20] Substantively, the FAA requires a court to enforce a written arbitration agreement as it would any other contract.[21] Specifically, the FAA states that written agreements to resolve disputes through arbitration are "valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract."[22] The scope of the FAA was broadened by a recent Supreme Court decision, in which the Court held that the FAA's provisions apply to arbitration agreements covering employment-related claims, such as that presented in the instant case.[23]

On several occasions, the Supreme Court has addressed the issue of whether statutory claims, such as those claims made by Gannon,[24] may be subject to compulsory arbitration. The Supreme Court has made it clear through a series of decisions that "statutory claims may be the subject of an arbitration agreement, enforceable pursuant to the FAA."[25] In the present case, Gannon argued that the Agreement should not be enforced because it did not adequately protect her statutory rights and remedies.[26] Specifically, Gannon argued that provisions limiting the amount of recoverable punitive damages, as well as a "fee-splitting" provision requiring the plaintiff to pay half the costs of the arbitration, should make the entire Agreement unenforceable.[27] Faced with arbitration agreements proscribing statutorily available remedies, courts have either severed the illegal provision and ordered arbitration, or held the entire agreement unenforceable.[28]

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

20. *See generally Moses H. Cone Meml Hosp. v. Mercury Constr. Corp.*, 460 U.S. 1, 24 (1983).

21. 9 U.S.C.§ 2 (1994).

22. *Id.*

23. *Circuit City Stores, Inc. v. Adams*, 532 U.S. 105 (2001). In *Adams*, the Supreme Court held that in the employment context, only contracts of employment of transportation workers are exempted from the coverage of the FAA. *Id.* at 114.

24. Gannon's claims under issue in the instant case are based on Title VII and the MHRA. *Gannon*, 262 F.3d at 679.

25. *Gilmer*, 500 U.S. at 26. Since *Gilmer* focused solely on the Age Discrimination in Employment Act ("ADEA"), the Supreme Court in that decision did not expressly decide whether claims under other civil rights statutes are subject to compulsory arbitration. In *Patterson v. Tenet Healthcare, Inc.*, 113 F.3d 832, 837 (8th Cir. 1997), the Eighth Circuit did assert: "Title VII claims, like ADEA claims, are subject to individual consensual agreements to arbitrate."

26. *Gannon*, 262 F.3d at 681.

27. *Id.* at 680. Under Title VII, a successful plaintiff may recover punitive damages up to an amount of $300,000. 42 U.S.C. § 1981(a)(b)(3)(1994). Under the MHRA, there is no limit on the amount of punitive damages that a successful plaintiff may recover. Mo. Rev. Stat. § 213.010 *et seq.* The Agreement limits the amount of punitive damages that a plaintiff may recover to the greater of $5000 or an amount equal to the award for lost wages and benefits. *Gannon*, 262 F.3d at 679.

28. *Compare Herrington v. Union Planters Bank, N.A.*, 113 F.Supp.2d 1026, 1033 (S.D. Miss. 2000)(severing an unlawful provision prohibiting award of punitive damages), *with Graham Oil Co. v. ARCO Products Co.*, 43 F.3d 1244, 1249 (9th Cir. 1994)(voiding the entire arbitration clause).

### A. Courts Enforcing Through Severance

Courts finding severance appropriate rely on either general contract interpretation principles, or the general federal policy in favor of enforcing arbitration agreements.[29]

In both *Wright v. Circuit City Stores, Inc.*,[30] and *Etokie v. Carmax Auto Superstores, Inc.*,[31] the respective courts ruled in favor of severance based on general contract interpretation principles. Arbitration agreements in both cases limited an employee's statutorily available remedies.[32] In *Wright*, several plaintiffs brought claims based on Title VII and 42 U.S.C. Section 1981.[33] Circuit City subsequently filed motions to compel arbitration, relying upon the same Circuit City Agreement considered in the instant case, including the limitation on punitive damages that is the crux of *Gannon*.[34] In its holding, the United States District Court for the Northern District of Alabama held:

> Looking to the terms, nature, and purpose of the Circuit City arbitration agreement, particularly the severability clause, the remedy limitations found in the agreement were not so interdependent with the other parts of the agreement as to make them not severable.[35]

The weight given to the enforceability of the severability clause in the Agreement played a key role in the *Wright* court finding the provision in question severable, rather than finding the entire arbitration Agreement voidable.[36]

The United States District Court for the District of Maryland reached a similar result in *Etokie*. In that case, the district court again paid great attention to the presence of a severability clause in the arbitration Agreement: "[W]hen this Court considers the terms and purpose of the CarMax agreement and specifically the severability clause, the remedy limitations . . . are not so interwoven with the other terms of the agreement as to make them not severable."[37] This approach, being a reliance solely on the "letter of the contract" rather than attempting to incorporate

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29. *Compare Etokie v. Carmax Auto Superstores, Inc.*, 133 F. Supp. 2d 390 (D. Md. 2000)(relying on a severance provision), *with Herrington*, 113 F.Supp.2d at 1032-33 (relying on policy favoring arbitration agreements).

30. 82 F. Supp. 2d 1279, 1287 (N.D. Ala. 2000).

31. 133 F. Supp. 2d at 395.

32. In *Wright*, such an employee was not able to enforce his available remedies under 42 U.S.C. § 1981 and Title VII, as there were limitations enforced by the Circuit City Agreement on his back pay, front pay, and his possible punitive damages. 82 F. Supp. 2d at 1286. In *Etokie*, the respective employee's remedies under both the Americans With Disabilities Act (ADA) and Title VII of the Civil Rights Act of 1964 were limited. 133 F. Supp. 2d at 395.

33. 82 F. Supp. 2d. at 1281.

34. *Id.*

35. *Id.* at 1287. The following passage was in the same opinion which quoted an earlier Eleventh Circuit decision as the fundamental rule guiding their decision:

> When an arbitration clause has provisions that defeat the remedial and deterrent functions of a statute, the prospective litigant cannot effectively vindicate [his or her] statutory rights, thereby making the arbitration clause unenforceable.

*Id.* at 1285, *quoting Paladino v. Avnet Computer Tech., Inc.*, 134 F.3d 1054, 1062 (11th Cir. 1998).

36. *Id.*

37. *Etokie*, 133 F. Supp. 2d at 395. CarMax is a subsidiary of Circuit City, and it utilizes the same Dispute Resolution Agreement. *Id.* at 393.

any policy arguments, represents the most conservative of the approaches courts have taken to severance.

Other courts have relied more on a general policy favoring arbitration agreements than on contractual interpretation principles in their decisions to sever the offending provision. For example, the United States District Court for the Southern District of Mississippi in *Herrington v. Union Planters Bank, N.A.*,[38] held that where the plaintiffs alleged their statutory right[39] to recover punitive damages was denied by their arbitration agreement with Union Planters Bank, the entire arbitration agreement should be voided.[40] The district court held that a waiver of punitive damages in an arbitration agreement does not necessitate a voiding of the entire agreement.[41] Moreover, the Truth in Savings Act did not even clearly provide for an employee's right to recover punitive damages in such a situation.[42] Because of this ambiguity, the plaintiff's burden of showing Congressional intent to circumvent arbitration was not met, and the arbitration agreement was enforced.[43] Citing similar holdings,[44] the court held that such a waiver of punitive damages could easily be severed from the arbitration agreement without consideration of a complete voidance.[45]

### *B. Courts Enforcing Through Voidance*

Courts that have rejected a call to sever the provision in question, and instead have voided the entire Agreement generally rely on a different rationale. Some, as the dissent articulates in the instant case, find that a contrary holding of severance would give an "improper incentive" to employers to include illegal provisions within the Agreement.[46] Others courts have found the agreement to be integrated, and thus severance to be inappropriate.[47] Still others, after analyzing the entire agreement,

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38. 113 F. Supp. 2d. at 1032.

39. This right was provided by the federal "Truth in Savings Act." *Id.*

40. *Id.* at 1032. Specifically, Plaintiffs argued that the right to pursue said punitive damages was afforded to them by the Truth in Savings Act. *Id.*

41. *Id.*

42. *Id.*

43. The court cited from the United States Supreme Court in discussing this burden: "If the parties agrees [sic] to arbitration, they '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.'" *Id.* at 1032., (quoting *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*, 473 U.S. 614, 628 (1985)). The court then concluded that the plaintiffs would have the burden to show that Congress intended the Truth in Savings Act to "override" the provisions of the Federal Arbitration Act. *Id.*

44. The court cited extensively from *Great Western Mortg. v. Peacock*, 110 F.3d 222, 232 (3rd Cir. 1997), finding that the *Peacock* court, upon being presented with a similar situation, found that a waiver of the right to recover punitive damages did not affect the issue as to whether Plaintiff's claim was arbitrable. *Id.* Furthermore, the court cited from *Jones v. Fujitsu Network Comm., Inc.*, 81 F.Supp.2d 688, 693 (N.D. Tex. 1999), which also severed an illegal provision that otherwise would have made the arbitration agreement unenforceable. *Id.*

45. *Id.*

*46. Gannon*, 262 F.3d at 684; *Perez v. Globe Airport Sec. Serv. Inc.*, 253 F.3d 1280, 1287 (11th Cir. 2001), *vacated*, 294 F.3d 1275.

47. *Graham Oil*, 43 F.3d at 1248; *Armendariz v. Foundation Health Psychcare Serv. Inc.*, 99 Cal. Rptr. 2d 745, 775 (Cal. 2000). "It is a well-known principle in contract law that a clause cannot be severed from a contract when it is an integrated part of the contract." *Graham Oil*, 43 F.3d at 1248.

have found multiple offending provisions that needed to be struck, and instead of striking them all have declared the entire Agreement unenforceable.[48]

In *Perez v. Globe Airport Sec. Services, Inc.*,[49] the Eleventh Circuit Court of Appeals clearly articulated the "incentive problem," and explained why the problem made severance such an inattractive option:

> If an employer could rely on the courts to sever an unlawful provision and compel the employee to arbitrate, the employer would have an incentive to include unlawful provisions in its arbitration agreements. Such provisions could deter an unknowledgable employee from initiating arbitration, even if they would ultimately not be enforced.[50]

Using this logic, the Eleventh Circuit voided an entire arbitration agreement that contained a provision that limited an employee's remedies that were statutorily available to him under Title VII.[51] The *Perez* court cited an earlier Eleventh Circuit decision, *Paladino v. Avnet Computer Tech. Inc.*,[52] in support of its proposition that a limitation on statutory remedies placed in an employment agreement by the employer would "defeat the remedial purpose of Title VII," tainting and rendering unenforceable the entire agreement."[53]

Three years before, the *Paladino* court had found two provisions in an arbitration agreement sufficiently illegal in nature to warrant a voidance of the entire agreement.[54] Again finding the agreement "tainted" by these illegal provisions, the Eleventh Circuit wrote that in the event of an arbitration agreement containing provisions that defeat statutorily established remedies and purposes, the employee is denied the opportunity to take advantage of all of his statutory rights.[55] The court

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*48. Hooters of America, Inc. v. Phillips*, 173 F.3d 933, 938-940 (4th Cir. 1999).

49. 253 F.3d 1280 (11th Cir. 2001), *vacated*, 294 F.3d 1275.

50. *Id.* at 1287. The California Supreme Court in *Armendariz v. Foundation Health Psychcare Services, Inc.*, 99 Cal. Rptr. 2d. 745 (Cal. 2000) had also recognized this rationale stating that the mere severance of one illegal provision "will not [deter an employer] from routinely inserting such a deliberately illegal clause into the arbitration agreements it mandates for its employees if it knows that the worst penalty for such illegality is the severance of the clause after the employee has litigated the matter. In that sense, the enforcement of a form arbitration agreement containing such a clause drafted in bad faith would be condoning, or at least not discouraging, an illegal scheme, and severance would be disfavored unless it were for some other reason in the interests of justice." *Armendariz*, 99 Cal. Rptr. 2d. at 775.

*51. Id.* The particular provision required the parties, in the event of arbitration, to split the costs of arbitration equally, in a "fee-splitting" arrangement. *Id.* Title VII allowed the employee to obtain costs and fees upon winning the lawsuit. *Id.*

52. 134 F.3d 1054 (11th Cir. 1998).

*53. Perez*, 253 F.3d at 1287.

*54. Paladino*, 134 F.3d at 1061. Specifically, the provisions were in violation of Title VII, with one provision failing to require the employer to advance the costs of arbitration, and the other sharply limiting the plaintiff's remedies to solely those obtainable in a breach of contract action. *Id.* It should be noted here that since the *Paladino* decision, the United States Supreme Court has addressed the first of the two illegal arbitration provisions in *Paladino*. *See Green Tree Fin. Corp. - Ala. v. Randolph*, 531 U.S. 79 (2000) (holding that an agreement that does not specifically require the employer to advance the arbitration costs does not necessarily render the agreement invalid). However, the *Perez* court addressed this possible abrogation scenario through asserting that the *Green Tree* decision did not affect the "vitality of the primary holding in *Paladino*." *Perez*, 253 F.3d at 1287.

55. *Id.* at 1062.

therefore felt compelled to void the entire arbitration agreement, due to the tainting of the entire agreement by the illegal provisions in question.[56]

The Ninth Circuit took a different approach to void an entire arbitration agreement in *Graham Oil Company v. Arco Products Company*.[57] In *Graham Oil*, the court voided an arbitration agreement where several of the Plaintiff's statutory rights were limited.[58] The court's holding asserted: "because the arbitration clause employed by ARCO compels Graham Oil to surrender important statutorily-mandated rights afforded franchisees by the [Petroleum Marketing Practices Act], we hold that the clause contravenes the Act."[59]

In reaching this holding, the *Graham Oil* court found that because the arbitration clause in the contract between the parties was not isolated in nature, but rather completely integrated, the entire arbitration clause must be severed.[60] In so holding, the court decided that to merely strike the illegal provisions of the arbitration clause would be insufficient as a matter of law.[61] Citing a treatise on contracts,[62] the court stated that defendants should not be allowed the opportunity to make an end run around what Congress had expressly forbidden through its establishment of statutory rights.

The Fourth Circuit Court of Appeals also reached a voidance holding through a different approach. In *Hooters of America, Inc. v. Phillips*,[63] the court found that several of the arbitration rules drafted by employer Hooters of America ("Hooters") were invalid due to their requirement that employees forego substantive Title VII rights.[64] The court rejected Hooters' contractually based arguments and held that Hooters had created "a sham system unworthy even of the name of arbitration."[65] The court held that rescission of the entire agreement was appropriate because adoption of these "egregious rules defeated the object of the contracting parties."[66] Similarly, in *Armendariz*,[67] the California Supreme Court also voided an entire arbitration agreement, upon finding several unconscionable provisions.[68] In

56. *Id.*

57. *Graham Oil*, 43 F.3d at 1244.

58. *Id.* at 1246. Specifically, Plaintiff could not seek punitive damages at all, could not recover reasonable attorney fees, and could not enforce a statutorily provided one year statute of limitations. *Id.* at 1247. These rights were provided for Plaintiff through the Petroleum Marketing Practices Act. *Id.*

59. *Id.* at 1248.

60. *Id.* Specifically, the court stated that the arbitration clause was not a single isolated unit, but rather a highly integrated unit containing three distinct provisions. *Id.*

61. *Id.*

62. *Id.* (quoting John D. Calamari & Joseph M. Perillo, The Law of Contracts 478 n. 76 (3rd. ed., West 1987).

63. 173 F.3d 933 (4th Cir. 1999).

64. *Id.* at 938-39.

65. *Id.* at 940.

66. *Id.* The egregious provisions included within the Hooters' arbitration agreement included the ability of Hooters to: decline to file responsive pleadings, expand the scope of arbitration to any matter, decline to file a list of witnesses at the outset, bring suit in court to vacate or modify the award, and finally to control the mechanism for selecting a panel of arbitrators. *Id.* at 938-39. Each of these provisions did not allow reciprocity on the part of the employee. *Id.*

67. 99 Cal. Rptr. 2d 745 (Cal. 2000)

68. *Id.* at 774. Specifically, the agreement included a sharp limitation on remedies, limiting an employee's remedies solely to a sum equal to the wages said employee would have earned from the date of discharge until the date of the arbitrator's award. *Id.* at 760.

performing an analysis upon the California Civil Code and general California common law, the California Supreme Court found that an arbitration agreement must be voided if the central purpose of the contract is infected with illegality.[69] In *Armendariz*, the court held that the central purpose of the contract was indeed infected with illegality due to the numerous illegal provisions that constituted a "systematic effort to impose arbitration on an employee not simply as an alternative to litigation, but as an inferior forum that works to the employer's advantage."[70] Finally, there "was no single provision that could be stricken to eradicate the unconscionable permeation from the agreement"[71] and thus voidance was necessary and proper.[72]

## IV. INSTANT DECISION

In the instant case, the issue before the Eighth Circuit Court of Appeals was to decide on which side of this profound circuit split the Eighth Circuit would fall.[73] Specifically, Circuit Judge Pasco Bowman's majority opinion outlined the issue as "whether a written agreement between an employee and employer to settle all employment-related disputes through binding arbitration remains enforceable after a provision within the agreement is found invalid."[74]

The Eighth Circuit began its analysis with a discussion of the Federal Arbitration Act, and the subsequent case interpretations of the Act which have resulted in a "liberal federal policy favoring arbitration agreements."[75] The court clearly stated its role in resolving the instant dispute: "Our role in determining whether a court should compel arbitration is limited. We must determine simply whether the parties have entered a valid agreement to arbitrate, and if so, whether the existing dispute falls under the coverage of the agreement."[76] The court then recognized the dispute at hand was one in which the overarching validity of the arbitration agreement was questioned.[77] Specifically, the court framed the issue as one in which an otherwise valid agreement to arbitrate continues to be valid and enforceable even when an illegal provision is identified within the agreement.[78] Circuit City argued that under contract law, the offending provision could be easily severed, with the overarching agreement remaining valid.[79] On the other hand,

69. *Id.* at 775. However, if the illegal provision or provisions in question are merely collateral to the central purpose of the contract, then the proper remedy is severance of the offending provisions. *Id.*

70. *Id.*

71. *Id.*

72. *Id.* For a review of *Armendariz*, *see generally* S. Kathleen Isbell, Student Author, *Compulsory Arbitration of Employment Agreements: Beneficient Shield or Sword of Oppression? Armendariz v. Foundation Health Psychcare Services, Inc.*, 22 Whittier L. Rev. 1107 (2001).

73. *Gannon*, 262 F.3d at 678.

74. *Id.* It is interesting to note that Bowman did not limit the issue to one focusing an illegal punitive damages provision, but rather delivered a rather expansive statement of the issue involved, as resolving a situation in which any provision within the arbitration agreement in question is found invalid.

75. *Id.* at 679-80.

76. *Id.* at 680. The court continued: "Once we conclude that the parties have reached such an agreement, the FAA compels judicial enforcement of the arbitration agreement." *Id.*

77. *Id.*

78. *Id.*

79. *Id.*

Gannon argued that the offending provision rendered the entire arbitration agreement unenforceable as a matter of public policy.[80]

In a narrow 2-1 decision, the Eighth Circuit Court of Appeals reversed the District Court and rejected Gannon's argument on both a contractual and a public policy basis, holding that an illegal provision could be easily severed from an arbitration agreement, and still allow the overarching agreement to remain valid and enforceable as a matter of law.[81]

### *A. Under Missouri Contract Law, Severance Is Proper*

In addressing Gannon's claims under Missouri contract law, the court began by highlighting a particular governing provision within the arbitration agreement.[82] Rule 18 of the Agreement "specifically stated the intent of the parties in the event a provision within the agreement is found invalid."[83] Rule 18 provided that should a provision be found to be illegal, it should be severed from the overarching agreement, with the remaining provisions completely enforceable.[84]

However, the court continued its analysis by asserting that even had this severability provision not been codified within the agreement, severance still would have been proper under Missouri contract law.[85] The court cited the general rule with regard to such a situation to be: "if the good be mixed with the bad, it shall nevertheless stand, provided a separation can be made."[86] The court found that indeed a separation could easily be made, asserting: "The punitive damages clause represents only one aspect of their agreement and can be severed without disturbing the primary intent of the parties to arbitrate their disputes."[87] Because such a separation could be made without affecting the other provisions of the arbitration agreement, severance was found to be proper under Missouri contract law.[88]

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80. *Id.*

81. *Id.* at 683.

82. *Id.* at 680.

83. *Id.* The court found this especially relevant due to the general rule that when a contract is unambiguous, the intent of the parties should be determined from the instrument alone. *Id.* (citing *Marshall v. Pyramid Dev. Corp.*, 855 S.W.2d 403, 406 (Mo.App. 1993)).

84. *Id.* Rule 18 specifically stated: "In the event that any of these Dispute Resolution Rules and Procedures agreed upon by the parties is held to be in conflict with a mandatory provision of applicable law, the conflicting Rule or Procedure shall be modified automatically to comply . . . In the event of an automatic modification with respect to a particular rule or procedure, the remainder of these Rules and Procedures shall not be affected." *Id.*

85. *Id.*

86. *Id.* at 680-81 (citing *Kisling v. MFA Mut. Ins. Co.*, 399 S.W.2d 245, 250 (Mo. App. 1966)). *Kisling* in turn cited the general rule from an early Missouri Supreme Court decision, *Koontz v. Hannibal Sav. & Ins. Co.*, 42 Mo. 126, 129 (1868).

87. *Id.* at 681. The logic expounded by the court here hearkens back to the Mississippi decision in *Herrington* and the Third Circuit decision in *Peacock*, which both stated that the presence of an illegal provision has no bearing on the overall issue of whether a claim is arbitrable. *See Herrington*, 113 F. Supp. 2d at 1032; *Peacock*, 110 F.3d at 232.

88. *Id.* The court also quoted extensively from *Schibi v. Miller*, 268 S.W. 434, 436 (Mo. App. 1925) to support this contention: "Where one provision in a contract, which does not constitute its main or essential feature or purpose, is void; but is clearly separable and severable from the other parts which are relied upon, such other parts are not affected by the invalid provision, and may be enforced as if no such provision had been incorporated in the contract." *Id.*

### *B. Public Policy Also Requires Severance, Rather Than Voidance*

Gannon's second argument was that public policy concerns override the contractual rules discussed *supra*, and thus require a voidance of the entire arbitration agreement.[89] The court recognized Gannon's argument as invoking a "narrow exception" that would prohibit severance in the event that public policy is threatened.[90] Gannon's argument essentially invoked the court's holding in *Perez* and argued that public policy would be threatened if only the provision was struck instead of the whole agreement being declared invalid.[91] Gannon also argued that such a holding would also give employers an incentive to include improper terms.[92] Employees will be forced to either arbitrate under the illegal provisions, something they may be reluctant to do, or go to court to have them removed from the agreement.[93]

The court rejected Gannon's policy argument.[94] The court cites *Hooters* as an example in which this exception may be invoked.[95] However, in the instant case, the offending provision is easily severable, and does not create a "sham system" unworthy of the name of arbitration.[96] Moreover, the court hints in dicta that a punitive damages limitation such as the one found in the instant case may not be illegal in the first place.[97]

Gannon also introduced general public policy arguments which the court rejected as beyond the scope of their deliberations.[98] The court again hearkened back to the general federal policy favoring enforcement of arbitration agreements, stating their rationale as: "In an evolving climate such as this, if we were to hold entire arbitration agreements unenforceable every time a particular term is held invalid, it

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89. *Id.* The Equal Employment Opportunity Commission filed a brief in support of this proposition as *amicus curiae*.

90. *Id.* This "narrow exception" is codified in both *Schibi* and *Koontz*, prohibiting a mere severance of a contractual provision "where there is some all-pervading vice, such as fraud, or some unlawful act which is condemned by public policy or the common law, and avoids all parts of the transaction because all are alike infected." *Id.*

91. *Id.*

92. *Id.*

93. *Id.*

94. *Id.* The court cited from *White v. McCoy Land Co.*, 87 S.W.2d 672, 685 (Mo. App. 1935), which "embraced the proposition that only the state constitution, laws, or judicial decisions represent proper evidence of public policy." *Id.*

95. *Id.*

96. *Id.*

97. *Id.* at 681-82. Because Circuit City did not appeal this specific issue from the district court, the court declined to consider that question. *Id.* Furthermore, Circuit City presented evidence that it had already amended the rules and procedures within its arbitration agreement to exclude the illegal provision in question. *Id.* Nevertheless, the court declined to give up this strong "hint" against necessarily finding a punitive damages limitation to be illegal, expressly stating its holding in *Larry's United Super, Inc. v. Werries*, 253 F.3d 1083 (8th Cir. 2001), which held that the question of whether a waiver of RICO punitive damages in an arbitration agreement was valid remained a matter for arbitrators, not the courts, to decide in the first instance. *Id.* at 1086.

98. *Id.* at 682. The court cited from *Werries*, in holding that their authority does not extend to the consideration of public policy advantages or disadvantages resulting from the enforcement of the agreement. *Id.* (citing *Werries*, 253 F.3d at 1086).

would discourage parties from forming contracts under the FAA, and severely chill parties from structuring their contracts in the most efficient manner for fear that minor terms eventually could be used to undermine the validity of the entire contract."[99]

### *C. Senior District Judge Vietor's Dissent*

In his dissent, Judge Vietor commences by asserting how public policy was violated in the instant case in the form of the illegal punitive damages provision.[100] The minority then quotes extensively from the Eleventh Circuit's decision in *Perez*, adopting the rationale set forth therein.[101] Specifically, Vietor finds fault with the majority's rationale that "holding entire arbitration agreements unenforceable upon the identification of an illegal provision" may undermine the arbitration agreement as an effective part of contracts.[102] He writes that this argument is effective only when applied to minor substantive or procedural provisions of an arbitration agreement.[103] The instant case involves "a term that guts a major substantive remedy that Congress and the Missouri legislature chose to provide to employees,"[104] and thus the entire arbitration agreement should have been voided.[105]

## V. COMMENT

Since the adoption of a strong federal policy favoring the enforceability of arbitration agreements,[106] courts have disagreed as to what constitutes a valid arbitration agreement. Specifically, courts have disagreed on whether the identification of an illegal or offending provision within an otherwise valid arbitration agreement necessitates no action, the severance of the offending provision, or the voidance of the entire agreement. Faced with this dilemma, and the existence of a profound circuit split across the nation, the Eighth Circuit in *Gannon v. Circuit City Stores, Inc.* articulated the Eighth Circuit's approach to such a situation, and in so doing, added "more fuel to the fire" of the circuit split.

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99. *Id.* The court continues: "Such an outcome would represent the antithesis of the 'liberal federal policy favoring arbitration agreements.'" *Id.* (citing *Moses H. Cone Mem'l Hosp. v. Mercury Constr. Corp.*, 460 U.S. 1, 24 (1983)).

100. *Id.* at 683. Judge Vietor stressed the "extreme" nature of the Circuit City limitation upon punitive damages. Furthermore, he stressed as relevant the fact that job applicants are not told that the limitation is far less than the amount recoverable at law. *Id.*

101. *Id.* at 683-84. It should be noted that the majority anticipates this *Perez*-based argument toward the end of their opinion through arguing that in being haled into court to defend an allegedly illegal provision, a party loses much of the advantages of arbitration. *Id.* at 682.

102. *Id.* at 684.

103. *Id.*

104. *Id.* Judge Vietor rationalizes that such a major term affecting these rights is quite different from a minor insignificant limitation, and thus should be afforded more significant implications in the event that such a major illegal provision is identified within an arbitration agreement.

105. *Id.* at 684.

106. *See generally Gilmer v. Interstate/Johnson Lane Corp.*, 500 U.S. 20, 24 (1991); *Moses H. Cone*, 460 U.S. at 24.

The *Gannon* court was faced with numerous well-reasoned opinions on both sides of the circuit split, as discussed throughout this Note. Specifically, only months earlier, the Eleventh Circuit was faced with a similar dilemma in *Perez*. It was the *Perez* decision that served as a springboard for argument throughout the majority and minority opinions in *Gannon*, as well as being the opinion that best articulates both the opposing views of the circuit split. *Perez* also acts as the essence of the dissent's argument in *Gannon*. As discussed *supra*, the agreement in *Gannon* contained a severability clause which provided a procedure by which provisions subsequently found illegal would be severed, and the remainder of the agreement would be enforced. An easy distinction could be made between the agreement in *Perez* and other decisions that have voided the entire agreement, and those decisions that only severed the illegal provisions: the former did not contain a severability clause. However, this would ignore the main thrust of the controversy at hand; that is, should public policy allow arbitration agreements to stand where an illegal provision is included, with or without a severability clause?[107]

Because courts on both sides of the circuit split are clear that arbitration agreements such as that at issue in *Hooters*[108] will not be enforced, it would seem that the issue today is limited to the enforceability of arbitration agreements such as that in the instant case; that is, an agreement with one or two identifiable illegal provisions. Thus, the *Perez* court[109] provides the most complete and relevant test in determining the enforceability of such an agreement: Is there an incentive created which benefits the employer to include unlawful provisions in its arbitration agreements?[110]

Given the rationale and the implications furthered in *Perez*,[111] it would seem that such an incentive is created, to an extent. However, it is important to consider that this incentive could be sharply curtailed. Circuit City alone has been involved in numerous lawsuits over the past five years with regard to the nuances of its arbitration agreement.[112] An expanded collateral estoppel approach would seem to be most beneficial in such a situation, allowing the Plaintiff to use a previous judicial

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107. This logic is supported in *Gannon* itself, which seems to thwart any attempt of distinction on a "presence of a severability clause" ground: "Even if the parties had not recorded their intentions in the severability provision, Missouri law declares severance to be proper in this instance." *Gannon*, 262 F.3d at 680. It should, however, be noted that the *Gannon* majority does recognize such a distinction in a footnote toward the end of the opinion. ("We note that the arbitration agreement in *Perez* did not have a severability clause and that the case is distinguishable from the present case on that ground.") *Id.* at 683.

108. 173 F.3d 933.

109. These sentiments are also echoed in *Armendariz*, 99 Cal. Rptr. 2d 745.

110. *See supra* n. 50 and accompanying text. The *Perez* court lists the implications of this "incentive" as follows: "Such provisions could deter an unknowledgable employee from initiating arbitration, even if they would ultimately not be enforced. It would also add an expensive procedural step to prosecuting a claim; the employee would have to request a court to declare a provision unlawful and sever it before initiating arbitration. Including an unlawful provision would cost the employer little, particularly where, as here, the arbitration agreement provides the employee must bear the employer's court costs and attorneys' fees incurred in defending the agreement if arbitration is challenged and the employer prevails." *Perez*, 253 F.3d at 1287.

111. *See generally Gilmer*, 500 U.S. at 24; *Moses H. Cane*, 460 U.S. at 24.

112. *See generally Gannon*, 262 F.3d at 677; *Wright*, 82 F. Supp. 2d at 1279; *Etokie*, 133 F.3d at 390; *Johnson v. Circuit City Stores, Inc.*, 203 F.3d 821 (4th Cir. 2000).

decision with the same provision in the same agreement in a different case as determinative of the provision's illegality in the case at hand. Such an approach, even if merely shifting the burden of proof to the employer, would sharply curtail the effectiveness of such an "incentive."

Courts addressing this issue will need to be cognizant of both the strong public interest in maintaining a party's statutory rights, as well as the strong public interest in advancing the interests and principles behind arbitration. A general rule that allows illegal provisions restricting a party's statutory rights to stand would reject the principles behind the former, while a general rule that rendered unenforceable an agreement containing an illegal provision would not fully appreciate the principles behind the latter. An effective approach would take into account the many factors associated with this issue, in light of the facts surrounding the case in question.

Included among these factors would be the relative sophistication of the parties.[113] Associated with the "sophistication" factor is the extent to which the parties understand the nuances and intricacies of the arbitration agreement they are consenting to sign. The dissent in *Gannon* particularly concentrates on this factor.[114] Also associated with these factors is the extent to which assent to the arbitration agreement is essential to being offered employment with the company. Judge Vietor's dissent in *Gannon* also focused on this factor as being instrumental in his determination that the agreement was contrary to public policy.[115]

The presence of a severability clause would seem to also be a factor to be considered, as the court in *Gannon* pointed out.[116] However, as stated and discussed *supra* in this section, this factor should not be determinative, especially in light of the sophistication factors discussed above. Perhaps the most influential factor is the ease with which the offending provision may be extricated from the agreement, and the extent to which the provision's absence affects the remaining provisions. From all accounts, the severing of the punitive damages limitation from the Circuit City agreement in *Gannon* had little effect on the remainder of the agreement.[117] However, severing essential provisions, or numerous illegal provisions such as those

113. *See generally* Margaret M. Harding, *The Redefinition of Arbitration by Those with Superior Bargaining Power*, 1999 Utah. L. Rev. 857 (giving a scathing attack on sophisticated parties for having undermined the principles underlying arbitration).

114. *Gannon*, 262 F.3d at 683. "Circuit City's counsel conceded at oral argument that job applicants are not told that the punitive damages limitation is far less than the amount recoverable under the law." *Id.*

115. *Id.* Judge Vietor writes of this factor: "The agreement to arbitrate was crafted by Circuit City, not by *the parties*. Ms. Gannon played no part in drafting the agreement. It was presented to her on a take-it-or-leave-it basis as a condition of gaining employment with Circuit city. She either signed or she did not get the job. Circuit City's job application form provided to Ms. Gannon clearly states: 'Circuit City will not consider your application unless the [Dispute Resolution Agreement] is signed.'" *Id.*

116. *Id.*

117. *Id.* "We do not believe that the severance of the provision limiting punitive damages diminishes [Gannon's] contractual intent to arbitrate because excluding the provision only allows her the opportunity to arbitrate her claims under more favorable terms than those to which she agreed." *Id.* at 682-83.

found in the *Hooters* case would summarily render the agreement worthless.[118]

## VI. CONCLUSION

Given the facts of the *Gannon* case, and the ease with which the offending limitation was stricken in light of the attached severability provision, the court's holding is a good one, even with consideration of a factor-based test outlined *supra*. While the court did not pay very much attention to the sophistication factors, it did consider the arguments made in the dissent, and deflected them with reason. Given the strong federal policy interest in maintaining and advancing the policies underlying arbitration, the *Gannon* holding will likely be a holding that more and more courts will adopt as their own.

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118. *See generally Hooters*, 39 F. Supp. 2d. at 627. This factor would appear to invoke consideration of the type of statutory right being threatened. It would seem that some statutory rights would be considered more fundamental than others, and necessarily afforded greater protection and weight in this factor-balancing scheme.