UNITED STATES COURT OF APPEALS
FOR THE EIGHTH CIRCUIT

No. 03-3075

STEVE FABER,

Plaintiff-Appellee,

v.

MENARD, INC.

Defendant-Appellant.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF IOWA

BRIEF FOR APPELLEE

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SUMMARY OF CASE AND ORAL ARGUMENT

Plaintiff-Appellee Steve Faber (Faber) was fired by Defendant-Appellant Menard, Inc. (Menards) after 20 years of employment. Shortly before he was terminated, Menards required Faber to sign an Employee Agreement compelling Faber to arbitrate all disputes with Menards and to bear his own costs and attorneys' fees, and his share of the costs of arbitration, regardless of whether he prevailed in the matter.

After his termination, Faber filed a complaint in federal district court alleging age discrimination and retaliation in violation of the Age Discrimination in Employment Act (ADEA), 29 U.S.C. § 621 et seq., and the Iowa Civil Rights Act, Iowa Code Ch. 216. Menards responded by filing a Motion to Compel Arbitration. The district court denied the motion after holding that the Employee Agreement's arbitration clause – specifically the attorneys' fees and cost-splitting provision – is procedurally and substantively unconscionable under Iowa law.

Although Faber does not believe that oral argument is necessary, he suggests argument time of 15 minutes per side if this Court believes oral argument would be helpful in the resolution of these issues.

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C & J Fertilizer, Inc. v. Allied Mutual Ins., 227 N.W.2d 169 (Iowa 1973).

Home Fed. Sav. & Loan Ass'n of Algona v. Campney, 357 N.W.2d 613 (Iowa 1984).

Gentile v. Allied Energy Prods., Inc., 479 N.W.2d 607, 609 (Iowa Ct. App. 1991).

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2. Whether an arbitration agreement that deprives an employee of his right under the Age Discrimination in Employment Act to obtain attorneys' fees and costs if he prevails undermines the remedial and deterrent functions of that Act and thus is void as a matter of public policy.

Gilmer v. Interstate/Johnson Lane Corp., 500 U.S. 20, 26 (1991).

Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc., 473 U.S. 614 (1985).

29 U.S.C. § 626(b)

STATEMENT OF THE CASE

A. Factual Background

In 1981, plaintiff-appellee Steve Faber began working for defendant-appellant Menard, Inc. (Menards), a home improvement store with 160 locations in states throughout the Midwest. Faber was promoted several times, and eventually was appointed store manager of Menards' Mason City, Iowa store. JA 44.

In February 2000, Faber met with Larry Menard, Operations Manager for Menards, and Ron Mehr, Personnel Manager, to discuss a new "Employee Contract" Menards had given him to sign. During the meeting, Faber raised concerns regarding two new provisions in the contract, one that reduced his bonus and another that required him to pay a $200 deductible if any driver he hired was in an automobile accident. JA 44. In his affidavit, Faber stated that in response to his concerns, "Larry Menard . . . told me that if I did not sign the agreement he would find someone younger who would work for less pay to do it. He said he did not have time to change every person's contract." JA 44. Faber "then signed the agreement because I believed I had no other choice." JA 44A.

Paragraph 20 of the Employee Agreement contains the following arbitration provision:

In consideration of employment, or continued employment, or a promotion and the compensation as outlined in Part B of the agreement by Menards, Menards and Manager agree that all claims and disputes between them, including but not limited to:

Statutory claims arising under the

- Age Discrimination in Employment Act
- Fair Labor Standards Act
- Title VII of the Civil Rights Act of 1964
- Title I of the Civil Rights Act of 1991
- Americans with Disabilities Act, and

Non-statutory Claims

- contractual claims
- quasi-contractual claims
- tort claims and
- any and all causes of action arising under the state laws

or common law shall be resolved by binding arbitration by the American Arbitration Association ("AAA") located at 225 North Michigan Avenue, Suite 2527, Chicago, IL 60601-7601, under its National Arbitration Rules. A copy of the Code, Rules and fee schedule of the American Arbitration Association may be obtained by contacting it at the address listed above.

Each party shall pay their own AAA fees, one half of the arbitrators' fees and their own attorney's fees.

The parties agree that all arbitrators selected shall be attorneys. This provision shall supersede any contrary rule or provision of the forum.

Menards is engaged in commerce using the U.S. Mail and telephone service. Therefore, the agreement is subject to the Federal Arbitration Act, 9 U.S.C. sections 1-14 as amended from time to time.

The final paragraph of the Employee Agreement contains the following agreement regarding "invalidity":

> Invalidity. In case any one or more of the provisions of this Agreement should be invalid, illegal, or unenforceable in any respect, the validity, legality, and enforceability of the remaining provisions contained in this Agreement will not be in any way affected or impaired thereby.

JA 46.

Although the agreement was not signed by Faber until February 25, 2000, it states that it is "effective" as of February 1, 2000. JA 46. The previous agreement between Faber and Menards, dated February 10, 1999, differed from the 2000 agreement in that it required the losing party to pay the prevailing party's attorneys' fees and costs. The 1999 agreement stated that "the prevailing party will be entitled to recover the reasonable attorneys' fees and costs incurred by such party in the course of prosecuting or defending any lawsuit or arbitration proceeding brought under the terms of this Agreement." JA 84-85 n.1.

In May 2001, Ron Mehr came to the Mason City Menards store and informed Faber that he was being replaced as store manager, but that he could accept a demotion to Assistant Store Manager at a Menards store in Minnesota. JA 44A. On June 5, 2001, Menards terminated Faber when he refused to accept the demotion. JA 44A.

In July 2001, Faber returned to the Menards store to do some shopping with his daughter. First Assistant Store Manager Todd Keck told

Faber he was trespassing and asked him to leave, which Faber promptly did. JA 44A.

B. Procedural Background

Faber filed a complaint of age discrimination and retaliation with the Mason City Human Rights Commission, the Iowa Civil Right Commission, and the Equal Employment Opportunity Commission. JA 6.

On April 14, 2003, Faber filed a timely complaint alleging age discrimination and retaliation in violation of the Age Discrimination in Employment Act (ADEA), 29 U.S.C. § 621 et seq., and the Iowa Civil Rights Act, Iowa Code Ch. 216. Faber sought back pay and benefits, liquidated damages, attorneys' fees, and litigation costs and expenses. JA 4.

Menards did not answer the complaint, but instead filed a Motion to Compel Arbitration and Stay Proceedings in which it claimed that the Employee Agreement signed by Faber and Menards on February 25, 2000, required Faber to arbitrate his age discrimination claim under the Federal Arbitration Act (FAA), 9 U.S.C. § 2.[1] Faber opposed the motion on the ground that the agreement was not valid under Iowa law. Specifically, Faber

[1] Menards originally asserted that the controlling agreement was the 1999 Employee Agreement, but it eventually conceded that the 2000 Employee Agreement governed the current dispute between Menards and Faber. JA 85-86.

argued that, under Iowa law, the arbitration clause is procedurally unconscionable because he could not negotiate its terms, and substantively unconscionable because it requires him to bear his own costs and attorneys fees and half the costs of the arbitrator. JA 90-91.

C. The Opinion Below

On June 17, 2003, the district court issued its memorandum opinion and order denying Menards' motion to compel arbitration. The district court began by noting that the FAA required it to determine whether, under Iowa law, Faber and Menards had entered a valid agreement to arbitrate Faber's age discrimination claim. JA 93. The district court agreed with Faber that the contract is invalid because it is unconscionable under Iowa law.[2] The district court first found that the contract is procedurally unconscionable because the evidence demonstrated a significant disparity in bargaining power between Menards, a "large national company," and Faber, an employee "in the relatively low position of store manager" of a single store. JA 103. In addition, the court noted that Faber had submitted an affidavit stating that Menards told him he would be replaced by a younger employee

[2] The district court rejected Faber's separate argument that the contract is invalid because it does not bind both parties to arbitrate their claims. The court concluded that the contract purports to require both parties to arbitrate.

if he did not sign the agreement as written, and Menards did not deny Faber's version of events. JA 103. The court explained:

> Faber avers – *and Menard does not dispute* – that he was plainly told that he was in no position to bargain: he could either sign the contract as it stood, or be replaced by a younger employee who would cost Menard less, with the added stinger that he was told that Menard would not, or that Larry Menard could not, negotiate terms of individual contracts.

JA 103 (emphasis added). Indeed, the district court noted that Menards had responded to Faber's factual showings with nothing but "deafening silence." JA 97.

Next, the court found that the provision requiring Faber to bear his own attorneys' fees and costs is substantively unconscionable because it deprives Faber of his right under federal law to be reimbursed for those fees and costs were he to prevail, and because it requires Faber to pay for costs of arbitration that he would not have to bear in litigation. JA 105-111. The court observed that federal antidiscrimination statutes provide for fee shifting to prevailing plaintiffs because often an award of costs and attorneys' fees to a plaintiff in a discrimination case nears or exceeds the plaintiff's recovery for backpay, compensatory, and punitive damages. JA 106. Thus, "requiring an employee to bear his or her own costs and half the arbitrator's costs would likely make any recovery in arbitration a 'Pyrrhic victory' at best." JA 106. The court concluded that no employee "in his

senses" would agree to forgo his or her federal statutory right to attorneys' fee and costs, and "no honest and fair" employer would accept such an agreement. JA 106 (citing *Lakeside Boating & Bathing, Inc. v. State*, 402 N.W.2d 419, 422 (Iowa 1987)).

Finally, the court concluded that the unconscionable provision of the arbitration clause is not severable because it affects the "central purpose" of that clause. JA 116. The court reached that conclusion after noting that Menards had chosen to specify that the parties must bear their own fees and costs, despite leaving almost all other details concerning arbitration to the American Arbitration Association under its National Arbitration Rules. JA 116. In addition, the court observed that the fee and cost-splitting provision was a "significant change" from the arbitration provision in the 1999 employment agreement. JA 117. Thus, the court concluded that the central purpose of the arbitration provision was so "tainted with illegality" that the unconscionable provisions could not be severed from the rest of the agreement. JA 117.

SUMMARY OF ARGUMENT

The arbitration agreement between Faber and Menards is both procedurally and substantively unconscionable under Iowa law. The agreement is procedurally unconscionable because Faber had no opportunity

to negotiate the terms of the Employee Agreement, but rather was forced to sign the agreement, as written by Menards, to keep his job. The provision requiring Faber to pay his attorneys' fees and split the costs of arbitration is substantively unconscionable, for two independent reasons.

First, the fee and cost-splitting provision deprives Faber of his right under the Age Discrimination in Employment Act to be reimbursed for his attorneys' fees and costs should he prevail in litigation, and benefits Menards by ensuring that, even if it loses, it will not have to pay Faber's costs and fees as it would have to do in a judicial forum. Second, the cost-splitting provision requires Faber to pay half the costs of the arbitral forum – costs that will certainly be higher than the $150 filing fee that would be the only expense Faber would bear were he to proceed in federal court. Because no employee "in his senses" would voluntarily agree to such terms, and "no honest and fair" employer would require an employee to sign such an agreement, the provision is unconscionable under Iowa Law. *Lakeside Boating & Bathing, Inc. v. State*, 402 N.W.2d 419, 422 (Iowa 1987).

Even if the Employee Agreement were not unconscionable under Iowa law, it is unenforceable as a matter of public policy because its attorneys' fees and cost-splitting provision deprives Faber of a significant remedy under the Age Discrimination in Employment Act, undermining the

Act's remedial and deterrent goals. As the Supreme Court has repeatedly stated, arbitration agreements that deprive the parties of their rights and remedies under federal law are unenforceable. *See, e.g., Gilmer v. Interstate/Johnson Lane Corp.*, 500 U.S. 20, 26 (1991); *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*, 473 U.S. 614, 627 (1985). Faber should not be required to arbitrate his ADEA claims under an agreement that strips him of his federal rights, undermining the deterrent and remedial purposes of the Act.

ARGUMENT

I. STANDARD OF REVIEW

The district court held that the employment agreement between Faber and Menards is unconscionable under Iowa law. This Court reviews *de novo* whether the district court applied the correct legal standard in reaching that conclusion. *Dobbins v. Hawk's Enterprises*, 198 F.3d 715, 717 (8th Cir. 1999). Factual findings that support the district's conclusion are reviewed only for clear error. *Lyster v. Ryan's Family Steak Houses, Inc.*, 239 F.3d 943, 945 (8th Cir. 2001).

II. THE EMPLOYMENT AGREEMENT IS UNCONSCIONABLE UNDER IOWA LAW.

The FAA was enacted in 1925 to reverse judicial hostility toward arbitration agreements and to place such agreements "upon the same footing as other contracts." *Gilmer v. Interstate/Johnson Lane Corp.*, 500 U.S. 20, 24 (1990). Although federal policy favors arbitration, *see Moses H. Cone Mem'l Hosp. v. Mercury Const. Corp.*, 460 U.S. 1, 24 (1983), courts first must find that the parties entered into a *valid* agreement to arbitrate a dispute, because Congress did not intend for the FAA to force parties who had not agreed to arbitrate into a non-judicial forum. *See Mitsubishi Motors Corp*, 473 U.S. at 626; *Prima Paint Corp. v. Flood & Conklin Mfg. Co.*, 388 U.S. 295, 404 n.12 (1967) ("[T]he purpose of Congress in 1925 was to make arbitration agreements as enforceable as other contracts, but not more so"). Thus, "[b]efore a party may be compelled to arbitrate under the Federal Arbitration Act, the district court must engage in a limited inquiry to determine whether a valid agreement to arbitrate exists between the parties and whether the specific dispute falls within the scope of that agreement." *Houlihan v. Offerman & Co., Inc.*, 31 F.3d 692, 694-95 (8th Cir. 1994).

The question whether an arbitration agreement is unconscionable under state law is a separate inquiry from the question whether an agreement is unenforceable because it conflicts with a right or remedy granted by a

federal statute. *See Arkcom Digital Corp. v. Xerox Corp.*, 289 F.3d 536, 539 n.2 (8th Cir. 2002) (noting that distinction). Although this Court has held (in conflict with most other courts of appeals) that the latter question must be addressed in the first instance by the arbitrator, *see id.*, this Court, like every other circuit, has held that the question whether an agreement is unconscionable under state law must be decided first by a court before the parties may be compelled to proceed in arbitration. *See, e.g., Lyster*, 239 F.3d at 947 (on motion to compel arbitration, addressing question whether arbitration agreement is unconscionable under state law); *Dobbins*, 198 F.3d at 717 (same).

In determining the validity of an agreement to arbitrate, federal courts "should apply ordinary state-law principles that govern the formation of contracts." *First Options of Chicago, Inc. v. Kaplan*, 514 U.S. 938, 944 (1995). Although state laws specifically targeting arbitration agreements are preempted by the FAA, "[g]enerally applicable contract defenses, such as fraud, duress, or unconscionability, may be applied to invalidate arbitration agreements." *Doctors's Associates, Inc. v. Casarotto*, 517 U.S. 681, 687 (1996). As the Supreme Court has declared, courts must "remain attuned to well-supported claims that the agreement to arbitrate resulted from the sort of fraud or overwhelming economic power that would provide grounds for

the revocation of any contract." *Mitsubishi Motors Corp.*, 473 U.S. at 627 (internal quotation marks omitted).

Menards does not contend that the district court misconstrued the FAA or Iowa law concerning unconscionability. Indeed, Menards agrees with Faber that the district court correctly held that generally applicable principles of Iowa contract law govern the validity of their employment agreement, and that unconscionability is a generally applicable contract defense under Iowa law. *See* Menards' Br. 10-11; *see also Federal Land Bank of Omaha v. Steinlage*, 409 N.W.2d 173, 174 (Iowa 1987); *Casey v. Lupkes*, 286 N.W.2d 204, 207 (Iowa 1979). The parties and the district court also agree that Iowa courts examine a multitude of factors in determining whether a contract is unconscionable, such as whether there was "assent, unfair surprise, notice, disparity of bargaining power, and substantive unfairness." *See* Menards' Br. 12; *see Gentile v. Allied Energy Prods., Inc.*, 479 N.W.2d 607, 609 (Iowa Ct. App. 1991). And the parties concur with the district court's conclusion that these factors can be sorted into two separate inquiries: First, whether the formation of the contract was procedurally unconscionable; and second, whether any of the terms of the contract are substantively unconscionable. *See* Menards' Br. 11. In short, Menards disagrees with the district court's factual findings, and not with its

articulation or application of the legal standard governing the validity of the arbitration clause.

A. The Employment Agreement Is Procedurally Unconscionable.

In determining procedural unconscionability, Iowa courts consider factors such as which party drafted the agreement, whether the terms were an unfair surprise to the non-drafting party, whether the party challenging the agreement was under financial pressure to sign it, and whether it was an adhesion contract – that is, a contract "drafted unilaterally by the dominant party and then presented on a 'take-it-or-leave-it' basis to the weaker party who has no real opportunity to bargain about its terms." *Home Fed. Sav. & Loan Ass'n of Algona v. Campney*, 357 N.W.2d 613, 618 (Iowa 1984). Whether an agreement is an adhesion contract is a significant factor in any determination about a contract's unconscionability. *See C & J Fertilizer*, 227 N.W.2d at 180 ("Standardized contracts ... drafted by powerful commercial units and put before individuals on the 'accept this or get nothing' basis, are carefully scrutinized by the courts for the purpose of avoiding enforcement of 'unconscionable' clauses.").

As the district court found, all of the evidence below supported Faber's contention that the employment agreement was a contract of adhesion because he had no opportunity to bargain over its terms. JA 103-

04. Menards produced *no* evidence to contradict or undermine the evidence produced by Faber.

The disparity in bargaining power between Menards and Faber is evident simply by comparing their respective positions. Menards is a "large national company" with stores across the Midwest. JA 103. Menards drafted the agreement at issue and presented it as a final product to Faber for his signature. JA 103. In contrast, Faber was a Menards employee who had worked for the chain for close to twenty years. JA 103. Accordingly, the district court found that "Faber was not only at a distinct disadvantage in bargaining power, but was also subject to very different financial pressures than Menard." JA 103. Proof of the disparity in negotiating position came when Faber attempted to challenge two new provisions in the employee agreement that he found unfair, and Larry Menard told him that "if [Faber] did not sign the agreement [Menard] would find someone younger who would work for less pay to do it. [Menard] said he did not have time to change every person's contract." JA 44.[3]

[3] Indeed, the agreement stated it went into effect on February 1, 2000, two weeks *before* Faber signed it, JA 46, which further indicates that Faber was not expected to have any say over its terms.

Menards "does not dispute" that Faber was told he could not alter the terms of the employment agreement. JA 103. As the district court explained:

> Faber has asserted facts suggesting that he was offered the contract on a "take-it-or-leave-it" basis and, moreover, was "threatened" with termination if he didn't sign the agreement as offered. Menard has responded to these allegations with a deafening silence.

JA 97.

Although Menards still does not deny that Larry Menard told Faber he had to sign the agreement as written, Menards argues that the district court erred in "assum[ing]" that Faber could not have successfully negotiated changes in the arbitration provision just because he was threatened with termination when he objected to *other* provisions in the employment agreement. Menards' Br. 13. The district court made no assumptions, but rather relied on the uncontested statement in Faber's affidavit that he was told he had to sign the agreement *as written*, which included the arbitration provision, or be replaced by a younger employee. JA 44. In any case, Larry Menard's threats in response to Faber's request to alter certain terms in the contract provide more than sufficient support for the district court's factual conclusion that Faber had no power to make changes to any other provisions in the agreement, including the terms of the arbitration agreement.

Menards further asserts that "the district court offers little or no evidence supported by the record to prove that Plaintiff had a lack of bargaining power." Menards' Br. 12. Menards is mistaken. As just explained, the district court based its conclusion on Faber's uncontested statement that he was threatened with termination when he tried to negotiate the terms of his contract. This evidence alone is enough to demonstrate procedural unconscionability. *Home Fed. Sav. & Loan Ass'n of Algona*, 357 N.W.2d at 618; *C & J Fertilizer*, 227 N.W.2d at 180. In addition, the district court relied on indisputable evidence showing that 1) Menards was a large, multi-state company, JA 103; 2) Faber held the "relatively low position" of store manager of a single Menards' store, JA 103; 3) Faber had been employed at Menards for twenty years, JA 82; and 4) the contract was drafted by Menards and presented to Faber on a "take it or leave it" basis, JA 103. Indeed, in its appellate brief, Menards admits that "it is undoubtedly true that Menard, Inc. has greater resources than Mr. Faber." Menards' Br. 20. Moreover, Menards has *never* denied that when Faber objected to some of the Employee Agreement's provisions he was told he had to sign the agreement or he would be replaced. Thus, the district court's factual finding that Faber had no bargaining power with which to negotiate the terms of his employment agreement is amply supported by the record.

In a similar vein, Menards asserts that the record is devoid of evidence regarding Faber's status and position in the company. Menards' Br. 13. Again, Menards has chosen to ignore the uncontroverted evidence. The record shows that Faber was manager of a single Menards store, JA 44, that he was eventually demoted and fired by Menards, JA 44A, and that he was threatened with arrest for trespass when he returned to the store, JA 44A. In short, the evidence demonstrates that Faber was treated as a minor and readily disposable employee within a large company, and that his continued employment there depended entirely on the whim of company's owners. The disparity in bargaining power between a single employee at one chain store and the chain's owners is, as Menards admits, a matter of "common sense." Menards' Br. 14. If Menards had evidence that, despite his low position in the company's hierarchy, Faber somehow had significant leverage over the company's owners in negotiations over his contract, it should have shared that information with the district court. On the basis of the evidence that *was* in the record below, the district court concluded that Faber had no authority to bargain over the terms of the Employee Agreement. This Court should defer to the district court's reasonable and well-supported factual conclusions that Faber could not negotiate the terms of the agreement, and thus that the contract was procedurally

unconscionable. *See Lyster*, 239 F.3d at 945 (district court's factual findings should be overturned only for clear error).[4]

B. The Provision Requiring Faber to Pay Arbitration Costs and His Attorneys' Fees is Substantively Unconscionable.

Under Iowa law, a contract is substantively unconscionable where the terms are unreasonably unfair to one party. *Gentile*, 479 N.W.2d at 609; *Lakeside Boating & Bathing, Inc.*, 402 N.W.2d at 422. A substantively unconscionable agreement is one that "no man in his senses and not under delusion would make. . . and no honest and fair man would accept." *Lakeside Boating & Bathing, Inc.*, 402 N.W.2d at 422.

The employment agreement between Menards and Faber requiring each party to bear its own costs and attorneys fees and half the arbitrators' costs, win or lose, is unconscionable for two reasons: First, it deprives Faber of his statutory right under the ADEA (and other federal statutes) to be reimbursed for his costs and attorneys' fees if he prevails; and second, it

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[4] Menards claims that the district court erred by "failing to examine each of the factors set forth by the *Gentile* court for the determination of procedural unconscionability," such as whether Faber assented to the Employee Agreement and whether he was unfairly surprised by its terms. Menards' Br. 12. Contrary to Menards' assertion, however, the district court discussed *all* of the factors listed in *Gentile*. The court concluded that Faber had assented to the Employee Agreement and that he was not unfairly surprised by its terms, JA 102, but nonetheless found the agreement unconscionable because Faber had no opportunity to negotiate the agreement but instead was presented with the agreement on a "take it or leave it" basis. JA 103.

requires that Faber pay half the costs of proceeding in arbitration, imposing on Faber a financial burden that he would not have to bear in a judicial forum.

1. The Employment Agreement is Substantively Unconscionable Because It Deprives Faber Of His Right Under Federal Law To Be Reimbursed For Attorneys' Fees And Costs If He Prevails.

The ADEA provides that a prevailing plaintiff shall be reimbursed by the defendant for costs and attorneys' fees. *See* 29 U.S.C. § 626(b) (incorporating 29 U.S.C. § 216(b), which grants a prevailing employee attorneys' fees and costs). In contrast, under the ADEA a prevailing defendant has no right to reimbursement of attorneys' fees and costs from the plaintiff. The requirement in the Employee Agreement that each party bear its own fees and costs therefore deprives Faber of a significant remedy that would otherwise have been available to him under the ADEA, while providing him with no countervailing benefit. In contrast, the provision aids Menards by ensuring that, even if it loses, it will not have to reimburse Faber for attorneys' fees and costs as it would have to do in a court of law. Accordingly, there are no circumstances in which the provision would disadvantage Menards, because Menards has no statutory right to fees if it prevails. In short, the arbitration provision plainly, and one-sidedly, benefits Menards at Faber's expense. *See Alexander v. Anthony International, L.P.*,

341 F.3d 256, 267 (3d Cir. 2003) (holding similar restriction on attorneys' fees and costs substantively unconscionable under state law because these "restrictions are one-sided in the extreme and unreasonably favorable to [employer]"); *Circuit City Stores, Inc. v. Adams*, 279 F.3d 889, 894 (9th Cir.), *cert. denied*, 535 U.S. 1112 (2002) (finding arbitration agreement substantively unconscionable because it deprives employee of federal statutory rights and remedies).

As this Court has recognized, the ADEA's fee-shifting provision is a vital aspect of the statute's remedy against age discrimination in employment. *See, e.g., Cleverly v. Western Elec. Co.*, 594 F.2d 638 (8th Cir. 1979); *Brennan v. Ace Hardware Corp.*, 495 F.2d 368 (8th Cir. 1974). Without reimbursement for attorneys' fees, a victory for Faber will not succeed in "making [him] whole" because any backpay award will likely be significantly decreased by attorneys' fees and costs. *See Albemarle Paper Co. v. Moody*, 422 U.S. 405, 421 (1975). As the district court commented, an award of costs and attorneys' fees to a prevailing plaintiff in a discrimination case often nears or exceeds the plaintiff's recovery for backpay, compensatory damages, and sometimes even liquidated or punitive damages. JA 106. No employee "in his senses" would voluntarily agree to forgo this significant benefit of victory under the ADEA and other federal

statutes for nothing in return, and no "honest and fair" employer would draft an agreement stripping its employees of a vital remedy provided by most federal statutes protecting employees from discrimination in the workplace. *Lakeside Boating & Bathing, Inc.* 402 N.W.2d at 422; *see also Alexander*, 341 F.3d at 267; *Circuit City Stores, Inc.*, 279 F.3d at 894.

Menards contends that the district court should have focused on Faber's "actual inability to afford arbitration costs and attorneys' fees" rather than making "assumptions" about whether costs would be prohibitive. Menards' Br. 23. Faber's ability to pay is only relevant to the question whether the agreement is unenforceable because it effectively deprives him of access to a forum in which to vindicate his substantive claims. *Cf. Green Tree Financial Corp.-Alabama v. Randolph*, 531 U.S. 79 (2000). Faber's argument here, however, is that the agreement is unconscionable under Iowa law because it is unreasonable and unfair to deprive him of a federal statutory remedy to which he would otherwise be entitled. *See* JA 42 (Faber's Opp. to Motion to Compel); JA 106 (district court held that attorneys' fees and cost-splitting provision is unconscionable in light of antidiscrimination statute's award of fees and costs to prevailing plaintiffs) In other words, the issue is whether the unjust terms of the agreement render it unconscionable under Iowa contract law, not whether Faber could

nonetheless afford to pay the extra, unfair expenses. Indeed, if Faber's ability to afford arbitration and attorneys' fees were the only relevant factor, then a contract requiring that Faber pay *all* of *Menards'* attorneys' fees and costs, as well as his own, would not be unconscionable unless Faber could show that he could not afford to do so. Menards cites several cases in which it says courts engaged in the type of close scrutiny of a plaintiff's finances that Menards thinks is required here. *See* Menards' Br. at 17-23 (citing and discussing *Gilmer*, 500 U.S. 20; *Green Tree Financial Corp.-Alabama*, 531 U.S. 79; *Blair v. Scott Specialty Gases*, 283 F.3d 595 (3d Cir. 2002); *Shankle v. B-G Maint. Mgmt. of Col., Inc.*, 163 F.3d 1230 (10th Cir. 1999); *Bradford v. Rockwell Semiconductor Sys., Inc.*, 238 F.3d 549 (4th Cir. 2001); *Williams v. Cigna Financial Advisors, Inc.*, 197 F.3d 752 (5th Cir. 1999)). However, in contrast to this case, those cases *did* involve the question whether "the existence of large arbitration costs could preclude a litigant ... from effectively vindicating her federal statutory rights in the arbitral forum." *Blair*, 283 F.3d at 605 (quoting *Green Tree*, 531 U.S. at 90). The issue in those cases was not whether the agreement was fair, but rather whether it effectively precluded the plaintiff from pursuing his or her underlying federal statutory rights by making arbitration cost-prohibitive.

For that reason, those courts looked to the individual litigant's ability to pay to determine whether that litigant could afford to go forward with arbitration. *See, e.g., Williams*, 197 F.3d 764-65 (examining Williams' finances to determine whether arbitration costs would preclude Williams from pursuing his claims in arbitration); *Shankle*, 163 F.3d at 1234; *Bradford*, 238 F.3d at 556; *Green Tree*, 531 U.S. at 522.[5] Faber is not making such an argument, and thus he need not produce evidence regarding whether he could afford arbitration. Because the arbitration provision at issue deprives Faber of his statutory right to have his costs and attorneys' fees paid by Menards if he prevails, without imposing any similar loss on Menards, the agreement is grossly unfair and thus void as unconscionable under Iowa law, regardless of whether Faber could afford to pay those costs and fees.[6]

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[5] It is also notable that all the cases Menards cites on this point concern the costs of the arbitration forum (such as administrative fees and arbitrators' fees), and none involves a claim that it is unconscionable to deprive a party of a statutory entitlement to attorneys' fees.

[6] Although not the basis for the district court's decision in this case, Faber's inability to pay arbitration costs is an independent ground for holding this arbitration agreement unenforceable. *See, e.g., Dobbins*, 198 F.3d 715. This Court need not reach that issue if it agrees with the district court that the attorneys' fees and cost-splitting provision is so unfair to Faber as to be unconscionable under Iowa law. However, if this Court does reach the issue, it should remand the case to permit Faber to present evidence regarding his ability to pay. *Id.* at 718.

2. The Employment Agreement is Substantively Unconscionable Because It Forces Faber to Pay Half the Costs of the Arbitration.

The agreement is also unconscionable under Iowa law because it forces Faber to pay half the costs of arbitration – costs that Faber would not have to pay if pursuing his ADEA claim in federal court. *Cf.* Jean R. Sternlight, 74 Wash. U. L.Q. 637, 682-83 (1996) (suggesting ways employers might structure arbitration to discourage claims, including requiring employees to pay arbitrators' fees, and noting that "at least when one goes to court the judge is free"); Ellie Winninghoff, *In Arbitration, Pitfalls for Consumers*, N.Y. Times, Oct. 22, 1994, at 37 (An attorney with arbitration experience says it is a myth "that [arbitration is] cheaper – that's definitely not true. If you go to trial, you get the judge for free."). Because Faber is required by the agreement to bear expenses that he would avoid were he able to proceed to litigation, and because those expenses impose a greater financial burden on Faber (a single employee) than on Menards (a multi-state company), the agreement is so unfair to Faber as to be unconscionable.

Once again, Menards' argument that Faber should have provided the district court with evidence of his own finances and the costs of arbitration misses the point. Faber does not contend at this time that he cannot afford

arbitration; rather, he challenges the provision as being unfair because it forces him to pay costs he could have avoided in a judicial forum – costs that are far more burdensome for him than for Menards. *See* JA 42. Menards cannot dispute that the costs of arbitral forum are more expensive than the $150 filing fee required to litigate Faber's claim in Iowa District Court. *See, e.g., Morrison v. Circuit City Stores*, 317 F.3d 646, 669 (6th Cir. 2003) ("Minimal research will reveal that the potential costs of arbitrating the dispute easily reach thousands, if not tens of thousands, of dollars, far exceeding the costs that a plaintiff would incur in court."); *Shankle*, 163 F.3d at 1234 ("Assuming Mr. Shankle's arbitration would have lasted an average length of time, he would have had to pay an arbitrator between $1,875 and $5,000 to resolve his claims."); *Cole v. Burns Intern. Security Svcs*, 105 F.3d 1465, 1480 n.8 (D.C. Cir. 1997). Menards concedes that it has "greater resources" than Faber, Menards' Br. 20, and it cannot deny that the cost-splitting provisions necessarily have a greater impact on the party with smaller resources – that is, on Faber. *See Alexander*, 341 F.3d at 267 (agreement to split fees and costs benefits "the party with a substantially stronger bargaining position and more resources, to the disadvantage of an employee"). Those facts alone demonstrate that Faber was disadvantaged by

an agreement that forces him to bring his dispute to a forum that is far more costly for him than litigation.

Many courts have recognized that a cost-splitting provision in an arbitration agreement is unconscionable because it benefits the employer at the expense of the employee. *See, e.g., Alexander*, 342 F.3d at 267; *Ting v. AT&T*, 319 F.3d 1126, 1151 (9th Cir. 2003), *cert. denied* __ S. Ct. __, 2003 WL 1988529 (Oct. 6, 2003) (holding contract unconscionable under California law because "it imposes on some consumers costs greater than those a complainant would bear if he or she would file the same complaint in court"); *Shankle*, 163 F.3d at 1234-35. As the D.C. Circuit explained:

> Arbitration will occur in this case only because it has been mandated by the employer as a condition of employment. Absent this requirement, the employee would be free to pursue his claims in court without having to pay for the services of a judge. In such a circumstance – where arbitration has been imposed by the employer and occurs only at the option of the employer – arbitrators' fees should be borne solely by the employer.

Cole, 105 F.3d at 1485.

This Court addressed a similar issue in *Dobbins v. Hawk's Enterprises*. In that case, the parties had contracted to purchase a mobile home, and included in that agreement was an arbitration provision requiring that the parties arbitrate their dispute under the American Arbitration Association's (AAA) rules. The AAA rules provide that the parties split the

costs of arbitration, with exceptions granted on the basis of a party's financial condition. This Court agreed that forcing a party to pay arbitration fees had the "potential" to make an arbitration agreement unconscionable, but concluded that the answer to that question "must be determined on a case-by-case basis in light of the state law governing unconscionability." 198 F.3d at 718. The Court then remanded the case and ordered the Dobbinses to seek a fee waiver from the AAA as permitted by the AAA rules incorporated in the arbitration agreement, and ordered the district court to retain jurisdiction over the case to ensure that fee was eliminated or lowered to a "reasonable" amount. *Id.*

This case differs from *Dobbins* in two significant ways. First, the agreement here *requires* each party to pay half the costs of arbitration, whatever they may be. Unlike the Dobbinses, Faber cannot seek a waiver of those costs.[7] Second, in this case, unlike *Dobbins*, the district court has

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[7] In this appeal, Menards argues for the first time that Faber could seek a hardship waiver of fees and expenses under AAA Rule 38. Menards' Br. 24. Menards never raised this argument below, and therefore it has been waived. *See United States v. Elliott,* 89 F.3d 1360, 1367 (8th Cir. 1996).

In any case, Menards cannot explain why the AAA Rule would supersede the specific provision in Menards and Faber's contract requiring each party to bear its own fees and costs. Menards notes that a separate clause in their agreement requiring that the arbitrators be attorneys is followed by the statement that this clause "shall supersede any contrary rule or provision of the forum." Menards reasons that the absence of such a "supersede" notation after the fee and cost-splitting provision means that it *is*

considered the question of unconscionability on the particular facts in light of applicable state law, so the unconscionability issue is squarely presented. Because requiring Faber to pay half the costs of arbitration is unfair, and because the agreement itself was a contract of adhesion, Faber has demonstrated that the cost-splitting agreement is unconscionable under Iowa law.

III. AN ARBITRATION PROVISION THAT ELIMINATES FEDERAL STATUTORY REMEDIES IS UNENFORCEABLE.

Even if the arbitration agreement were not unconscionable under Iowa law, it would be unenforceable as a matter of public policy because its fee and cost-splitting provision deprives Faber of his remedies under the ADEA, undermining the ADEA's compensatory and deterrent goals. Although previous panels in this Circuit have held that conflicts between federal statutes and arbitration provisions should be resolved in the first instance by

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trumped by the AAA rules. Menards' argument is illogical, for it suggests that every specific provision in its arbitration agreement would be superseded by AAA rules absent a "supersede" clause, which would undermine the whole purpose of specifying procedures in its contract. This Court should not adopt Menards' self-interested and strained construction of the contract. *See Mastrobuono v. Shearson Lehman Hutton, Inc.*, 514 U.S. 52, 62 (1995) (noting the "common-law rule of contract interpretation that a court should construe ambiguous language against the interest of the party that drafted it"). Moreover, Menards has never offered to pay Faber's fees and costs. *Cf. Alexander*, 341 F.3d at 269-70 (noting that employer had not agreed to pay fees and costs).

the arbitrator in arbitration, *see, e.g., Arkcom Digital Corp.*, 289 F.3d at 539 we raise this issue to preserve it for subsequent review.

In deciding whether a federal cause of action is arbitrable, courts should determine whether the litigant will be denied the ability to vindicate federal rights in the arbitral forum. If so, the agreement violates public policy and thus is unenforceable, and the parties cannot be compelled to arbitrate their claims unless those provisions are severable. *See, e.g., EEOC v. Waffle House*, 534 U.S. 279, 295 & n.10 (2002) (holding that parties to arbitration agreement cannot waive substantive statutory rights); *Mitsubishi Motor Corp.*, 473 U.S. at 628. As the Supreme Court declared in *Mitsubishi Motor Corp.*: "By agreeing to arbitrate a statutory claim, a party does not forgo the substantive rights afforded by the statute; it only submits to their resolution in an arbitral, rather than a judicial, forum." *Id.*

As explained above, the attorneys' fees and cost-shifting provision in the ADEA serves the important remedial purpose of making the litigant whole for injuries suffered as a result of age discrimination. *See, e.g., Cleverly*, 594 F.2d at 642-43; *Brennan*, 495 F.2d at 373. In addition, forcing defendants to bear plaintiffs' costs and fees deters future discrimination. As the Supreme Court has repeatedly noted, monetary awards for claimants who bring discrimination claims serve as an incentive for employers to eliminate

their discriminatory practices. *See, e.g., Kolstad v. American Dental Ass'n*, 527 U.S. 526, 545 (1999); *McKennon v. Nashville Banner Publ'g Co.*, 513 U.S. 352, 358 (1995). Thus, the elimination of this significant statutory right in Menards' employment agreement undermines both the remedial and deterrent purposes of the ADEA, and cannot be enforced. *See Gilmer*, 500 U.S. at 28.

Circuit courts have consistently applied this reasoning to hold arbitration agreements unenforceable where they require one party to give up significant statutory rights and remedies. *See Adams v. Philip Morris, Inc.*, 67 F.3d 580, 584 (6th Cir. 1995) ("It is the general rule in this circuit that an employee may not prospectively waive his or her rights under either Title VII or the ADEA."); *Kendall v. Watkins*, 998 F.2d 848, 851 (10th Cir. 1993) ("There can be no prospective waiver of an employee's rights under Title VII."). Moreover, every circuit court to address the question has held that "provisions in arbitration agreements that limit the remedies available in the arbitral forum, compared to those remedies in the judicial forum, are [] unenforceable." *Morrison*, 317 F.3d at 672 (holding arbitration agreement unenforceable because it "undermines the deterrent purposes of Title VII by placing stringent limits on punitive damages"); *Investment Partners, L.P. v. Glamour Shots Licensing, Inc.*, 298 F.3d 314 (5th Cir. 2002) (holding that

restriction on punitive damages in RICO action is unenforceable); *Brooks v. Travelers Ins. Co.*, 297 F.3d 167 (2d Cir. 2002) (holding that numerous limitations on statutory rights, including restrictions on the length of the hearing, damages, and attorneys' fees and costs, are unenforceable); *Blair,* 283 F.3d at 605-06; *Circuit City*, 279 F.3d at 895 (holding arbitration agreement unenforceable because it "forces [the employee] to arbitrate his statutory claims without affording him the benefit of the full range of statutory remedies"); *Perez v. Globe Airport Sec. Servs., Inc.*, 253 F.3d 1280, 1286 (11th Cir. 2001) ("[F]ederal statutory claims are arbitrable only when arbitration can serve the same remedial and deterrent functions as litigation, and an agreement that limits the remedies available cannot adequately serve those functions."); *Paladino v. Avnet Computer Technologies*, 134 F.3d 1054, 1062 (11th Cir. 1998) (noting that arbitrability of discrimination "claims rests on the assumption that the arbitration clause permits relief equivalent to court remedies."); *Cole*, 105 F.3d at 1484 (holding provisions of arbitration agreement unenforceable because they failed to provide for all the types of relief that would otherwise be available in court).

In the past, this Court has held that issues about whether arbitration conflicts with rights and remedies under federal law should be decided in the

first instance by the arbitrator, not the court. *See, e.g., Bob Schultz Motors, Inc. v. Kawasaki Motors Corp.*, 334 F.3d 721, 726 (8th Cir. 2003); *Arkcom Digital Corp.*, 289 F.3d at 539. Most courts have reached the opposite conclusion. *See, e.g., Shankle*, 163 F.3d at 1235; *Adkins v. Labor Ready, Inc.*, 303 F.3d 496, 506 (4th Cir. 2002); *Williams*, 197 F.3d at 764-65; *Paladino*, 134 F.3d at 1057-58; *but see Thompson v. Irwin Home Equity Corp.*, 300 F.3d 88, 92 (1st Cir. 2002). Moreover, the Supreme Court has treated the question whether arbitration undermines the goals of specific federal statutes as a threshold issue to be decided before the parties can be compelled to arbitrate. For example, in *Gilmer*, the employee challenged the employer's motion to compel arbitration, arguing that arbitration would undermine the goals of the ADEA. The Supreme Court did not refuse to hear the case on the ground that the issue should first be decided by an arbitrator, but instead analyzed whether the arbitration agreement impermissibly conflicted with the policies of the Act. Deferring the issue is harmful to employees, such as Faber, who are at a significant disadvantage in obtaining representation and pursuing their claims in a forum that deprives them of the ability to fully vindicate their federal statutory rights.

Like the agreements at issue in the cases cited above, the arbitration provision at issue here prohibits Faber from recovering attorneys' fees and

costs – substantial sums to which he would be entitled under the ADEA if he were to prevail. Because this provision undermines the remedial and deterrent goals of the ADEA, this Court should hold it unenforceable as a matter of public policy, and should not compel Faber to proceed with arbitration.

IV. THE COST AND FEE-SPLITTING PROVISIONS IN FABER AND MENARDS' EMPLOYMENT AGREEMENT ARE NOT SEVERABLE.

The district court correctly concluded that the attorneys' fees and cost-splitting provision of the employment agreement was not severable from the rest of the contract because it "tainted" the "central purpose" of the arbitration provision. *See Paladino*, 134 F.3d at 1058 ("[T]he presence of an unlawful provision in an arbitration agreement may serve to taint the entire arbitration agreement, rendering the agreement completely unenforceable, not just subject to judicial reformation."); E. Allan Farnsworth, *Farnsworth on Contracts* § 5.8, at 70 (1990) (severance is inappropriate when the entire provision represents an "integrated scheme to contravene public policy"); *Alexander,* 341 F.3d at 271 (refusing to sever unconscionable arbitration provisions – such as those requiring employee to split costs of arbitration and pay attorneys' fees – despite a savings clause).

The district court's conclusion was based on factual findings that Menards does not dispute. First, the district court observed that, aside from the issue of fees and costs, the arbitration provision left almost all the details of arbitration proceedings to be governed by the AAA under its National Arbitration Rules, indicating the importance of the fee and cost-splitting provision to Menards. JA 116. Second, the court noted that the 1999 employment agreement between Menards and Faber did not contain the fee and cost-splitting provision, but rather required that the losing party reimburse the prevailing party for attorneys' fees and costs. JA 116. The fee and cost-splitting provision was the "most significant change" between the arbitration clause in the 1999 agreement and the arbitration clause in the 2000 agreement, "suggesting the importance of the revised provision to the arbitration scheme as conceived by Menard." JA 117.

Remarkably, Menards contends that the "fee-splitting provision is *not in any way connected to* the central purpose of the arbitration clause, which is to settle disputes out of court." Menards' Br. 38 (emphasis added). Menards can provide no justification for this extreme assertion. The fee and cost-splitting provision is located in the section of the employment agreement concerning arbitration. Moreover, arbitration costs only arise when disputes are brought to an arbitral forum, and attorneys' fees are

normally awarded to the prevailing plaintiff in an employment discrimination litigation brought in a judicial forum, which the arbitration clause is designed to avoid. Thus, the fee and cost-shifting provision necessarily is "connected to" arbitration and has a profound impact on Faber's ability to vindicate his federal rights in the arbitral forum.

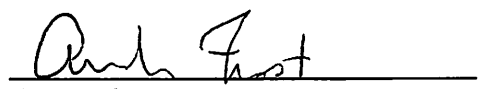
Menards further argues that there is no "compelling legal authority or meaningful analysis by the court to conclude that the fee-splitting provision 'defines the whole arbitration scheme.'" Menards Br. 38-39 (quoting JA 115). Again, Menards has made an empty assertion that is unsupported by review of the district court's decision in this case. As described above, the district court's analysis of this issue was based on the significant role the fee and cost-splitting provision played in the contract between Menards and Faber. Moreover, Menards does not dispute that, under Iowa law, unconscionable provisions of a contract are not always severable. Menards concedes that if "a contract or term thereof is unconscionable at the time the contract is made a court may refuse to enforce the contract." Menards' Br. 29 (citing *C & J Fertilizer*, 227 N.W. 2d at 180), and acknowledges that other courts have also concluded that unconscionable terms are not severable from arbitration agreements. Menards' Br. 40 (citing *Hooters of America, Inc. v. Phillips*, 173 F.3d 933, 940 (4th Cir. 1999)); *see also Alexander,* 341

F.3d at 271. Thus, Menards has not demonstrated that the district court made erroneous factual findings or misconstrued Iowa law when concluding that the arbitration provision was not severable.

CONCLUSION

For the foregoing reasons, the decision of the district court should be affirmed.

Respectfully submitted,



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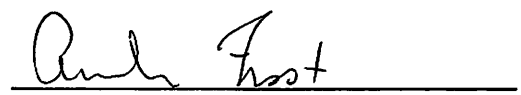

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CERTIFICATE OF SERVICE

The undersigned certifies that on the 10th day of November 2003, two copies of the Appellee's Brief was served by Federal Express to counsel for Appellant at the address below.

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