Journal of Dispute Resolution

Volume 2012 | Issue 1

Article 13

2012

Unconscionable Construction: How the Ninth Circuit Evades the FAA by Severing Arbitration Agreements as Unconscionable Note

Daniel B. Mitchell

Follow this and additional works at: https://scholarship.law.missouri.edu/jdr

Part of the Dispute Resolution and Arbitration Commons

Recommended Citation

Daniel B. Mitchell, *Unconscionable Construction: How the Ninth Circuit Evades the FAA by Severing Arbitration Agreements as Unconscionable Note*, 2012 J. Disp. Resol. (2012)
Available at: https://scholarship.law.missouri.edu/jdr/vol2012/iss1/13

This Note is brought to you for free and open access by the Law Journals at University of Missouri School of Law Scholarship Repository. It has been accepted for inclusion in Journal of Dispute Resolution by an authorized editor of University of Missouri School of Law Scholarship Repository. For more information, please contact bassettcw@missouri.edu.

Unconscionable Construction: How the Ninth Circuit Evades the FAA by Severing Arbitration Agreements as Unconscionable

Bridge Fund Capital Corp. v. FastBucks Franchise Corp.[1]

I. INTRODUCTION

Some courts engage in a practice of covert construction to vindicate state policies in lieu of applying the Federal Arbitration Act (FAA).[2] By doing so, they abuse the FAA's savings clause and exhibit hostility to arbitration and the strong national policy in favor of arbitration.[3] One example of covert construction to abuse the FAA's savings clause is the widespread use of the doctrine of unconscionability to refuse enforcement of contractual terms that do not "shock the conscience."[4] The doctrine of unconscionability is a sloppy tool, and is only appropriate when used as a last resort.[5] When used excessively, the doctrine looks more like a way for judges to exploit the FAA's savings clause in order to avoid arbitration and reach the merits of a dispute and affect social policies.

Bridge Fund illustrates a recent manifestation of an ongoing judicial hostility to arbitration. As the Supreme Court has developed its FAA jurisprudence to limit the severance of arbitration agreements, many lower courts have continued to develop legal justifications to circumvent these restrictions. The FAA's savings clause does afford some latitude for severance of arbitration agreements, but the Supreme Court has not yet defined the limits of the savings clause, nor whether the general contract defenses and their justifications are sufficient to supersede FAA policy. *Bridge Fund* shows how the doctrine of unconscionability is being used to advance state consumer protection policies not as a last resort to protect individual parties from unconscionable agreements. Without a strong tether to objective standards, using the doctrine of unconscionability to sever arbitration

1. Bridge Fund Capital Corp. v. FastBucks Franchise Corp., 622 F.3d 996 (9th Cir. 2010).

2. Federal Arbitration Act, 9 U.S.C. §§ 1-16 (2010).

3. Federal Arbitration Act savings clause, 9 U.S.C. § 2; Moses H. Cone Mem'l Hosp. v. Mercury Const. Corp., 460 U.S. 1, 24 (1983) ("Section 2 [of the Federal Arbitration Act] is a congressional declaration of a liberal federal policy favoring arbitration agreements . . . ."); *see* Karl Llewellyn, Book Review, 52 HARV. L. REV. 700, 703 (1939) (reviewing O. PRAUSNITZ, THE STANDARDIZATION OF COMMERCIAL CONTRACTS IN ENGLISH AND CONTINENTAL LAW (1937)) (paraphrasing Llewellyn's often quoted sentence "covert tools are never reliable tools").

4. SAMUEL WILLISTON, WILLISTON ON CONTRACTS § 18:10 (Richard Lord ed., 4th ed. 2001) (summarizing state by state definitions of what is unconscionable, some notion of shocking to the conscious is common throughout).

5. An example of an appropriate use of unconscionability to invalidate an arbitration agreement would be when the arbitration agreement is clearly designed by a party of superior bargaining power to avoid the courts and serves solely as an exculpatory mechanism. In effect the weaker party never has an opportunity for redress for any breach by the stronger party, yet is bound to honor their own obligations or face sanction.

agreements does little to put drafters of arbitration agreements on notice on how to draft agreements that will survive an unconscionability analysis. The more difficult it becomes to draft an arbitration agreement that withstands scrutiny from courts hostile to arbitration, the more expensive arbitration becomes, making it appealing which is the exact opposite of the purported purpose of the FAA. *Bridge Fund* represents an intrusion on party autonomy to choose how they will resolve their disputes and consequently endangers the use of arbitration as a viable alternative to traditional litigation.

II. FACTS AND HOLDING

Bridge Fund Capital Corporation and Big Bad 1, LLC (Bridge Fund) and FastBucks Franchise Corporation (FastBucks) found themselves in California state court two years after entering in a payday loan franchise agreement, despite an arbitration clause in the franchise agreement.[6] FastBucks successfully removed the case to the Eastern District of California seeking to compel arbitration pursuant to the terms of the franchise agreement.[7] The district court denied the motion to compel arbitration, finding four of the five clauses in the arbitration agreement to be unconscionable under California law, therefore making the arbitration agreement severable from the franchise agreement.[8] FastBucks appealed the denial of its motion to compel arbitration to the Ninth Circuit Court of Appeals.[9]

FastBucks presented three arguments to the Ninth Circuit: whether the question of arbitrability is to be determined by the arbitrator when no express challenge to the arbitration agreement is in the complaint;[10] whether the district court abused its discretion by invalidating the entire arbitration agreement rather than severing unconscionable provisions;[11] and whether the franchise agreement's choice of law provision should have compelled the application of Texas and not California law of unconscionability.[12]

The Ninth Circuit unanimously held against FastBucks with respect to each issue, holding that submission of the issues to an arbitrator under the rules of the agreement would adversely affect fundamental policies of California and therefore be unconscionable to enforce.[13] First, the Ninth Circuit dispatched FastBucks'

6. Bridge Fund Capital Corp. v. Fastbucks Franchise Corp., No. 2:08-cv-00767-MCE-EFB, 2008 WL 3876341 (E.D. Cal. Aug. 20, 2008), *aff'd and rem'd*, 622 F.3d 996 (9th Cir. 2010). Bridge Fund alleged "breach of written franchise contracts, fraud and deceit, negligent misrepresentation, violation of the California Franchise Investment Law ("CFIL"), unfair trade practices under [California law]," and that certain provisions of the contract were unconscionable. *Id.* at *1-*2.

7. Bridge Fund Capital Corp. v. FastBucks Franchise Corp., 622 F.3d 996, 998 (9th Cir. 2010).

8. *Id.* at 998-99 ("[T]hat (1) the arbitrator, a Texas bar member, shall hear the dispute in Dallas County, Texas; (2) the claims subject to arbitration shall not be arbitrated on a class-wide basis; (3) while the Franchisor may institute an action for temporary, preliminary, or permanent injunctive relief, the franchisee is not afforded the same remedy; (4) there is a one year statute of limitations for all claims; and (5) the parties are limited to recovery of actual damages, and waive any right to consequential, punitive or exemplary damages.").

9. *Id.* at 998.

10. *Id.*

11. *Id.*

12. *Id*

13. *See id.* at 1003-04. Interestingly *Bridge Fund* never made any allegation that the decision of an arbitrator would lead to an unconscionable outcome.

argument that the issue of arbitrability was for an arbitrator to decide, holding that its "crux of the complaint" rule allows a court to distinguish a specific challenge to an arbitration agreement term from a challenge to the agreement as a whole, despite the challenge not appearing in the complaint.[14] Affirming the district court's application of California law, the Ninth Circuit held that the fundamental nature of the state policies at issue, specifically unconscionability and fair business practices, gave California a "materially greater interest" in the disposition of the case.[15] Lastly, the Ninth Circuit found no abuse of discretion by the district court, because of the latitude traditionally given to the district court to sever unconscionable provisions or refuse enforcement altogether.[16] In short, the Ninth Circuit held that the district court could, *sua sponte,* construe a challenge to a contract as a whole to include a specific challenge to an arbitration clause, and that the absence of one state's fundamental state policies from a choice of law provision is sufficient to be construed as unconscionable.[17] Furthermore, the Ninth Circuit reached its decision despite the sophistication of the parties who dealt at arm's length and agreed to use arbitration to resolve their disputes.[18]

III. LEGAL BACKGROUND

Arbitration agreements have been in use in the United States since the inception of the country, but it was not until 1925 with the passage of the FAA that arbitration agreements grew teeth.[19] One of the purposes of the FAA was to curb long standing judicial hostility against mandatory arbitration agreements.[20] Application of the FAA is tied to Congress' power to regulate interstate commerce.[21] Revocability of arbitration agreements which fall within the protection of the FAA

14. *Id.* at 1001-02 ("[I]n cases in which the arbitration clause's invalidity is an entirely distinct issue from the contract claims . . . we would not generally expect the plaintiff to raise claims against the validity of the arbitration clause in the complaint, because such claims generally would be unrelated to plaintiff's principle prayer for relief.").

15. *Id.* at 1003-04 (this "materially greater interest" exists because application of another state's law could potentially impair California policies); *see also* RESTATEMENT (SECOND) OF CONFLICT OF LAWS § 187 cmt. g (1971) ("To be 'fundamental,' a policy must in any event be a substantial one.").

16. *Id.* at 1005-06 (The court was convinced that the district judge did not abuse his discretion, rationalizing that severability just offending clauses in this instance would have "left almost nothing to the arbitration clause.").

17. The importance here is the issue of arbitrability. Arbitrators are tasked with deciding if the contract is valid if a challenge is made, while a court is limited to deciding challenges to the arbitration agreement. If the arbitration agreement is valid then the court cannot reach the merits of the dispute, but if the arbitration agreement is not valid and severable, then the court may proceed to the merits of the dispute. *See infra* Part III A.

18. *Bridge Fund,* 622 F.3d at 996. I highlight that the two parties here are both businesses and therefore should not be looked at in the same way as one might expect when having an individual entering into an agreement with a corporate entity.

19. Imre S. Szalai, *Modern Arbitration Values and the First World War,* 49 AM. J. LEGAL HIST. 355, 355 (2007).

20. *See generally id* (discussing how activists for arbitration reform capitalized on the post-World War I political climate by championing that commercial arbitration agreements could be a means to end and prevent future wars).

21. Perry v. Thomas, 482 U.S. 483, 489 (1987) ("Section 2 . . . embodies a clear federal policy of requiring arbitration unless the agreement to arbitrate is not part of a contract evidencing interstate commerce or is revocable 'upon such grounds as exist at law or in equity for the revocation of any contract.'"); *see* 9 U.S.C. § 2 (2010).

is limited to "grounds [that] exist at law or in equity for the revocation of any contract"; among these grounds is the doctrine of unconscionability.[22] Currently, challenges to arbitration agreements are able to exploit the FAA's savings clause because of a lack of uniformity as to what general principles of revocability—and, by implication, the policies that underlie those grounds of revocability—are sufficient grounds for severing an arbitration clause. [23] The lack of uniformity also presents uncertainty in predicting what kinds of terms will be enforceable in which jurisdictions, and how contractual terms may be construed by courts.[24] To protect against the savings clause swallowing the rule, the Supreme Court has created a scheme where the general contract principles that may invalidate an arbitration agreement cannot be specific only to arbitration agreements.[25]

A. Revocability- Severing an Arbitration Agreement

The Supreme Court in *Prima Paint Corp. v. Flood & Conklin Mfg. Co.* held that federal law was the appropriate source of law when determining the validity of a contract involving interstate commerce and containing an arbitration clause.[26] The Court reasoned that Congress' power to set the substantive rules for adjudication of arbitration agreements logically extended from its power to regulate interstate commerce.[27] The use of federal substantive contract law in *Prima Paint* ensured that contracts containing arbitration agreements would be enforceable, despite state laws to the contrary.[28] The arbitration clause could still be severed but only according to state law principles that apply to all contracts equally.[29] This approach, the Court reasoned, would fulfill the purpose of the FAA "to make arbitration agreements as enforceable as other contracts, but not more so."[30]

Approximately twenty years after *Prima Paint,* the Supreme Court expanded the application of the FAA to state courts by requiring them to apply the same federal substantive law analysis from *Prima Paint.*[31] In *Southland Corp. v. Keat-*

---

22. 9 U.S.C. § 2.

23. *See* Aaron-Andrew P. Bruhl, *The Unconscionability Game: Strategic Judging and the Evolution of Federal Arbitration Law*, 83 N.Y.U. L. REV. 1420, 1436-37 (2008) (invalidation of an arbitration clause must be on grounds applicable to all contracts and not just for arbitration agreements); *see also* William G. Phelps, *Pre-emption by Federal Arbitration Act (9 U.S.C.A. §§ 1 et seq.) of State Laws Prohibiting or Restricting Formation or Enforcement of Arbitration Agreements*, 108 A.L.R. FED. 179 (1992).

24. Phelps, *supra* note 23.

25. Bruhl, *supra* note 21, at 1437 (describing this limitation as a "federal[ly] impose[d] . . . hard-to-monitor duty of evenhandedness").

26. 388 U.S. 395, 403-404 (1967).

27. *Id.* at 405. In its holding the Court noted that challenges of the existence of a valid arbitration agreement because of a fraudulent contract could be determined by a court by using federal substantive law without conflicting with *Erie*, but such a determination would be made by the court and not the arbiter if the fraud alleged "is a fraud in the inducement of the arbitration clause itself." *Id.*

28. *Id.* at 399-400.

29. *Id.* (discussing differing treatments of the "severability" of an arbitration clause under federal substantive law).

30. *Id.* at 404.

31. Southland Corp. v. Keating, 465 U.S. 1, 35 (1984). Some commentators have described this as a "reverse-Erie question." David S. Schwartz, *The Federal Arbitration Act and the Power of Congress over State Courts*, 83 OR. L. REV. 541, 584 (2004) (discussing three methods he observed that "Con-

ing, the Supreme Court reviewed a decision by the California Supreme Court that some specific employment issues could be excluded from arbitration as a matter of public policy.[32] The Supreme Court reversed, reasoning that had this claim been brought in federal court arbitration would have been ordered according to federal substantive law.[33] The Court held that the use of state court proceedings to abrogate the protections of the FAA would promote forum shopping.[34] Additionally, limiting the application of the FAA to federal courts alone would not be consistent with the intent of Congress.[35] Despite expanding the application of the FAA to state courts directly, the Court reaffirmed that the FAA did not preempt all state contract law principles so long as those state principles were the same sort generally applicable to revocation of any provision of a contract. [36]

Southland Keating also exposed a rift among the Supreme Court Justices regarding the extent to which the FAA should be applied. In a separate opinion, Justice Stevens expressed concern that the majority had expanded the intent of Congress.[37] Justice Stevens concurred with the majority that state legislation designed to "undercut" the enforceability of arbitration agreements in general would violate the FAA, but reasoned that general contract principles of law or equity could properly be applied according to state policies.[38] Justice Stevens reasoned that the savings clause in section 2 of the FAA served as an expression of Congress' intent that the FAA does not occupy the entire field of legislation affecting arbitration agreements.[39] State laws that govern the enforceability of all agreements generally would be acceptable because the effect on arbitration agreements would be incident to policies that affect all contracts equally.[40] Justice O'Connor, writing for the dissent, expressed the belief that the FAA was never intended to be applied in state courts, and that the Court had inappropriately pushed federal substantive law onto the states.[41] The majority simply rejected Justice O'Connor's

gress may influence the procedural aspects of federal rights heard in state courts"); *see generally* Eric R. Co. v. Tompkins, 304 U.S. 64 (1938).

32. *Southland Corp.*, 465 U.S. at 5, 20. California's Franchise Investment Law was interpreted by the California Supreme Court to require judicial review of all claims brought under that statute. *Id.*

33. *Id.*

34. *Id.* at 15.

35. *Id.* at 15-16 ("[W]e are unwilling to attribute to Congress the intent, in drawing on the comprehensive powers of the Commerce Clause, to create a right to enforce an arbitration contract and yet make the right dependent for its enforcement on the particular forum in which it is asserted.").

36. *Id.* at 16 n. 11 ("We agree, of course, that a party may assert general contract defenses such as fraud to avoid enforcement of an arbitration agreement. We conclude, however, that the defense to arbitration found in the California Franchise Investment Law is not a ground that exists at law or in equity "for the revocation of *any* contract" but merely a ground that exists for the revocation of arbitration provisions in contracts subject to the California Franchise Investment Law.")

37. *Id.* at 18 (Stevens, J., dissenting) ("[I]t is by no means clear that Congress intended entirely to displace State authority in this field.").

38. *Id.* at 14-21.

39. *Id.*

40. *Id.* at 18-21; *see also* Volt Info. Scis., Inc. v. Bd. of Trs. of Leland Stanford Junior Univ., 489 U.S. 468, 469 (1989) (Supreme Court holding that arbitration agreements must be enforced when properly contracted but rejecting the notion that this is synonymous with enforcement being according to a "certain set of procedural rules" meaning that if an arbitration contract contains a choice of law provision, then that states arbitration rules and laws could apply so long as their effect was not contrary to the intent of the FAA).

41. *Southland Corp.*, 465 U.S. at 33-35.

belief that "a state policy of providing special protection . . . can be recognized without impairing the basic purposes of the federal statute."[42]

The Supreme Court again discussed the limits to enforcing arbitration agreements in *Buckeye Check Cashing, Inc. v. Cardegna*.[43] The Supreme Court of Florida refused to compel arbitration, reasoning that the enforcement of an allegedly unlawful contract by compelling arbitration would be against state policy and general tenants of contract law.[44] The Supreme Court reversed, and in its opinion outlined two acceptable challenges to the validity of an arbitration agreement.[45] The first challenge is an attack against the contract as a whole.[46] This type of challenge will not result in a stay of arbitration because the arbitrator or arbitration panel makes the threshold decision about the validity of the contract as a whole.[47] The second type of challenge is an attack against the arbitration clause itself.[48] The effect of a successful challenge to the arbitration clause alone results in the severance of the arbitration clause while preserving the contract between the parties. Furthermore, a challenge to an arbitration clause alone is decided by the courts and not arbitrators, even if the analysis is similar to deciding the validity of a contract as a whole.[49]

The Supreme Court, reversing, determined that construing the contract as "void or voidable" to avoid enforcement of the arbitration clause would lead to an unnatural reading of the text of the FAA.[50] In dicta, the Court inferred that had the arbitration clause alone been challenged, *Prima Paint*'s severability rule would control and, assuming the arbitration agreement was defective, the same result would have occurred.[51] By voiding an arbitration agreement first—and therefore removing the contract from the scope of the FAA—a court is free to settle the dispute.[52] The lesson from *Buckeye* is that severance of an arbitration agreement is not prohibited by the FAA, and that severance of the arbitration clause must occur before reaching the merits of the container contract dispute so that the contract is beyond the scope of the FAA.[53] Post-*Buckeye*, contract-construction takes on a new dimension. A socially or politically active judiciary can strategically construe arbitration agreements to make them severable, and then use the container contract (whose disputes were expected to be decided in private arbitration) as a vehicle for vindicating state policies.

B. Unconscionability a Covert Tool For Severing Arbitration Agreements

California provides several cases that illustrate the tension a court faces when a contract, subject to compulsory arbitration, implicates a legitimate state inter-

42. *Id.* at 21.
43. 546 U.S. 440 (2006).
44. *Id.* at 443, 446.
45. *Id.* at 444-45, 449.
46. *Id.* at 444.
47. *Id.*
48. *Id.*
49. *Buckeye Check Cashing, Inc.*, 546 U.S. at 445.
50. *Id.* at 446-47.
51. *Id.* at 447.
52. *Id.* at 448-49.
53. *Id.* 445-46.

est.[54] While the Supreme Court was preparing to hear *Buckeye,* the California Supreme Court was deciding *Discover Bank v. Superior Court.*[55] The issue in *Discover Bank* was an arbitration agreement that prohibited any class action proceedings by Discovery Bank customers.[56] The trial court initially entered judgment in favor of Discover Bank, compelling arbitration as required by the judge's understanding of the FAA.[57] However a contradictory opinion by one of California's appellant courts resulted in a stay of arbitration.[58] The Second California District Court of Appeals panel affirmed the lower court's initial decision to compel arbitration, agreeing with the assessment that the FAA preempted California's policy on class action waivers.[59] Faced with a split among its lower courts, the California Supreme Court granted an appeal.[60]

The first observation of the California Supreme Court in *Discover Bank* was not about the validity of the arbitration agreement, but, rather, the potential for high power parties to use adhesive contracts to take advantage of consumers and the possible use of arbitration to prevent judicial review of state public policy claims.[61] The court then analyzed California's public policy on class action suits to determine the enforceability of class action waivers.[62] The court reasoned that the effect of a contract term which prohibited class action lawsuits was to prevent complaints from being brought forward, thereby preventing less powerful parties from vindicating their rights, an outcome contrary to public policy.[63] As a result, the class action waiver in *Discover Bank* was found to be procedurally and substantively unconscionable.[64] Holding the arbitration agreement unconscionable, the second issue addressed by the court was the preemptive limits of the FAA.[65] The court found the class action waiver provision void and severable from the contract as a whole, because the use of arbitration without the opportunity for class action litigation would prevent the judicial protection of consumers, an unconscionable outcome.[66] With the arbitration agreement severed, the contract was no longer within the protective scope of the FAA and the case was remanded for

54. Despite the opinions that follow, there seems to be an underlying hostility to the contract as a whole which is used as part of the reasoning that the arbitration agreement is unconscionable.

55. 113 P.3d 1100, 1103-04 (Cal. 2007) (alleging that such class action waivers were unconscionable and unenforceable under California law).

56. *Id.* at 1103-04.

57. *Id.* at 1104.

58 *Id.* Unfortunately for Discover Bank, California's Fourth District Court of Appeals found a near identical class action waiver unconscionable, so the district court ordered a stay of the arbitration until its parent district court, the California Second District Court of Appeals, made a ruling.

59. *Id.* at 1105 (noting that under some circumstances a class action waiver could be unconscionable and therefore be severable).

60. *Id.*

61. *Id.* at 1105-06.

62. *Id.*

63. *Id.* The court reasoned that because a typical dispute between the parties would be over a small sum of money the arbitration clause disincentivizes individual claimants from vindicating their rights. *Id.*

64. *Id.* at 1108-09. In California an adhesive contract is almost always considered at least procedurally unconscionable, meaning that any substantively unconscionable provision would fulfill the normal two prong test of procedurally and substantive unconscionability needed to construe a term as void.

65. *Id.* at 1105-17.

66. *Id.*

litigation.[67] Nowhere in its analysis did the California Supreme Court require suggest that an arbitration agreement coupled with a class action waiver actually or even apparently act as an "exculpatory contract clause . . . contrary to public policy" in order to be unconscionable.[68]

The principle of *Discover Bank* mirrors the principle later implied by the Supreme Court in *Buckeye*: unconscionability is a valid way to void and sever an arbitration agreement.[69] This principle was ratified by the Ninth Circuit in *Shoyer v. New Cingular Wireless.*[70] *Shoyer*, like *Discover Bank*, centered on a challenge to an arbitration clause that also served as a class action waiver.[71] Applying California law, the Ninth Circuit looked to the analysis of *Discover Bank* and its three part test to determine whether a class action waiver contained in an adhesion contract was unconscionable.[72] In holding that the class arbitration waiver in *Shoyer* fulfilled all three elements of the *Discover Bank* test, the Ninth Circuit left open the possibility that an arbitration agreement/class action waiver provision could be unconscionable even if all three elements of the *Discover Bank* test were not satisfied.[73] The Ninth Circuit also asserted that *Discover Bank* did not require that all adhesive arbitration agreements be *per se* unconscionable, although "absent unusual circumstances, use of a contract of adhesion establishes a minimal degree of procedural unconscionability notwithstanding the availability of market alternatives. . . ."[74]

The Ninth Circuit in *Shoyer,* like the California court in *Discover Bank,* also addressed the question of whether the FAA preempted the use of unconscionability to revoke an arbitration clause.[75] The Ninth Circuit echoed the reasoning of Justice Stevens in *Buckeye*, holding that § 2 of the FAA serves as a savings clause, granting the states use of generally applicable contract defenses against arbitration agreements, and that the intent of the FAA is simply to put arbitration agreements on the "same footing" as other contracts.[76] Allowing a class action waiver to be effective merely because of the existence of an arbitration clause,

67. *Id.* at 1108-09.

68. *Id.* at 1108-17.

69. *See* Buckeye Check Cashing, Inc. v. Cardegna, 546 U.S. 440, 445-48 (2006). Consider, though, that the ultimate outcome in *Buckeye* was that the contract as a whole would not be enforced while in *Discover Bank* the contract as a whole would remain in force and be decided in court.

70. Shroyer v. New Cingular Wireless Serv., Inc., 498 F.3d 976, 981 (9th Cir. 2007) ("It is well-established that unconscionability is a generally applicable contract defense, which may render an arbitration provision unenforceable."). AT&T acquired Cingular before *Shoyer* was heard by the Ninth Circuit.

71. *Id.*

72. *Id.* at 981-83. The three-part test included: "(1) whether the agreement is 'a consumer contract of adhesion' drafted by a party that has superior bargaining power; (2) whether the agreement occurs 'in a setting in which disputes between the contracting parties predictably involve small amounts of damages'; and (3) whether 'it is alleged that the party with the superior bargaining power has carried out a scheme to deliberately cheat large numbers of consumers out of individually small sums of money.'" *Id.* at 983 (quoting Cohen v. DirecTV, Inc., 142 Cal. App. 4th 1442, 1451-53, 48 Cal. Rptr. 3d 813 (Cal. Ct. App. 2006)).

73. *Id.* at 983.

74. *Id.* at 985 ("[T]he doctrine [of unconscionability] has both a procedural and a substantive element, the former focusing on oppression or surprise due to unequal bargaining power, the latter on overly harsh or one-sided results.").

75. *Id* at 987-93.

76. *Id.* at 990. Keep in mind this savings clause concept was first voiced by Justice Stevens who was dissenting in *Southland Keating*.

when such a waiver would not be allowed in any other contract, would put arbitration agreements on a different footing than an ordinary contract.[77] As a result, the Ninth Circuit held the *Discover Bank* test applicable to all class action waivers, regardless of the existence of an arbitration provision.[78] The Ninth Circuit flatly rejected the implied preemption argument that application of *Discover Bank* to invalidate class action waivers would obstruct the intent of the FAA by "reduc[ing] the efficiency and expeditiousness of arbitration in general."[79]

IV. INSTANT DECISION

After losing its motion to compel arbitration, FastBucks appealed to the Ninth Circuit.[80] Addressing the issue of arbitrability, the Ninth Circuit engaged in analysis of when a dispute is in the realm of the arbitrator or the court to decide.[81] The court quickly distinguished *Buckeye* from the present case by highlighting the difference between challenges to the arbitration agreement (construed into the challenge to the whole contract by the court) from the direct challenges to the contract as a whole (as in *Buckeye*).[82] Because challenges to the arbitration agreement were not the same as the challenges to the contract as a whole, the Ninth Circuit held the ultimate question of arbitrability was properly before the court.[83]

The court then balanced competing policy implications presented by the choice of law provision of the arbitration agreement.[84] The Ninth Circuit found California to have the greater material interest by determining that application of Texas law in this dispute would cause fundamental public policies of California to suffer most.[85]

Lastly, the Ninth Circuit applied *Discover Bank* to determine if the arbitration agreement was unconscionable and severable. Because the contract was adhesive in nature, the court found the arbitration provision procedurally unconscionable.[86] The arbitration agreement was construed as substantively unconscionable because of the one sided nature of the waiver of statutory rights and the denial of injunctive relief to Bridge Fund.[87] The court concluded that severing only the offending

---

77. *Id.*

78. *Id.* at 988.

79. *Id.*

80. Bridge Fund Capital Corp. v. FastBucks Franchise Corp., 622 F.3d 996, 998 (9th Cir. 2010).

81. *Id.* at 1000-02.

82. *Id.*; *see also supra* Pt. III.A., ¶¶ 4-5 (discussing Buckeye Check Cashing, Inc. v. Cardegna, 546 U.S. 440 (2006)).

83. *Bridge Fund*, 622 F.3d at 1002 ("Plaintiffs' argument that the arbitration provision contained in the franchise agreement was both procedurally and substantively unconscionable . . . are clearly arguments marshaled against the validity of the arbitration clause alone, and separate from Plaintiffs' fraudulent inducement claims.").

84. *Id.* Weighing the interests of the parties in the enforcement of the choice of law provision against the possible implication of fundamental policy of the state. The purpose was to see if a "substantial relationship" exists. If the relationship is not "substantial" then the forum state's law (California) is applicable when it has a "materially greater interest" in the outcome of the controversy.

85. *Id.* at 1003-04 (discussing the public policy "against enforcing class action waivers . . . in arbitration agreements").

86. *Id.* at 1004. Although not dispositive, an adhesive contract in California is almost always considered procedurally unconscionable.

87. *Id.* at 1004-05. Bridge Fund was considered the weaker party to the contract because it did not draft the agreement and it was essentially written as a take it or leave it deal. *Id.*

provisions of the arbitration clause to save the rest of the arbitration agreement would be impractical because the agreement would be simply agreeing to arbitrate, without anything more to guide the proceeding.[88] As a result, the Ninth Circuit affirmed the lower court's denial to compel arbitration and remanded the case to be heard by the trial court for a decision on the merits.[89]

V. COMMENT: AVOIDING COVERT CONSTRUCTION – CHANGING OUR APPROACH TO THE FAA

For over 50 years the U.S. Supreme Court has held that an arbitrator is the decision maker for the determination of the enforceability of a contract containing an arbitration agreement.[90] Meanwhile, revocation of an arbitration clause based on general principles of state contract law remains open to judicial review thanks to the FAA's savings clause, which begs the question to what extent state law can be used to void an arbitration clause.[91] Arbitration has the potential to be in conflict (if not actually in conflict already) with many public policy goals such as consumer protection laws or class action litigation devices.[92] The Ninth Circuit has found such importance in state policies such as consumer protection and franchise investment that a violation of them would be unconscionable and therefore sufficient to sever an arbitration agreement, thus allowing the court to affect public policy by reaching the merits of case. This approach seems to cast doubt on the Ninth Circuit's trust in arbitration and creates tension with the pro-enforcement decisions of the Supreme Court. The severance of an arbitration clause changes the nature of a contract, and the impact of the resolution between the parties should not be liberally engaged in, or some parties may simply choose to forgo attempts to enter arbitration agreements because of the potential for added cost without much confidence in the ability to actually compel arbitration.

The doctrine of unconscionability is highly subjective, and at its most basic level simply a justification for not enforcing a contract or term that is beyond the pale.[93] An unconscionability analysis is predictive in nature and results-oriented, unlike determining the volition of the parties making an agreement.[94] The opinion

---

88. *Id.* at 1006.

89. *Id.*

90. Prima Paint Corp. v. Flood & Conklin Mfg. Co., 388 U.S. 395, 400-05 (1967).

91. *See generally* Southland Corp. v. Keating, 465 U.S. 1 (1984); Buckeye Check Cashing, Inc. v. Cardegna, 546 U.S. 440 (2006); Preston v. Ferrer, 552 U.S. 346 (2008).

92. *Southland Corp.*, 465 U.S. at 7 ("Contracts to arbitrate are not to be avoided by allowing one party to ignore the contract and resort to the courts. Such a course could lead to prolonged litigation, one of the very risks the parties, by contracting for arbitration, sought to eliminate."); *see generally* Mo Zhang, *Contractual Choice of Law in Contracts of Adhesion and Party Autonomy*, 41 AKRON L. REV. 123, 151 (2008) (stating that other potential issues on the Court's mind include Federalism, and political considerations such as some Congressional hostility to the extent that the FAA has been found by the Court to be applicable to the states); *see also* Arbitration Fairness Act of 2009, S. 931, 111th Cong. § 2 (2009) (finding that the US Supreme Court has changed the original meaning and intent of Congress when it passed the FAA, and among other things that the use of mandatory arbitration "undermines the development of public law for civil rights and public rights. . . .").

93. E. ALLEN FARNSWORTH, CONTRACTS § 4.28 (Aspen 3d. ed. 1999) ("[T]he term is undefinable.").

94. *See* RESTATEMENT (SECOND) OF CONTRACTS § 178 cmt. a (1981) ("Occasionally, on grounds of public policy, legislation provides that specified kinds of promises or other terms are unenforceable.");

of *Bridge Fund* is short on how compelling arbitration would be unconscionable, long why the court, not an arbitrator, should decide the case, and looks like an exploitation of the FAA savings clause to reach not only the merits of the case, but also external policy considerations implicated by the contract.[95]

Enforcing adhesive contracts has been a bitter pill for some courts to swallow since the early 1900s, despite the fact that standardized contracts are often more efficient and practical than negotiating and drafting a new contract for every transaction.[96] In part, this reluctance can be attributed to judges wedded to the common law ideal of an individual bound to an agreement where presumably most of the terms of the contract were negotiated.[97] This idealized concept does not take into account the realities of the modern world; it is rare that no bargaining disparities exist between parties, but still completely foreseeable that all parties desire to "exclude or control the irrational factor[s] [of] litigation."[98] The world has changed; choices for essential goods and services have become fewer while bargaining disparity between parties has become greater.[99] Take it or leave it, bargaining is no longer a viable option to most consumers.[100] In the early twentieth century, courts reacted to prevent "freedom to contract" from becoming a "one sided privilege" and developed a "highly contradictory and confusing" common law on form contracts that we deal with today.[101] Despite efforts to streamline and standardize doctrines such as unconscionability, the holdings of *Buckeye* and *Bridge Fund* show the truth of Professor Kessler's observation that "freedom of contract must mean different things for different . . . contracts."[102]

Some scholars have identified the use of unconscionability as one of the most prevalent challenges to the enforcement of arbitration agreements.[103] The use of unconscionability to sever arbitration agreements has also been recognized as a

---

see also id. § 162(1), (2) ("[M]isrepresentation is fraudulent if the maker intends . . . to induce a party to manifest his assent[.]").

95. *See generally* Bridge Fund Capital Corp. v. FastBucks Franchise Corp., 622 F.3d 996 (9th Cir. 2010); *see also Buckeye Check Cashing, Inc.*, 546 U.S. at 444 n. 11 (discussing the importance of valid acceptance of the arbitration agreement as opposed the validity of the contract as a whole).

96. Friedrich Kessler, *Contracts of Adhesion – Some Thoughts About Freedom of Contract*, 43 COLUM. L. REV. 629, 632 n.13 (1943) (crediting E.W. Patterson as the originator of the term "contract of adhesion").

97. *Id.* at 632.

98. *Id.*; *see also* JOHN EDWARD MURRAY, MURRAY ON CONTRACTS § 97 (2001).

99. Kessler, *supra* note 96, at 633, 640-41. By choices becoming smaller Kessler meant that as businesses tend to operate essentially the same, the choices for the consumer in what can be truly bargained for is limited in all practicality even if the selection of goods available increases.

100. *Id.*

101. *Id.*

102. *Id.* at 642. Professor Kessler didn't suggest one way or another if adhesive contracts should be given special consideration by a court. Instead he simply pointed out that the economic and business realties of the modern world presented a more complex environment than traditional common law principles to contract formation and enforcement gave guidance. Kessler seemed to imply that the legislature was the key to solving this issue by settling what "dogma" should be followed.

103. Aaron-Andrew P. Bruhl, *The Unconscionability Game: Strategic Judging, and the Evolution of Federal Arbitration Law*, 83 N.Y.U. L. REV. 1420, 1466 (2008); *see also* William H. Baker, *Class Action Arbitration*, 10 CARDOZO J. CONFLICT RESOL. 335 (2009) (explaining the trend of striking class action waiver in arbitration agreements as unconscionable).

potential tool for a sort of arbitration-litigation forum shopping.[104] The cost to defend the enforceability of an arbitration agreement in a court hostile to arbitration court provides leverage in negotiation and discourages the use of arbitration.[105] California's law on unconscionability represents a fundamental concept of contract law: society does not wish to allow a wrongdoer to absolve themselves of liability by operation of law in the enforcement of a contract.[106] This concept makes sense, but the instant case lacks even an allegation that the arbitration serves as an exculpation clause. Instead, the Ninth Circuit held that compelling arbitration according to the terms of the agreement (in large part because of the "adhesive" form of the agreement) is unconscionable because arbitration would adversely impact the policies of California.[107] This post hoc interjection of the court in the bargaining process appears to be a departure from the "freedom of contract" principles that previous courts tried to preserve.[108]

One of the purposes of the FAA was to put arbitration agreements on "equal footing" with ordinary contracts.[109] However, according to the logic of *Shoyer*, an adhesion contract is almost automatically procedurally unconscionable and becomes substantively unconscionable when compelling arbitration would be contrary to any public policy.[110] Although the Ninth Circuit has yet to hold that all arbitration clauses in an adhesion contract are *per se* unconscionable, a sample of other cases where the Ninth Circuit has used unconscionability to sever arbitration agreements lends to a cynical view that the court is engaging in covert construction to use unconscionability to sever an arbitration agreement and use the dispute to further state policies.[111] Surely Congress did not envision putting arbitration

104. *See* Bruhl, *supra* note 103, at 1466; *see also* Southland Corp. v. Keating, 465 U.S. 1, 14-16 (1984) (discussing the potential for forum shopping if the FAA were construed as only a "procedural remedy in the federal courts" instead of binding on state courts as well).

105. *See* Szalai, *supra* note 19; *see also* Shroyer v. New Cingular Wireless Serv., Inc., 498 F.3d 976, 981 (9th Cir. 2007) ("It is well-established that unconscionability is a generally applicable contract defense, which may render an arbitration provision unenforceable."). Even if on later review the decision to sever the arbitration agreement is overturned, the damage is done. After the added time and expense of litigation, the party who was denied arbitration may well decide that one litigation is more cost effective than litigating a motion to compel and even is successful having to pay for arbitration and risk losing in that proceeding.

106. CAL. CIV. CODE ANN. § 1668 (2006) ("All contracts which have for their object, directly or indirectly, to exempt anyone from responsibility for his own fraud, or willful injury to the person or property of another, or violation of law, whether willful or negligent, are against the policy of the law.").

107. Bridge Fund Capital Corp. v. FastBucks Franchise Corp., 622 F.3d 996, 1006 (9th Cir. 2010) ("Fastbucks would not suffer any *undeserved* detriment by being forced to litigate this case in California court. Although Fastbucks's arbitration scheme is not illegal, it is inconsistent with California public policy concerning the rights of California franchisees.").

108. Kessler, *supra* note 96, at 639. Or, as Professor Kessler put it, those courts convinced about their role in contract law will be convinced only by that which supports their view.

109. Laster v. AT&T Mobility LLC., 584 F.3d 849, 857-58 (9th Cir. 2009).

110. *Shoyer*, 489 F.3d at 982; *see also* Zhang, *supra* note 92, at 153 (discussing how when courts "employ a sliding scale analysis with regard to the presence of the procedural and substantive components of unconscionability – that is, the more significant one is, the less significant the other need be.").

111. *See Laster*, 584 F.3d at 849; *see also Shoyer*, 498 F.3d at 976. It seems the Ninth Circuit has simply made it an academic exercise of holding arbitration clauses in adhesion contracts to be unconscionable, by using the adhesive contract as proof of procedural unconscionability and then inserting a competing state interest that may be implicated as proof of the substantive unconscionability of private arbitration.

agreements on "equal footing" with other contracts only when a dispute might not further a state policy.[112] If a challenge to an arbitration agreement for being "voidable" is insufficient to deny arbitration (as in *Buckeye*), it does not follow that a challenge to an arbitration clause for any grounds other than volition should be decided by anyone other than the arbitrator.[113]

Some scholars believe that Congress should act to clarify its intent, or perhaps change the FAA to effectively reverse *Southland Keating*.[114] If the Supreme Court continues to bear the burden of clarifying the FAA, one solution might be to extend its prior holdings and find federal substantive contract law principles to be the universal standard in determining all challenges to both arbitration agreements as a whole and arbitration clauses individually.[115] This could create a (more) unified concept of what is unconscionable, to be applied evenly to all arbitration agreements affecting interstate commerce.[116] Such a decision would also limit forum shopping by those trying to compel arbitration in U.S. District Court and those seeking to avoid arbitration in state court.[117]

Professor Andrew Bruhl identified several other methods that the Supreme Court could use to deal with the rising tide of unconscionability as a method of challenging class action waiver arbitration agreements.[118] One method in particular appears most consistent with the Supreme Court's treatment of the FAA and utilizes the so called "separability doctrine" to shift an unconscionability determination from the court to an arbitrator. Professor Bruhl's proposal requires a high degree of confidence in the arbitration process and trusts that an arbitrator will act fairly, impartially, and, if necessary, against his own interests.[119] Until Congress takes action or the Supreme Court provides more guidance, it is likely that courts such as the Ninth Circuit will continue to use the doctrine of unconscionability as a tool to sever arbitration agreements from standardized contracts and decide the merits of the case. There must be some objective forewarning of the contours of unconscionability to allow parties the greatest opportunity to contract out of litiga-

---

112. *Id.* This not only looks like analysis of whether the arbitrator will decide the issue incorrectly, but also hints at an undertone that there is a limit to what parties can bargain for, or at least bargain to arbitrate over.

113. *See* Buckeye Check Cashing, Inc. v. Cardegna, 546 U.S. 440, 448-49 (2006) ("It is true, as respondents assert, that the *Prima Paint* rule permits a court to enforce an arbitration agreement in a contract that the arbitrator later finds to be void. But it is equally true that respondents' approach permits a court to deny effect to an arbitration provision in a contract that the court later finds to be perfectly enforceable. *Prima Paint* resolved this conundrum-and resolved it in favor of the separate enforceability of arbitration provisions."); *see also* Baker, *supra* note 103, at 335 (providing an overview of recent developments in the area of class arbitration including general arguments in favor and against such proceedings).

114. Bruhl, *supra* note 23, at 1487; *see, e.g.*, Arbitration Fairness Act of 2009, S.B. 931, 111th Cong. § 2(5)(2009).

115 Bruhl, *supra* note 23, at 1483-87. In no way does this author suggest that this would be a preferred solution.

116. *Id.*

117. *Id.; see also* Southland Corp. v. Keating, 465 U.S. 1, 7 (1984) (requiring states to apply substantive federal contract law principles for all arbitrations that would fall under the FAA).

118. *See generally* Bruhl, *supra* note 23.

119. *Id* at 1470-72. The issue of an arbitrator making a determination of if he or she can hear a dispute has clear conflict of interest and ethical dilemmas, compounded by the fact that for the most part, arbitration decisions are final and binding.

tion and into arbitration.[120] More guidance on the use of an "undefinable" standard to invalidate arbitration agreements is needed to counter the appearance, if not actual use, of "covert tools" that nullify the parties' abilities to choose their own method of dispute resolution.[121]

VI. CONCLUSION

When arbitration is bargained for, the effect of an arbitration decision on unnamed parties should not be relevant; the decision is not binding on third parties. Unless it is clear that arbitration is being used to discourage parties from bringing legitimate claims, or is merely a screen from liability, enforcement should not depend on other policies not immediately related to the parties.[122] Unconscionability as a means to sever arbitration agreements appears to be a clumsy tool and should be used sparingly to avoid stretching the concept of what is unconscionable beyond what little consensus there is on the subject. If unconscionability is to be the basis of non-enforcement, it should be limited to instances where compelling arbitration would be unconscionable to one of the parties.

Modern economic practices require the use of standardized contracts. Arbitration avoids the cost and time of litigation and offers the potential for personalized justice that cannot be replicated in the court system. Without predictability of what terms will survive a searching unconscionability analysis, challenges to arbitration agreements raise the overall cost of arbitration, and also diminish the incentives to arbitration that the FAA was drafted to protect. Arbitration should not become an exculpation device for the powerful, but the use of discreet and subjective principles to sever an arbitration agreement is likely to lead only to more complex contractual language, or a movement away from arbitration altogether. A system without clear rules for severability detracts from the "promot[ion] [of] . . . efficient and expeditious resolution of claims," and unnecessarily creates conflict between federal and state policies.[123]

DANIEL B. MITCHELL

---

120. Bruhl, *supra* note 23, at 1479 (providing an example of a circumstance in which a party with clearly superior bargaining power is using arbitration as a pretense to contract itself out of liability as described by the court in *Discover Bank*).

121. *See* E. ALLEN FARNSWORTH, CONTRACTS § 4.28 (Aspen 3d. ed. 1999) (attempting to show that unconscionability is as a "term . . . undefinable.").

122. An example of an intent to avoid liability would be in circumstances were little money is normally in dispute and the terms of the arbitration agreement make it unlikely or burdensome to vindicate ones rights in arbitration. *See generally* AT&T Mobility LLC v. Concepcion, 131 S. Ct. 1740, 1761 (2011) (discussing how use of arbitration can be used to disincentivize claims).

123. Laster v. AT&T Mobility LLC, 584 F.3d 849, 857 (9th Cir. 2009) *cert granted,* 130 S. Ct. 3322, 176 L. Ed. 2d 1218 (U.S. 2010). *Laster* preceded *FastBucks* and was heard by the US Supreme Court as AT&T Mobility LLC v. Conception, and once decided may clarify the extent that unconscionability may be used to sever arbitration provisions from a contract). *See also Concepcion* 131 S. Ct. at 1753 (2011) (abrogating *Discover Bank v. Superior Court* for "stand[ing] as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress.").