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California's Unique Approach to Arbitration: Why This Road Less Traveled Will Make All the Difference on the Issue of Preemption under the Federal Arbitration Act

Michael G. McGuiness

Adam J. Karr

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*Michael G. McGuinness & Adam J. Karr**

I. INTRODUCTION

It is an oft-quoted axiom that in 1925 Congress enacted the Federal Arbitration Act (FAA)[1] to "reverse centuries of judicial hostility to arbitration agreements by placing them on equal footing with other contracts."[2] Recent decisions in California state courts and the Ninth Circuit, however, show that the same judicial hostility ostensibly thwarted eighty years ago continues today, albeit in a more subtle—but equally hostile—form.

Indeed, the state of arbitration law is at a pivotal crossroads. This article traces how, despite the laudable goals of the FAA, "judicial hostility" to arbitration has reared its unwelcome head once again. Today, courts in California translate their judicial hostility into seemingly innocuous pronouncements of "unconscionability" and "unwaivable statutory protections." We also explain why, at the end of the day, this brief judicial foray by the lower courts should be held preempted by the FAA.

We begin this article by framing the issue in simple terms. The statute itself is clear. The FAA contains a "savings clause" that provides that arbitration agreements shall be "*valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract.*"[3] By its terms, the FAA permits courts to refuse to enforce arbitration agreements if the agreement is

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* Michael G. McGuinness and Adam J. Karr are attorneys in the Los Angeles office of O'Melveny & Myers LLP. McGuinness and Karr specialize in labor and employment matters. The authors would like to thank Crystal Silva for her significant assistance in preparing this article. The authors are also indebted to Scott Dunham, Adam KohSweeney, Kristin Feitelson, and Christin Cho for their invaluable editing and research work.

1. Pub. L. No. 401, 43 Stat. 883 (1925) (codified as amended at 9 U.S.C. §§ 1-15 (2004)).

2. Shearson/Am. Express v. McMahon, 482 U.S. 220, 225-26 (1987); Allied-Bruce Terminix Cos. v. Dobson, 513 U.S. 265, 270 (1995). *See also* H.R. REP. NO. 68-96, at 1-2 (1924). The report, outlining the historical perspective, states as follows:

> The need for the law arises from an anachronism of our American law. Some centuries ago, because of the jealousy of the English courts for their own jurisdiction, they refused to enforce specific agreements to arbitrate upon the ground that the courts were thereby ousted from their jurisdiction. This jealousy survived for so long a period that the principle became firmly embedded in the English common law and was adopted with it by the American courts.

Id.

3. 9 U.S.C. § 2 (emphasis added).

invalid under state laws that "arose to govern issues concerning the validity, revocability, and enforceability of contracts generally."[4]

In essence, arbitration agreements must be treated like all other contracts—no better, no worse. To this end, courts are empowered by the FAA to apply generally applicable contract defenses, like unconscionability and fraud, in assessing the validity of agreements to arbitrate. But state laws—whether of legislative or judicial origin—that are uniquely hostile to arbitration are preempted by the FAA. Courts are required "to enforce privately negotiated agreements to arbitrate, like other contracts, in accordance with their terms."[5]

To use an old cliché, "this is where the trouble came from." Beginning with the California Supreme Court's seminal decision in *Armendariz v. Foundation Health Psychcare Services, Inc.* (and perhaps before),[6] California courts—and the Ninth Circuit—have taken the FAA's "savings clause" where no court has gone before. With only a few exceptions, arbitration agreements that have been evaluated under California's post-*Armendariz* law have been held invalid under the "generally applicable contract defense" of unconscionability. The FAA's savings clause, which was enacted with the aim of placing arbitration agreements "on equal footing with other contracts," is now used as the platform to strike them down in legion.

The FAA permits courts to apply general contract principles—like unconscionability—to arbitration agreements and this is, for the most part, just what California courts and the Ninth Circuit claim to be doing. In fact, they are not. It is a ruse that has the transparent appeal of compliance with the FAA, but merely cloaks the ever expanding judicial hostility that permeates the courts' decisions in the arbitration context. Indeed, California has created a new brand of unconscionability. It is far more demanding—and it is unique to arbitration. It is this brand of unconscionability that is preempted by the FAA.

In this article, we seek to prove this point, which we readily admit, to date, has fallen on deaf ears before the courts. To prove our point, we delve into the subtleties of the FAA, the unconscionability doctrine (then and now), and several recent cases on the topic. Specifically, in Section II of this article we provide some background on the FAA, its enactment, and the case law dealing with FAA preemption. In Section III, we address unconscionability—as a general contract theory—and its original doctrinal formulation. In Section IV, we put all of this together and provide a few examples that illustrate why California's—and the Ninth Circuit's—application of unconscionability in an arbitration setting, despite the courts' statements to the contrary, is "unique and hostile to arbitration" and, thus, preempted by the FAA. Section V paints with a broader brush and deals with the California—and Ninth Circuit—decisions related to arbitration with a focus on the courts' application of unconscionability doctrine and its transparent hostility to arbitration.

4. Perry v. Thomas, 482 U.S. 483, 492 n.9 (1987).
5. Volt Info. Scis., Inc. v. Bd. of Trs. of Leland Stanford Junior Univ., 489 U.S. 468, 478 (1989).
6. 6 P.3d 669 (Cal. 2000).

II. THE FEDERAL ARBITRATION ACT

A. History and Structure of the Federal Arbitration Act

We begin with some historical flare and a brief description of the structure of the FAA. Prior to the enactment of the FAA, courts—in an almost uniform voice—refused to enforce private arbitration agreements.[7] "American courts in general demonstrated hostility toward ordering specific performance of an agreement to arbitrate, seemingly adopting a jealous notion . . . that arbitration agreements were nothing less than a drain on their own authority to settle disputes."[8] The judiciary's refusal to enforce these agreements thwarted the interests of commercial enterprises that relied upon the efficiency and institutional knowledge of the arbitral forum to resolve their disputes.[9] Over time, business interests began to exert pressure on state legislatures to invalidate the common law rules that denied specific performance of arbitration agreements.[10] These efforts swelled during the early twentieth century when the business community and the legal profession jointly lobbied state governments and Congress for legislation compelling courts to enforce arbitration agreements.[11] During this same time, the American Bar Association's Committee on Commerce, Trade and Commercial Law went to work on the original draft of the FAA, which was ultimately submitted to Congress.[12] In 1925, both houses of Congress passed the FAA and it was signed into

7. Henry C. Strickland, *The Federal Arbitration Act's Interstate Commerce Requirement: What's Left for State Arbitration Law?*, 21 HOFSTRA L. REV. 385, 389 (1992). *See also* Ins. Co. v. Morse, 87 U.S. 445, 458 (1874) (refusing to enforce an agreement to arbitrate found in an insurance contract); Red Cross Line v. Atl. Fruit Co., 264 U.S. 109, 120-22 (1924); Allied-Bruce Terminix Cos. v. Dobson, 513 U.S. 265, 270-71 (1995) (explaining the historical prejudice against arbitration agreements); Rowe v. Williams, 97 Mass. 163, 165 (Mass. 1867). Because courts would not enforce agreements to arbitrate, arbitration was practicable only in settings where non-legal sanctions, such as reprisals by other actors within the market, obliged parties to abide by their arbitration agreements. Christopher R. Drahozal, *"Unfair" Arbitration Clauses*, 2001 U. ILL. L. REV. 695, 701 (2001) [hereinafter Drahozal, *Unfair*]. *See* H.R. REP. NO. 68-96, at 1-2 (1924); S. REP. NO. 68-536, at 2-3 (1924); 3 SAMUEL WILLISTON, THE LAW OF CONTRACTS § 1719 (1920) (explaining the hostility and quoting Lord Campbell in *Scott v. Avery*, 4 H.L. Cas. 811, "It has been asserted and never denied that this hostility probably originated 'in the contests of the courts of ancient times for extension of jurisdiction—all of them being opposed to anything that would altogether deprive every one of them of jurisdiction'").

8. Raasch v. NCR Corp., 254 F. Supp. 2d 847, 853 (S.D. Ohio 2003) (citing Dean Witter Reynolds Inc. v. Byrd, 470 U.S. 213, 219-20 n.6 (1985)).

9. The business community found that arbitration provided a more efficient forum for resolving commercial disputes. Sarah Rudolph Cole, *Incentives and Arbitration: The Case Against Enforcement Of Executory Arbitration Agreements Between Employers and Employees*, 64 UMKC L. REV. 449, 460 (1996).

10. *Id.* at 465. In 1920, the New York state legislature led this movement by passing a statute that revoked that state's common law rule denying specific performance of agreements to arbitrate. 1920 N.Y. Laws 275. New Jersey followed in short order, enacting a similar statute three years later. 1923 N.J. Laws 134.

11. Jeffrey W. Stempel, *A Better Approach to Arbitrability*, 65 TUL. L. REV. 1377, 1380 (1991); Christopher R. Drahozal, *In Defense of Southland: Reexamining the Legislative History of the Federal Arbitration Act*, 78 NOTRE DAME L. REV. 101, 125-26 (2002) [hereinafter Drahozal, *In Defense of Southland*]. *See generally* Cole, *supra* note 9, at 461.

12. Cole, *supra* note 9, at 466. The FAA was actually modeled on the arbitration statute enacted by the New York state legislature. Linda R. Hirshman, *The Second Arbitration Trilogy: The Federalization of Arbitration Law*, 71 VA. L. REV. 1305, 1312 (1985). Julius Henry Cohen, general counsel for the New York Chamber of Commerce and a member of the ABA Committee on Commerce, Trade &

law by President Calvin Coolidge.[13] The stated purpose of the FAA was to reverse the pervasive and longstanding judicial hostility towards arbitration.[14]

The central paradigm of the FAA is that courts are to assess the enforceability of arbitration provisions as they would any other contract provision. This principle is embodied in section 2 of the FAA, which provides that, while arbitration provisions in agreements involving "maritime" or "commerce" are valid, courts may declare them unenforceable on the same grounds as they would any other contract provision.[15] Section 2 of the FAA states:

> A written provision in any maritime transaction or a contract evidencing a transaction involving commerce to settle by arbitration a controversy thereafter arising out of such contract or transaction, or the refusal to perform the whole or any part thereof, or an agreement in writing to submit to arbitration an existing controversy arising out of such a contract, transaction, or refusal, *shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract.*[16]

In short, the FAA places arbitration agreements on equal footing with other contracts. It binds courts either to enforce an arbitration agreement or refuse to enforce it in accord with traditional contract defenses.[17] What courts cannot do is single out arbitration agreements and refuse to enforce them under special rules applicable only to arbitration agreements.[18] At the time of the FAA's enactment, many believed it applied only in federal courts,[19] but the United States Supreme

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Commercial Law, authored the first draft of the FAA. Drahozal, *In Defense of Southland*, *supra* note 11, at 130. For a thorough discussion of the historical rules related to arbitration, up to and including the FAA, see Paul L. Sayre, *Development of Commercial Arbitration Law*, 37 YALE L.J. 595 (1928).

13. Pub. L. No. 401, 43 Stat. 883 (1925). *See* Julius Henry Cohen & Kenneth Dayton, *The New Federal Arbitration Law*, 12 VA. L. REV. 265, 265 (1926). Cohen and Dayton wrote, "By this Act there is reversed a hoary doctrine that agreements for arbitration are revocable at will and are unenforceable . . . . This statute is not an isolated change of an outworn rule of law. It is a single step in a movement of growing momentum. The movement finds its origin in the unfortunate congestion of the courts and in delay, expense and technicality of litigation."

14. Allied-Bruce Terminix Cos. v. Dobson, 513 U.S. 265, 270-71 (1995); Anne Brafford, *Arbitration Clauses in Consumer Contracts of Adhesion*, 21 J. CORP. L. 331, 334 (1996). In 1927, California enacted the California Arbitration Act (CAA). CAL. CIV. PROC. CODE §§ 1280-1294.2 (West 2004). The CAA requires arbitration when a written agreement to arbitrate exists between the parties. *See id.* § 1281.1. The CAA embodies, for the most part, identical substantive terms and a public policy similar to the FAA. *See, e.g.*, Dryer v. Los Angeles Rams, 709 P.2d 826, 833 (Cal. 1985).

15. 9 U.S.C. § 2 (2004).

16. *Id.* (emphasis added).

17. Stephen J. Ware, *The Effects of Gilmer: Empirical and Other Approaches to the Study of Employment Arbitration*, 16 OHIO ST. J. ON DISP. RESOL. 735 (2001).

18. Volt Info. Scis., Inc. v. Bd. of Trs. of Leland Stanford Junior Univ., 489 U.S. 468, 478 (1989) (citing Prima Paint Corp. v. Flood & Conklin Mfg. Co., 388 U.S. 395 (1967)).

19. Traci L. Jones, *State Law of Contract Formation in the Shadow of the Federal Arbitration Act*, 46 DUKE L.J. 651, 656 (1996). One month after Congress passed the FAA, the American Bar Association Committee that drafted the Act wrote:

> The statute establishes a procedure in the [f]ederal courts for the enforcement of arbitration agreements. . . . A [f]ederal statute providing for the enforcement of arbitration agreements does relate solely to procedure in the [f]ederal courts . . . . [W]hether or not an arbitration agreement is to be enforced is a question of the law of procedure and is determined by the law of the jurisdiction wherein the remedy is sought. That the enforcement of arbitration agreements is within

Court, in cases discussed fully below, clarified that both state and federal courts are bound by the FAA.[20]

The FAA also establishes the mechanisms necessary to empower courts to enforce arbitration agreements. It authorizes courts, pursuant to a party's petition, to order the parties to proceed with arbitration in accord with the terms of the agreement and to stay judicial proceedings until arbitration is concluded.[21] The FAA does not, however, create an independent basis for federal jurisdiction.[22] Instead, parties must rely on traditional bases of federal jurisdiction, such as diversity jurisdiction or federal question jurisdiction, in order for federal courts to exercise jurisdiction.[23]

B. Supreme Court Decisions Interpreting the Federal Arbitration Act: The Force of Preemption

The FAA was enacted as remedial legislation intended to thwart judicial hostility to arbitration and force courts to assess the enforceability of arbitration agreements just as they do all other contractual provisions.[24] The United States Supreme Court has, over time, defined the contours of the FAA to vigorously effectuate this aim. The Court has relied on the Supremacy Clause of the United States Constitution to conclude that the FAA established "a body of federal substantive law of arbitrability."[25] The Court has broadly interpreted the FAA provisions that direct courts to enforce arbitration agreements, while narrowly construing those provisions that limit the reach of the FAA. Because the scope of the

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the law of procedure as distinguished from substantive law is well settled by the decisions of our courts.

Southland Corp. v. Keating, 465 U.S. 1, 26 (1984) (alterations in original) (quoting Committee on Commerce, Trade & Commercial Law, *The United States Arbitration Law and Its Application*, 11 A.B.A. J. 153, 154-55 (1925)).

20. Erie R.R. v. Tompkins, 304 U.S. 64, 77-79 (1983) (challenging conventional wisdom and holding that federal courts must apply state substantive law in diversity cases). The *Erie* decision provided that federal courts lacked the authority to create substantive law, thereby bringing the question of whether the FAA was a purely procedural statute or substantive law that applied in both federal and state courts to the fore. *Id.* If the FAA were passed as substantive law pursuant to the grant of authority in Article III, its validity was uncertain because the thrust of the *Erie* decision resolved that Congress exceeded its authority if it provided federal rules of decision for state-created rights in diversity cases. Hirshman, *supra* note 12, at 1317-18. On the other hand, if Congress enacted the FAA pursuant to its authority to regulate interstate commerce, then the FAA was federal substantive law not subject to the *Erie* doctrine. *Id.*

21. 9 U.S.C. § 3 (2004). This is one of the primary distinctions between the FAA and many of its state counterparts, including the CAA, which permit courts to allow judicial proceedings to proceed first or concurrently under certain circumstances. *See, e.g.*, Mount Diablo Med. Ctr. v. Health Net of Cal., Inc., 101 Cal. App. 4th 711, 717 (Cal. Ct. App. 2002) (interpreting CAL. CIV. PROC. CODE § 1281.2(c) to authorize California courts to refuse to enforce a contractual arbitration provision if arbitration threatens to produce a result that may conflict with the outcome of related litigation not subject to arbitration).

22. Moses H. Cone Mem'l Hosp. v. Mercury Constr. Corp., 460 U.S. 1, 25 n.32 (1983). The court stated, "The Arbitration Act is something of an anomaly in the field of federal-court jurisdiction. It creates a body of federal substantive law establishing and regulating the duty to honor an agreement to arbitrate, yet it does not create any independent federal-question jurisdiction . . . ."

23. *Id.*

24. Shearson/Am. Express Inc. v. McMahon, 482 U.S. 220, 225-26 (1987).

25. *Moses H.*, 460 U.S. at 24. The FAA does not incorporate an express preemption clause. Brafford, *supra* note 14, at 336.

FAA—and its application to California's courts—is contingent on this precedent, below we review the leading Supreme Court decisions defining the jurisdictional breadth and preemptive scope of the FAA.

The Supreme Court has, as an initial matter, resolved that the threshold question of whether claims are arbitrable must be decided with a "healthy regard for the federal policy favoring arbitration."[26] Consequently, when the parties include claims within the ambit of their arbitration agreement, the FAA ensures that the agreement will be enforced even if a state statute or a state common law rule would otherwise operate to exclude it from arbitration.[27] While the core purpose of the FAA is to ensure arbitration provisions are interpreted and enforced according to their terms,[28] ambiguities regarding the scope of the arbitration clause must be resolved in favor of arbitration.[29] Similarly, state law principles governing contract interpretation must be applied with a due regard for the federal policy favoring arbitration.[30]

The Supreme Court embarked on the task of defining the scope of the FAA in *Prima Paint Corp. v. Flood & Conklin Manufacturing Co.*[31] The primary issue in *Prima Paint* was whether a claim of fraud in the inducement related to a contract that contained an arbitration clause was properly adjudicated in the courts or arbitration.[32] For purposes of this article, far more important than this issue, the Court also used *Prima Paint* to rule on the then unsettled question of whether the Court could apply the FAA to disputes where jurisdiction was based solely on diversity of citizenship.[33] The Court held it could, declaring that "it [was] clear beyond dispute" that Congress enacted the FAA pursuant to its authority to legislate regarding interstate commerce and admiralty, and therefore, the Act established a body of substantive federal law applicable to all cases involving interstate commerce.[34] The FAA, therefore, authorized federal courts to determine whether an arbitration clause in a contract is valid and enforceable. In accord with the mandate of *Erie Railroad Co. v. Tompkins*,[35] however, the *Prima Paint* court also acknowledged that federal courts addressing the enforceability of arbitration agreements were bound to apply state substantive contract law in making their assessment.[36]

The *Prima Paint* decision resolved that federal courts sitting in diversity jurisdiction are bound by the FAA, but it did not address whether state courts were

26. Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc., 473 U.S. 614, 626 (1985).

27. Mastrobuono v. Shearson Lehman Hutton, Inc., 514 U.S. 52, 58 (1995).

28. Volt Info. Scis., Inc. v. Bd. of Trs. of Leland Stanford Junior Univ., 489 U.S. 468, 469 (1989).

29. *Id.* at 476.

30. *Id. See also* Gilmer v. Interstate/Johnson Lane Corp., 500 U.S. 20, 37 (1991).

31. 388 U.S. 395 (1967).

32. *Id.* at 396-97. The party resisting arbitration alleged that Flood & Conklin fraudulently induced the contract by advancing false representations of its financial strength only a week before it filed for bankruptcy. *Id.* at 398. The Court held that a defense to enforcement of an arbitration provision may only be adjudicated in a judicial forum when the defense is directed at the arbitration provision itself, rather than the contract as a whole. *Id.* at 404. In other words, the court must sever the arbitration provision from the contract and assess its enforceability separately.

33. *Id.* at 404. In light of *Erie*, federal courts were bound to follow state rules of decision in substantive matters or when application of the rule is "outcome determinative." *Id.* at 404-05.

34. *Id.* at 405.

35. 304 U.S. 64 (1938).

36. *Prima Paint*, 388 U.S. at 404-05.

also obligated to abide by the FAA's terms. Approximately twenty years later, however, the Supreme Court in *Moses H. Cone Memorial Hospital v. Mercury Construction Corp.* provided the first indication that the FAA did, in fact, govern in state courts.[37] As the Court considered whether it was proper for a federal district court to stay an arbitration compelled pursuant to the FAA on the grounds that a parallel action was taking place in state court, the Court also took the opportunity to pronounce that the FAA "governs [the issue of arbitrability] in either state or federal court"[38] because the Act embodies a "liberal federal policy favoring arbitration agreements"[39] and established "a body of federal substantive law of arbitrability."[40] The Court pointed out that it would be absurd for Congress to enact a law that requires enforcement of arbitration agreements against a party who files suit in federal court, but not against one who files an identical suit in state court.[41] This is particularly true in light of the fact that the FAA broadly mandated enforcement of arbitration agreements.[42]

Although the language in *Moses H.* strongly suggested that the Supreme Court was prepared to apply the dictates of the FAA to state courts, this issue was not expressly resolved until the Court's decision in *Southland Corp. v. Keating*.[43] In *Keating*, franchisees filed suit against their franchisor for violation of the California Franchise Investment Law and other common law claims.[44] The franchisor petitioned for an order compelling arbitration based on an arbitration provision contained in the franchise agreement.[45] This dispute made its way to the California Supreme Court, which held that by statutory directive claims under the California Franchise Investment Law could only be adjudicated in a judicial forum, not in arbitration.[46] The Supreme Court granted *certiorari* to resolve whether this holding, which barred specific types of claims from arbitration, violated the Supremacy Clause of the United States Constitution.[47]

In considering this question, the Supreme Court first noted that the California Supreme Court's interpretation of the statute directly conflicted with the FAA's commands.[48] The Supreme Court reasoned that by declaring a "national policy favoring arbitration," Congress, pursuant to its authority to regulate commerce,[49] withdrew the authority of the states to require judicial adjudication of claims that contracting parties have agreed to resolve by arbitration.[50] Among other things,[51]

37. 460 U.S. 1 (1983).
38. *Id.* at 24.
39. *Id.*
40. *Id.*
41. *Id.* at 27 n.34.
42. *Id.*
43. 465 U.S. 1 (1984).
44. *Id.* at 4.
45. *Id.*
46. *Id.* at 5.
47. *Id.* at 6.
48. *Id.* at 10.
49. *Id.* at 10-11.
50. *Id.* at 10.
51. The court also recognized that exempting state courts from the dictates of the FAA, especially in light of the fact that the majority of litigation takes place in state courts, would "encourage and reward forum shopping," thereby substantially thwarting the aim of the FAA to ensure parties who agree to arbitrate enjoy a speedy resolution of their dispute. *Id.* at 15.

the Court also relied on indications in the legislative history of the FAA that Congress intended to redress judicial hostility against arbitration in both state and federal courts.[52] In a decision that remains open to fierce debate to this day,[53] the Supreme Court ultimately held that, by enacting the FAA, Congress established a substantive arbitration rule that governed in both federal and state courts.[54]

Determining that the FAA applied in state courts raised the more pressing question—how? In *Keating*, the Supreme Court, relying on the Supremacy Clause, declared that the FAA "foreclose[d] state legislative attempts to undercut the enforceability of arbitration agreements."[55] In other words, the FAA preempts state laws that conflict with the FAA's mandate that arbitration agreements are valid and enforceable, except upon such grounds that exist for the revocation of any contract. With that, the Supreme Court held that the California Franchise Investment Act, to the extent it required a judicial forum for adjudication of claims, was preempted by the FAA.[56]

In cases subsequent to *Keating*, the Supreme Court has struck down many other state laws that expose arbitration agreements to special, or unique, scrutiny. In *Perry v. Thomas*, the Court invalidated a California statute that required wage claims to proceed in a judicial forum, regardless whether there was an agreement to arbitrate, because the statute conflicted directly with the FAA's mandate that arbitration agreements be rigorously enforced.[57]

Similarly, in *Doctor's Associates, Inc. v. Casarotto*, the Court held that the FAA preempted a Montana statute that imposed special notice requirements only on arbitration agreements, in part, because the policies of the FAA are "antithetical to threshold limitations placed specifically and solely on arbitration provisions."[58] The Court applied similar reasoning to strike down an Alabama statute that made predispute arbitration agreements unenforceable[59] and a New York court rule that prohibited an arbitrator from awarding punitive damages in all circumstances.[60]

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52. *See id.* at 16.

53. Justice O'Connor issued a strong dissent, in which Justice Rehnquist joined, asserting that Congress did not intend the FAA to govern in state courts and that the majority "utterly failed to recognize the clear congressional intent underlying the FAA," which proved that "Congress intended to require federal, not state, courts to respect arbitration agreements." *Id.* at 22-23 (O'Connor, J., dissenting). Justices Scalia and Thomas continue to dissent in cases considering the application of the FAA to state courts. Allied-Bruce Terminix Cos. v. Dobson, 513 U.S. 265, 285 (1995) (Thomas, J. dissenting). In fact, Justice Scalia declared that, although he will not continue to dissent in future cases, he is prepared to join with four other justices to overrule *Keating*. *Id.* at 285 (Scalia, J., dissenting). *See also* Drahozal, *In Defense of Southland*, *supra* note 11; *Cf. Allied-Bruce*, 513 U.S. at 283 (O'Connor, J., concurring). Justice O'Connor directly stated, "I have no doubt that Congress could enact, in the first instance, a federal arbitration statute that displaces most state arbitration laws. But I also have no doubt that, in 1925, Congress enacted no such statute." *Id.*

54. Southland Corp. v. Keating, 465 U.S. 1, 16 (1984).

55. *Id. See also Allied-Bruce*, 513 U.S. at 271-72 (explaining that the *Keating* court decided that, although the FAA was substantive law, Congress enacted it pursuant to its authority to regulate commerce and admiralty and intended that it apply in state courts).

56. *Keating*, 465 U.S. at 16. A decade later, the Supreme Court, in *Allied-Bruce*, rejected a plaintiff's request, joined by each attorney general of twenty states, to reverse its decision in *Keating*. *Allied-Bruce*, 513 U.S. at 272.

57. 482 U.S. 483, 490-91 (1987).

58. 517 U.S. 681, 688 (1996).

59. *See* Allied-Bruce Terminix Cos. v. Dobson, 513 U.S. 265, 281 (1995).

60. Mastrobuono v. Shearson Lehman Hutton, Inc., 514 U.S. 52, 52 (1995).

The fierce preemptive force of the FAA is not limited to state statutes—it applies with equal force to laws of judicial origin.[61] By virtue of section 2 of the FAA, courts may apply state decisional law "if that law arose to govern issues concerning the validity, revocability, and enforceability of contracts generally."[62] "Thus, generally applicable contract defenses, such as fraud, duress, or unconscionability, may be applied to invalidate arbitration agreements without contravening [section] 2."[63] But "[a] court may not . . . in assessing the rights of litigants to enforce an arbitration agreement, construe that agreement in a manner different from that in which it otherwise construes nonarbitration agreements under state law."[64] According to the Supreme Court, this also means that courts may not, in only an arbitration setting, pervert generally applicable state law contract doctrines as a means of avoiding the FAA's proscriptions. The Supreme Court has commanded that "*a court [may not] rely on the uniqueness of an agreement to arbitrate as a basis for a state-law holding that enforcement would be unconscionable, for this would enable the court to effect what we hold today the state legislature cannot.*"[65] In other words, a court may not "decide that a contract is fair enough to enforce all its basic terms (price, service, credit), but not fair enough to enforce its arbitration clause."[66]

With virtually no exceptions, the modern Supreme Court has expanded the scope of the FAA's reach in case after case.[67] For example, the Court has held that the FAA applies with equal force to both common law and statutory claims. In *Mitsubishi Motors Corp. v. Soler-Chrysler-Plymouth, Inc.*, the Court explained that there is no basis in the terms of the FAA "for disfavoring agreements to arbitrate statutory claims."[68] The Court rejected the notion that a party submitting a statutory claim to arbitration relinquishes the substantive rights afforded by the statute.[69] Instead, the party merely agrees to resolve the claim in an arbitral, rather than a judicial forum.[70] The Court did, however, note that, as with any statutory directive, the party resisting arbitration could prove that the pro-arbitration mandate of the FAA was overridden by a contrary Congressional directive embodied

61. *See* Gutierrez v. Autowest, Inc., 114 Cal. App. 4th 77, 86 n.6 (Cal. Ct. App. 2003) (noting that "[c]ourt decisions on the preemptive effect of the FAA do not distinguish between state statutes, administrative regulations and judicial decisions that burden arbitration agreements").

62. Perry v. Thomas, 482 U.S. 483, 492 n.9 (1987).

63. Doctor's Assocs. v. Casarotto, 517 U.S. 681, 687 (1996).

64. *Perry*, 482 U.S. at 492 n.9.

65. *Id.* (emphasis added).

66. Allied-Bruce Terminix Cos. v. Dobson, 513 U.S. 265, 281 (1995).

67. The Supreme Court has treated issues involving collective bargaining agreements that contain arbitration provisions, as opposed to individual agreements, in a different manner. In *Alexander v. Gardner-Denver*, the Court held that an employee required to arbitrate an employment discrimination claim pursuant to the terms of a collective bargaining agreement is not precluded from later seeking relief in court. 415 U.S. 36, 54 (1974). Arbitration under a collective bargaining agreement will necessarily involve not only the interests of a particular employee, but also the union and its relationship with the employer. *Id.* at 58 n.19. The Supreme Court has held that this distinction between a collective bargaining agreement and an individual agreement is of great significance and determined that the rule of *Gardner-Denver* applies only to collectively bargained arbitration agreements. Gilmer v. Interstate/Johnson Lane Corp., 500 U.S. 20, 34-35 (1991).

68. 473 U.S. 614, 627 (1985).

69. *Id.* at 628.

70. *Id.*

in the federal statute at issue.[71] This defense, definitionally, does not apply to contrary directives by state legislatures.

The burden is on the party resisting arbitration to prove that, based on the language, legislative history or an inherent conflict between arbitration and the underlying purpose of the statute, Congress intended to mandate a judicial forum for litigation of the statutory rights at issue.[72] In practice, the utility of this defense is *de minimis* because the Supreme Court has already submitted a wide array of statutory claims—including claims under RICO,[73] the ADEA,[74] the Sherman Act[75] and the Securities and Exchange Act of 1934[76]—to the arbitral forum. The circuit courts are in accord.[77]

The Supreme Court's decision in *Gilmer v. Interstate/Johnson Lane Corp.* is of particular significance on the issue of arbitrability of statutory claims.[78] In *Gilmer*, the Court was asked to decide whether an employee could be compelled to arbitrate a discrimination claim under the ADEA based on a predispute compulsory arbitration agreement.[79] The Court answered in the affirmative, holding that "'by agreeing to arbitrate a statutory claim, [an employee] does not forego the substantive rights afforded by the statute; [he] only submits to their resolution in an arbitral, rather than a judicial forum.'"[80] The Court reaffirmed its earlier commitment to the principle that arbitration is not, in and of itself, an inferior tribunal for resolution of claims, even those claims dealing with matters involving fundamental civil rights.[81]

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71. *Id.* at 627-28.

72. Shearson/Am. Express v. McMahon, 482 U.S. 220, 226-27 (1987).

73. *See id.* at 242.

74. Gilmer v. Interstate/Johnson Lane Corp., 500 U.S. 20, 35 (1991).

75. *See* Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc., 473 U.S. 614, 636 (1985).

76. *McMahon*, 482 U.S. at 238.

77. *See, e.g.*, Bercovitch v. Baldwin Sch., Inc., 133 F.3d 141, 143 (1st Cir. 1998) (ADA, Rehabilitation Act); Bird v. Shearson Lehman/Am. Express, Inc., 926 F.2d 116, 118 (2d Cir. 1991) (ERISA); Ballay v. Legg Mason Wood Walker, Inc., 878 F.2d 729, 730 (3d Cir. 1989) (Securities Act of 1933); United States v. Bankers Ins. Co., 245 F.3d 315, 318 (4th Cir. 2001) (False Claims Act); Walton v. Rose Mobile Homes, L.L.C., 298 F.3d 470, 473 (5th Cir. 2002) (Magnuson-Moss Warranty Act); Morrison v. Circuit City Stores, Inc., 317 F.3d 646, 652 (6th Cir. 2003) (Title VII); Kowalski v. Chicago Tribune Co., 854 F.2d 168, 173 (7th Cir. 1988) (Sherman Act); Bailey v. Ameriquest Mortgage Co., 346 F.3d 821, 822 (8th Cir. 2003) (FLSA); Paulson v. Dean Witter Reynolds Inc., 905 F.2d 1251, 1254 (9th Cir. 1990) (Securities & Exchange Act of 1934); Adrian v. Smith Barney, Harris, Upham & Co., 841 F.2d 1059, 1060 (11th Cir. 1988) (RICO; Securities & Exchange Act of 1934).

The glaring exception to the rule, albeit a dated one, is *Duffield v. Robertson Stephens & Co.*, 144 F.3d 1182 (9th Cir. 1998), *overruled by* EEOC v. Luce, Forward, Hamilton & Scripps, 345 F.3d 742, 744-45 (9th Cir. 2003). In *Duffield*, the Ninth Circuit held that Congress, by its enactment of the Civil Rights Act of 1991, intended to preclude mandatory arbitration of civil rights claims, covered by the FAA. *Id.* Every circuit other than the Ninth Circuit rejected *Duffield*. *See* Rosenberg v. Merrill Lynch, Pierce, Fenner & Smith Inc., 170 F.3d 1, 11 (1st Cir. 1999); Gold v. Deutsche Aktiengesellschaft, 365 F.3d 144, 148 (2d Cir. 2004); Seus v. John Nuveen & Co., 146 F.3d 175, 183 (3d Cir. 1998); Hooters of Am., Inc. v. Phillips, 173 F.3d 933, 937 (4th Cir. 1999); Mouton v. Metro. Life Ins. Co., 147 F.3d 453, 455 (5th Cir. 1998); Koveleskie v. SBC Capital Mkts., Inc., 167 F.3d 361, 365 (7th Cir. 1999); Weeks v. Harden Mfg. Corp., 291 F.3d 1307, 1315 (11th Cir. 2002). Eventually, the Ninth Circuit itself—in an *en banc* decision—overturned *Duffield*. *Luce*, 345 F.3d at 744-45.

78. 500 U.S. 20, 23 (1991).

79. *Id.*

80. *Id.* at 26 (quoting *Mitsubishi Motors Corp.*, 473 U.S. at 628).

81. Gilmer v. Interstate/Johnson Lane Corp., 500 U.S. 20, 30-32 (1991). *Gilmer* did establish certain criteria that must be met within the arbitration forum itself to ensure that the arbitration does not

The Supreme Court has also expanded those provisions of the FAA that confer jurisdiction. For example, the Court has held that the FAA's "involving commerce" requirement, as stated in section 2 of the FAA, is a signal of "Congress' intent to exercise its Commerce Clause power to the full," and should be expansively interpreted.[82] Section 2 of the FAA provides that it applies only to "a written provision in any maritime transaction or a contract evidencing a transaction involving commerce . . . ."[83] The Court has interpreted the phrase "involving commerce" expansively to reach most arbitration agreements.[84]

The use of the term "evidencing" led some courts and commentators to speculate that, in non-maritime transactions, the FAA applied only if the terms of the agreement revealed that the parties actually contemplated engaging in interstate commerce.[85] In *Allied-Bruce Terminix Cos. v. Dobson*, the Supreme Court rejected this notion and reaffirmed that Congress, in enacting the FAA, exercised its entire authority to legislate pursuant to the Commerce Clause.[86] The Court interpreted the term "evidencing a transaction involving commerce" as equivalent to the term "affecting commerce," which meant the FAA embraced all contracts that involve commerce within its scope.[87] *Allied-Bruce* tied the scope of the FAA to the outer limits of the Commerce Clause, rather than to the vagaries of contractual intent.

While the Supreme Court has expanded those provisions of the FAA that confer jurisdiction, it has simultaneously narrowed those provisions that limit it. For example, in *Circuit City Stores, Inc. v. Adams*,[88] the Court interpreted language found in section 1 of the FAA that excludes the "contracts of employment of seamen, railroad employees, or any other class of workers engaged in foreign or interstate commerce" from the FAA.[89] The Ninth Circuit had held that this provision excluded all employment contracts from coverage under the FAA.[90] The Court rejected this conclusion in *Adams*. In reaching its decision, the Supreme Court refused to consider the legislative history of the FAA, and, instead, interpreted the text of the statute using the *ejusdem generis* statutory maxim (i.e., general words following specific words are to be constructed to encompass objects

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serve as a vehicle to cause a *de facto* waiver of statutory rights. *See id.* at 28-30. *See also* discussion *infra* Section V.

82. Allied-Bruce Terminix Cos. v. Dobson, 513 U.S. 265, 273 (1995).

83. 9 U.S.C. § 2 (2004).

84. *See Allied-Bruce*, 513 U.S. at 273.

85. Metro Indus. Painting Corp. v. Terminal Constr. Co., 287 F.2d 382, 387 (2d Cir. 1961) (Lumbard, J., concurring). The Chief Justice framed the jurisdictional inquiry under section 2 of the FAA as to whether the parties contemplated substantial interstate commerce at the time they entered into the agreement. *Id. See also* Janet M. Grossnickle, Note, *Allied-Bruce Terminix Cos. v. Dobson: How the Federal Arbitration Act Will Keep Consumers and Corporations Out of the Courtroom*, 36 B.C. L. REV. 769, 781 (1995).

86. 513 U.S. at 277.

87. *Id.* at 277-81.

88. Circuit City Stores v. Adams, 532 U.S. 105 (2001).

89. 9 U.S.C. § 1 (2004).

90. *See* Craft v. Campbell Soup Co., 177 F.3d 1083, 1094 (9th Cir. 1999) (holding that labor and employment contracts are outside the scope of the FAA), *overruled by* Circuit City Stores, Inc. v. Adams, 532 U.S. 105, 119 (2001). The Ninth Circuit was the only court to take the position that section 1 of the FAA excluded all employment contracts from the proscriptions of the Act. *Adams*, 532 U.S. at 110-11.

similar in nature to the specific words).[91] Relying on this maxim, the Court narrowed the exemption, "other class of workers engaged in foreign or interstate commerce,"[92] to embrace only the employment contracts of transportation workers.[93] The Court deflected policy arguments favoring a broader reading of the exemption based on alleged detriments to employees subject to arbitration agreements.[94] Instead, the Court asserted that the benefits of arbitration do not "somehow disappear when transferred to the employment context."[95] The Court broadened the scope of the FAA by expansively interpreting the component of the FAA that confers jurisdiction (i.e., the phrase "evidencing a transaction involving commerce . . .")[96] and simultaneously limiting the portion of the FAA that narrows jurisdiction (i.e., the phrase "engaged in foreign or interstate commerce").[97]

As shown above, Congress and the Supreme Court have acted with vigilance in enforcing the FAA, laying waste to laws that "single out arbitration provisions for suspect status" and ever expanding the scope of the FAA.[98] The premise of this article is that California courts—and the Ninth Circuit—are proceeding on precisely the opposite path. They do so by cloaking their judicial hostility to arbitration in the doctrine of unconscionability. In contrast to a state statute that is overtly anti-arbitration, the detection of California's "unique" application of unconscionability in an arbitration setting is—at least in most cases—a bit more difficult to reveal. Below we summarize the doctrine of unconscionability as a "generally applicable contract defense."

III. THE DOCTRINE OF UNCONSCIONABILITY: A TRUE "GENERALLY APPLICABLE CONTRACT DEFENSE"

Unconscionability is not new. The doctrine originated as an affirmative defense to the enforcement of contractual provisions "*that were so unfair as to shock the conscience of the court.*"[99] The doctrine originated in England and was expressly recognized by United States equity courts as early as 1795.[100] "This use was consistent with the general concern of the equity courts to do justice between the parties and to refrain from enforcing agreements that were unduly harsh or oppressive or that had been imposed on one party by another through sharp dealing or some other reprehensible action."[101]

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91. *Id.* at 114-15.
92. 9 U.S.C. § 1 (2004).
93. *Adams*, 532 U.S. at 119 (stating that "[s]ection 1 exempts from the FAA only contracts of employment of transportation workers").
94. *Id.* at 122-23.
95. *Id.* at 123.
96. 9 U.S.C. § 2.
97. 9 U.S.C. § 1.
98. Doctor's Assocs. v. Casarotto, 517 U.S. 681, 687 (1996).
99. E. ALLEN FARNSWORTH, CONTRACTS § 4.27 (2d ed. 1990) (emphasis added).
100. HOWARD O. HUNTER, MODERN LAW OF CONTRACTS § 19:06 (rev. ed. 1993).
101. HUNTER, CONTRACTS, *supra* note 100, § 19:06. In equity, the doctrine developed along both substantive and procedural lines, with cases falling into usually one or the other category. JOSEPH M. PERILLO, CORBIN ON CONTRACTS: AVOIDANCE & REFORMATION § 29.2 (rev. ed. 2002). The substantive cases primarily prevented default for late payment on mortgages, use of land by those holding in trust, and enforcement of penalty clauses that infringe on legal remedies in the commercial context. *Id.*

By the late 1800s, equity courts frequently used unconscionability to set aside contracts. Courts of law, however, only rarely referred expressly to unconscionability[102] and generally "resorted to imaginative flanking devices to defeat the offending contract."[103] These devices included failure of consideration, lack of mutual assent, inadequacy of pleading, lack of integration in a written contract, and findings of ambiguity where none existed.[104] This trend of avoiding reference to unconscionability diminished by the mid-twentieth century with landmark decisions like *Campbell Soup Co. v. Wentz*,[105] *Henningsen v. Bloomfield Motors, Inc.*[106] and *Williams v. Walker-Thomas Furniture Co.*[107] With the adoption of the Uniform Commercial Code (UCC) unconscionability provision in 1962, the doctrine was "officially" embraced by courts as a defense distinct from fraud, duress and misrepresentation.[108] Like other contractual defenses, "the party asserting that defense [of unconscionability] bears the burden of proving it by substantial evidence."[109]

On the other hand, procedural cases voided contractual provisions for reasons such as misrepresentation and undue influence. *Id.*

102. Within the first 150 years after the formation of the United States, only 6 published cases expressly employed the unconscionability doctrine. HUNTER, CONTRACTS, *supra* note 100, § 19:06 (1993).

103. CORBIN ON CONTRACTS, *supra* note 101, § 29.2.

104. *Id.*

105. 172 F.2d 80 (3d Cir. 1949). In *Campbell Soup*, the Third Circuit refused to grant the legal remedy of specific performance because it found that the agreement between Campbell Soup and a carrot grower was an "unconscionable bargain." *Id.* at 83. The contract at issue substantially favored Campbell Soup at the expense of the grower because the grower was not only bound to sell all of his carrots to Campbell Soup, but was also prohibited from selling to a different party if Campbell Soup did not approve the sale first. *Id.* In addition, the contract allowed Campbell Soup to recover liquidated damages, but provided no similar recovery for the grower and, actually, precluded the grower from recovering any damages for Campbell's breach. *Id.* Consequently, in spite of the fact that the grower breached the contract by refusing to sell his carrots to Campbell Soup at the contract price, the court refused to grant specific performance because it was "too hard a bargain and too one-sided an agreement to entitle [Campbell Soup] to relief in a court of conscience." *Id.*

106. 161 A.2d 69 (N.J. 1960). In *Henningsen*, the court found that a car manufacturer's disclaimer warranty was unconscionable and against public policy. *Id.* at 408. The court found determinative the mass distribution of the warranty, its standardized form, and the inability to purchase a car without agreeing to the terms. *Id.* at 390.

107. 350 F.2d 445, 449-50 (D.C. Cir. 1965). In *Williams*, each defendant had entered into a contract with a furniture store that specified any default of payment on an undue balance gave the store a right to repossess the item. *Id.* at 447. The contract specified that payments received were to be "credited pro rata on all outstanding leases." *Id.* Both defendants defaulted on a payment and, as a result of the pro rata provision, defaulted on all purchases that they had previously made and not yet paid off. *Id.* Defendants asserted unconscionability as an affirmative defense to the action for replevin brought against them by the furniture store. *Id.* The lower court declined to rule on the affirmative defense and explained that its failure to address the issue was because "review of the legislation in the District of Columbia affecting retail sales and the pertinent decisions of the highest court in this jurisdiction disclose . . . no ground upon which this court can declare the contracts in question contrary to public policy." *Id.* at 448. The appellate court, however, disagreed with this analysis of the common law and, citing both *Campbell Soup* and *Henningsen*, enunciated the standard for what constitutes substantive and procedural unconscionability. *Id.*

108. RICHARD A. LORD, WILLISTON ON CONTRACTS, § 18:2 (4th ed. 1999). "[T]he UCC provision on unconscionability was designed to do two things: (1) encourage courts to openly strike down provisions of the type that had previously been denied enforcement at law, largely through covert means; and (2) achieve a substantive merger of equity doctrine into law." CORBIN ON CONTRACTS, *supra* note 101, § 29.2.

109. Bess v. Check Express, 294 F.3d 1298, 1306-07 (11th Cir. 2002).

Although unconscionability is generally considered an accepted contract principle,[110] it is, by its very nature, vaguely defined.[111] This is due, in large measure, to the strong public policy in favor of freedom of contract and the fact intensive analysis that courts undertake in their opposition to reformation and voidance of contractual agreements.[112] The United States Supreme Court has declared unconscionable contracts to be those "*that no man in his senses and not under delusion would make on the one hand, and as no honest and fair man would accept on the other.*"[113] This very general characterization is reflected in the UCC provision, which uncharacteristically failed to include a definition of the term.[114] While the definition remains imprecise, it is generally recognized that an unconscionable agreement includes both substantive and procedural unconscionability.[115] In addition, the doctrine "condemns specific bargains and bargaining techniques only if they are grossly unfair 'according to the mores and business practices of the time and place.'"[116]

The doctrine of unconscionability has developed along both procedural and substantive lines. The substantive unconscionability analysis scrutinizes the terms of the contract, while procedural unconscionability evaluates the formation process.[117] While the substantive element requires a showing that "harsh, one-sided or oppressive"[118] provisions unreasonably favor one party over the other it does not oblige the parties to accept equivalent rights and obligations or to enjoy equal benefits.[119] Indeed, "[a] court will not relieve a party of his obligations under a

110. CORBIN ON CONTRACTS, *supra* note 101, § 29.3.

111. "Unconscionability is one of the most amorphous terms in the law of contracts." *Id.* § 29.1.

112. LORD, WILLISTON ON CONTRACTS, *supra* note 108, § 18:10.

113. Hume v. United States, 132 U.S. 406, 411 (1989) (emphasis added) (citing Earl of Chesterfield v. Janssen, 2 Ves. Sr. 125, 155 (1750)).

114. CORBIN ON CONTRACTS, *supra* note 101, § 29.1-29.2. "[T]he UCC defines a large number of terms, but refrains from a definition of unconscionability. This omission points to a legislative intent to utilize a term in the same general sense in which it has been employed in the legal system in the past." *Id.* § 29.2. California has codified the doctrine of unconscionability. CAL. CIV. PROC. CODE § 1670.5(a) (2003). Section § 1670.5 instructs:

> If the court as a matter of law finds the contract or any clause of the contract to have been unconscionable at the time it was made, the court may refuse to enforce the contract, or it may enforce the remainder of the contract without the unconscionable clause, or it may so limit the application of any unconscionable clause so as to avoid any unconscionable result.

Id. This language is identical to the UCC section. A & M Produce Co. v. FMC Corp., 135 Cal. App. 3d 473, 484 (Cal. Ct. App. 1982) (comparing the California statute to UCC § 2-302). The commentary to the Civil Code section is also the same as the UCC commentary. The only difference between the two provisions "is that section 1670.5 [is] placed under the 'Unlawful Contracts' heading of division 3, part 2, title 4 of the Civil Code [and] applies to all contracts rather than being limited to those sales transactions governed by the Commercial Code." *Id.* at 485.

115. FARNSWORTH, CONTRACTS, *supra* note 99, § 4.28.

116. United States v. Bedford Assocs., 657 F.2d 1300, 1313 (2d Cir. 1981) (quoting CORBIN ON CONTRACTS § 128 (1963)).

117. Susan Randall, *Judicial Attitudes Toward Arbitration and the Resurgence of Unconscionability*, 52 BUFF. L. REV. 185, 191 (2004).

118. *Id. See also* FARNSWORTH, CONTRACTS, *supra* note 99, § 4.28; LORD, WILLISTON ON CONTRACTS, *supra* note 108, § 18:9 (citing Williams v. Walker-Thomas Furniture Co., 350 F.2d 445 (D.C. Cir. 1965)).

119. Under federal law and the law of a majority of states, contractual agreements and arbitration clauses "need not be supported by equivalent obligations." Harris v. Green Tree Fin. Corp., 183 F.3d 173, 183 (3d Cir. 1999). In *Harris*, the Third Circuit examined an arbitration agreement between homeowners and a financial institution for unconscionability. *Id.* The district court had denied the

contract because he has made a bad bargain containing contractual terms which are unreasonable or impose an onerous hardship on him."[120] Rather, the court must find that the contract provision was "so one-sided as to lead to absurd results" as determined by industry custom.[121]

The procedural aspect requires surprise or the absence of meaningful choice by the party with weaker bargaining power.[122] Factors considered by courts in determining whether procedural unconscionability is present include "the experience, intelligence, and education of the parties, their relative bargaining power, the presence or absence of meaningful choice on the part of the weaker party, the conspicuousness and clarity of the contract terms, and other factors."[123] Indeed, a court may ask, whether "each party to the contract, considering his obvious education or lack of it, [has] a reasonable opportunity to understand the terms of the contract, or were the important terms hidden in a maze of fine print and minimized by deceptive sales practices?"[124] If, however, a party to an agreement does "not attempt to determine if anyone else could provide th[e] service" requested, then procedural unconscionability will not be found even where the party is "given no opportunity to negotiate the terms of th[e] agreement."[125]

Not all allocations of risk that appear unreasonable are unconscionable.[126] The requisite amounts of procedural and substantive unconscionability that must be present are fact specific and assessed on a sliding scale "such that the greater the unfair surprise or inequality of bargaining power, the less unreasonable the risk reallocation which will be tolerated."[127] On the sliding scale, "the greater the harshness or unreasonableness of the substantive terms, the less important the regularity of the process of contract formation that gave rise to the term becomes."[128]

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institution's motion to compel arbitration on the grounds that it "lacked the requisite mutuality and, therefore, was unconscionable." *Id.* at 178. On appeal, the Third Circuit reversed the denial and stated that it was "of no legal consequence that the arbitration clause gives Green Tree the option to litigate arbitrable issues in court, while requiring the Harrises to invoke arbitration." *Id.* at 181.

120. Fotomat Corp. of Fla. v. Chanda, 464 So. 2d 626, 630 (Fla. Dist. Ct. App. 1985).

121. Troy Mining Corp. v. Itmann Coal Co., 346 S.E.2d 749, 752 (W. Va. 1986).

122. FARNSWORTH, CONTRACTS, *supra* note 99, § 4.28; LORD, WILLISTON ON CONTRACTS, *supra* note 108, § 18:9.

123. Randall, *supra* note 117, at 191.

124. Williams v. Walker-Thomas Furniture Co., 350 F.2d 445, 449 (D.C. Cir. 1965). California decisions in a non-arbitration setting have followed a similar analysis. A & M Produce Co. v. FMC Corp., 135 Cal. App. 3d 473, 484 (Cal. Ct. App. 1982). In *A & M Produce,* a farmer bought weight equipment from a manufacturer pursuant to a sales contract entered into by both parties. *See id.* at 478-79. The contract was on a long, pre-printed form and required a down payment before the equipment was delivered and installed. *Id.* at 500. The farmer paid the deposit and the machinery was installed. *Id.* at 479. When it did not work as he had been told it would the farmer attempted to return the product and recover the down payment when the manufacturer refused. *Id.* at 480. The farmer brought an action for damages and the court held that the contract was unconscionable because the warranty and disclaimer terms were buried in the form contract. *Id.* at 493 (concluding that the trial court was correct in finding unconscionability).

125. *Fotomat,* 464 So. 2d at 631.

126. *A & M Produce,* 135 Cal. App. 3d at 487. *See also* CAL. CIV. CODE § 1670.5 (2004), Legislative Committee Comment (1979) (the principle of unconscionability is one of the prevention of oppression and unfair surprise and not the disturbance of allocation of risks because of superior bargaining power).

127. *A & M Produce,* 135 Cal. App. 3d at 487.

128. LORD, WILLISTON ON CONTRACTS, *supra* note 108, §18:14.

IV. THE PREEMPTIVE SCOPE OF THE FAA AND ITS CONVERGENCE WITH THE STATE LAW DOCTRINE OF UNCONSCIONABILITY

Four years ago, in *Armendariz*, the California Supreme Court redefined the judicial landscape related to the viability of arbitration agreements.[129] The *Armendariz* court had before it the enforceability of a compulsory predispute arbitration agreement that applied to statutory employment discrimination claims.[130] The court rejected an argument that such claims are *per se* not arbitrable, but focused its decision on two issues related to enforcement of arbitration agreements.

First, the *Armendariz* court considered procedural and substantive unconscionability, the two generally accepted elements of the contract defense, which the court held applies to all arbitration agreements irrespective of the claim at issue. The court held that "few employees are in a position to refuse a job because of an arbitration agreement" and that when an agreement is presented to an employee or prospective employee on a take it or leave it basis the element of procedural unconscionability is satisfied.[131] On the issue of substantive unconscionability, the court held that an employer-employee arbitration agreement must contain a "modicum of bilaterality" and not commit the employee to the arbitration forum while reserving the right of the employer to go to court without some "business realit[y]" justifying the lack of mutuality.[132]

Second, as to claims affecting public rights (e.g., employment discrimination claims), the *Armendariz* court held that in order for an arbitration agreement to be enforceable it must meet certain "minimum requirements": (1) no limitation of available remedies; (2) adequate discovery; (3) a written arbitration decision setting forth, however briefly, the essential findings and conclusions on which the decision is based; and (4) all expenses unique to arbitration are to be borne by the employer.[133] These "minimum requirements," which do not, at least by reason of *Armendariz*, apply to an unconscionability analysis are addressed in Section V.

Armendariz set off a literal fire storm of reported decisions related to the enforceability of arbitration agreements under California law; that fire is still raging today. As shown below, these decisions have, among other things, required strict mutuality—if not more—in arbitration agreements and the courts, ostensibly following *Armendariz*, routinely strike down agreements on this basis.

With this backdrop in mind, we turn again to the settled law. The United States Supreme Court has held that "as a matter of federal law, any doubts concerning the scope of arbitrable issues should be resolved in favor of arbitration, whether the problem at hand is the construction of the contract language itself or an allegation of waiver, delay, or a like defense to arbitrability."[134] But, as we

129. Armendariz v. Found. Health Psychcare Servs., Inc., 6 P.3d 669 (Cal. 2000). For a further discussion of Armendariz, see *infra* Section V.

130. *Armendariz*, 6 P.3d at 669.

131. *Id.* at 690.

132. *Id.* at 690-91.

133. *See generally id.*

134. Moses H. Cone Mem'l Hosp. v. Mercury Constr. Corp., 460 U.S. 1, 24-25 (1983); Volt Info. Scis., Inc. v. Bd. of Trs. of Leland Stanford Junior Univ., 489 U.S. 468, 475-76 (1989) (quoting *Moses H.* 460 U.S. at 25).

explained more fully in Section II, this does not mean that states may not apply *any* of their own laws when it comes to arbitration agreements.

The "savings clause," found in section 2 of the FAA, permits courts to apply "generally applicable contract defenses, such as fraud, duress, or unconscionability . . . to invalidate arbitration agreements."[135] Indeed, the FAA preserves the authority of courts to refuse to enforce an arbitration agreement "upon such grounds as exist at law or in equity for the revocation of any contract."[136] In *Perry*, however, the Supreme Court cautioned that such state laws may only be relied upon if "[they] arose to govern issues concerning the validity, revocability, and enforceability of contracts generally."[137] Arbitration agreements must be treated the same as any other contracts—no better, no worse—irrespective of the fact that they have "arbitration" as their focus.

This seemingly bland pronouncement of federal arbitration law has, as in the case of California, been easier stated than applied. Unconscionability has presented particular difficulty.[138] As shown above, it is an axiomatic principle that any unconscionability analysis requires a court to assess whether the contract is "substantively" unconscionable. This is, by definition, a fact specific inquiry that derives its very meaning from, among other things, the subject matter of the contract being evaluated.[139]

This presents a curious dilemma, as the United States Supreme Court has held that "a court may [not] rely on the uniqueness of an agreement to arbitrate as a basis for . . . holding that enforcement would be unconscionable, for this would enable the court to effect what . . . the state legislature cannot."[140] Similarly, a principle of state law that "takes its meaning precisely from the fact that a contract to arbitrate is at issue does not comport with [the] requirement of [section] 2."[141]

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135. Doctor's Assocs., Inc. v. Casarotto, 517 U.S. 681, 687 (1996); Perry v. Thomas, 482 U.S. 483, 492 n.9 (1987).

136. 9 U.S.C. § 2 (2004).

137. *Doctor's Associates*, 517 U.S. at 687 (quoting *Perry*, 482 U.S. at 492 n.9).

138. Years before section 2 of the FAA became an issue in the courts, commentators foresaw the potential difficulty in applying the unconscionability doctrine under the FAA:

> State unconscionability rules pose a unique and difficult problem for courts applying a nondiscrimination test. A state rule that held all arbitration agreements unconscionable per se would be essentially a disguised version of the common law rule that arbitration agreements are unenforceable and would clearly conflict with section 2 of the Act. Assuming that a state applies its unconscionability rules both to arbitration agreements and to other contract terms, the difficult question becomes whether the Act ever permits a state to hold an arbitration agreement unconscionable. On the one hand, the Act contemplates that the full range of legal and equitable defenses to the enforcement of any contract will be available to parties opposing arbitration, and many states recognize an unconscionability defense to contract enforcement. On the other hand, a finding of unconscionability seems to reflect a judicial determination that arbitration is unfair, a view that implies judicial hostility toward arbitration.

Note, *Incorporation of State Law Under the Federal Arbitration Act*, 78 MICH. L. REV. 1391, 1411 (1980) (internal citations omitted).

139. Freeman v. Wal-Mart Stores, Inc., 111 Cal. App. 4th 660, 669 (Cal. Ct. App. 2003) (holding that "unconscionability is a flexible doctrine designed to allow courts to consider numerous factors in determining whether a contract is unconscionable"); Gutierrez v. Autowest, Inc., 114 Cal. App. 4th 77, 89 (Cal. Ct. App. 2003) (noting that "numerous factual issues may bear on" the question of unconscionability).

140. Perry v. Thomas, 482 U.S. 483, 492 (1987).

141. *Id.*

The only apparent means of reconciling these seemingly conflicting principles starts with the most basic statement of the FAA. The FAA was a prophylactic statute enacted to "reverse centuries of judicial hostility to arbitration agreements by placing them on equal footing with other contracts."[142] Similarly, and consistent with this principle, the Supreme Court has held that "we are well past the time when judicial suspicion of the desirability of arbitration and of the competence of arbitral tribunals" should inhibit enforcement of the FAA.[143]

One rule can be distilled from the above: in applying an unconscionability analysis to an arbitration agreement, a court may not presume that arbitration in and of itself is inferior to a court proceeding or apply some "unique" unconscionability test to arbitration agreements. There are certainly gray areas in any reasoned analysis of whether the unconscionability doctrine is applied in an arbitration specific manner by a particular court. As we show below in Section IV, much of California's decisional law tests these boundaries, as its hostility to arbitration is transparent. Below we deal with a less gray area, where California courts—and the Ninth Circuit—have *changed* the unconscionability doctrine to strike down arbitration agreements. We focus on arbitration in an employment setting because, as demonstrated by *Armendariz* and its progeny, this is, at present, the most litigated area in arbitration law.

A. The FAA Preempts California's (and the Ninth Circuit's) Arbitration Specific Doctrine of Unconscionability

Professor Karl Llewellyn once wrote that "covert tools are never reliable tools."[144] This quote is apropos to any current discussion of unconscionability and arbitration agreements in California. California courts and the Ninth Circuit are not applying the "unconscionability" doctrine as any other court—
or, in fact, these courts—have known it in the past. It is a new form of "unconscionability," known only to arbitration and only to California. Its apparent aim is to accomplish what the FAA commands cannot be done. And it does so all under the guise of a "generally applicable contract defense."[145]

There is irony in the fact that, as a general contract principle, the "unconscionability" doctrine was developed, in part, to stop courts from disingenuously using "imaginative flanking devices" and "surreptitious" means to avoid enforce-

142. Shearson/Am. Express v. McMahon, 482 U.S. 220, 225-26 (1987). *See also* Gilmer v. Interstate/Johnson Lane Corp., 500 U.S. 20, 36 (1991).

143. Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc., 473 U.S. 614, 626-27 (1985).

144. KARL N. LLEWELLYN, THE COMMON LAW TRADITION: DECIDING APPEALS 365 (1960) (quoting Karl Llewellyn, *The Standardization of Commercial Contracts in English and Continental Law*, 52 HARV. L. REV. 700, 703 (1937)).

145. Doctor's Assocs., Inc. v. Casarotto, 517 U.S. 681, 687 (1996) (giving examples of "generally applicable contract defenses"). A useful analogy to the issues under the FAA involving unconscionability is drawn by looking to equal protection cases that distinguish between those laws that facially discriminate and those that are neutral on their face but administered in a discriminatory manner. *Compare* Loving v. Virginia, 388 U.S. 1 (1967) (statute prohibiting interracial marriages) *with* Louisiana v. United States, 380 U.S. 145 (1965) (statute requiring that all potential voters understand the Constitution irrespective of race).

ment of what they perceived as overly harsh and unfair contracts.[146] In the context of arbitration, the remedy has become the ill.[147] To avoid the FAA's preemptive scope, California's courts (and the Ninth Circuit) are cloaking their inherent bias against arbitration in the "unconscionability" doctrine. We address two of the most extreme examples below.

1. Ingle v. Circuit City Stores and the Rebuttable Presumption of Substantive Unconscionability

On the first day of law school—and, in particular, the first day of contracts class—nearly every American law student had the following blackletter principle etched in her mind: *contracts, legal in subject matter, will be enforced as written unless the party resisting enforcement of the contract can establish a defense to enforcement.*[148] That is the law; it has always been the law. And nothing is different for the defense of unconscionability. Indeed, "[t]he party asserting the defense of unconscionability must prove it."[149] Not so in the Ninth Circuit when dealing with arbitration agreements assessed under California law (at least in an employment setting).

In *Ingle v. Circuit City Stores*, the Ninth Circuit, applying California law, manipulated the contractual defense of unconscionability in an arbitration setting under California law and held that "a contract to arbitrate between an employer and an employee . . . raises a *rebuttable presumption* of substantive unconscionability."[150] The *Ingle* court did nothing short of reinterpret the doctrine of unconscionability by placing the burden of proof on the party seeking enforcement of a contract to show affirmatively that it is not substantively unconscionable. Yet, that is not how generally applicable contract defenses work. No California state court had adopted the "rebuttable presumption" standard prior to *Ingle*, and none has adopted it since. The fact that *Ingle* is in an employment setting is irrelevant, as the Supreme Court has been "clear in rejecting the supposition that the advan-

146. JOHN D. CALAMARI & JOSEPH M. PERILLO, THE LAW OF CONTRACTS 401 (3d ed. 1987); John A. Spanogle, Jr., *Analyzing Unconscionability Problems*, 117 PA. L. REV. 931, 931 (1969) (describing unconscionability as a "fashionable . . . all-purpose weapon against [all] contract problems").

147. California and North Carolina were the only two jurisdictions to omit section 2-302 when originally adopting the UCC. In California, this was in 1962. The California State Bar Committee on the UCC, in a bit of foreshadowing, explained that the rationale behind this decision was based on a concern about potentially excessive discretion on the part of judges to strike down contracts based on subjective, indeterminate views of unfairness. California State Bar Committee on the Uniform Commercial Code, *Uniform Commercial Code*, 37 CAL. ST. B.J. 117, 135-36 (1962).

148. *See, e.g.*, Steven W. Feldman, *Resolving Contractual Ambiguity in Tennessee: A Systematic Approach*, 68 TENN. L. REV. 73, 75 n.6 (2000); Ballard v. N. Am. Life & Cas. Co., 667 S.W.2d 79, 82 (Tenn. Ct. App. 1983) (explaining that absent grounds for avoidance, "a contract must be interpreted and enforced as written even though it contains terms which may be thought harsh and unjust"). *See generally* FARNSWORTH, CONTRACTS, *supra* note 99, § 19.

149. FARNSWORTH, CONTRACTS, *supra* note 99, § 4.28. Notably, Professor Farnsworth was the reporter for the Restatement (Second) of Contracts. *See also* Engalla v. Permanente Med. Group, Inc., 15 Cal. 4th 951, 972 (Cal. 1997); Woodside Homes of Cal., Inc. v. Super. Ct., 107 Cal. App. 4th 723, 727-28 (Cal. Ct. App. 2003) (stating "the party asserting unconscionability as a defense has the burden of establishing that condition"); Szetela v. Discover Bank, 97 Cal. App. 4th 1094, 1099 (Cal. Ct. App. 2002) (stating that "the party opposing arbitration has the burden of proving the arbitration provision is unconscionable"); Westlye v. Look Sports, Inc., 17 Cal. App. 4th 1715, 1738-39 (Cal. Ct. App. 1993).

150. Ingle v. Circuit City Stores, 328 F.3d 1165, 1174 (9th Cir. 2003) (emphasis added).

tages of the arbitration process somehow disappear when transferred to the employment context."[151]

The "basis" for the *Ingle* court's holding is troubling. The *Ingle* court held that substantive unconscionability exists where the "terms of the agreement . . . are so one-sided as to shock the conscience."[152] The holding in *Ingle* was not a controversial statement of the law. But in the Ninth Circuit's view, it does not matter whether the text of the agreement commits employers as well as employees to arbitration. The mere fact that the agreement is between an employer and employee is enough to make it so one-sided as to "shock the conscience":

> [Where an] arbitration agreement subjects [an employer] to the same terms that apply to its employees . . . the agreement is one-sided anyway. Because the possibility that [an employer] would initiate an action against one of its employees is so remote, the lucre of the arbitration agreement flows one way . . . . The only claims realistically affected by an arbitration agreement between an employer and an employee are those claims employees bring against their employers.[153]

Ingle—at least on its face—does allow an employer to rebut the presumption of substantive unconscionability by demonstrating that the "effect of a contract to arbitrate is bilateral . . . with respect to a particular employee."[154] In practice, how an employer can do this, when bilateral contract language is itself not enough, is a mystifying question. Not surprisingly, no employer has done so yet.[155]

The Ninth Circuit's rule is obviously arbitration specific and applies unconscionability in a manner that takes "its meaning precisely from the fact that a contract to arbitrate is at issue." Furthermore, the *Ingle* court based its decision on a concern that employees are required to "waive their right to seek redress in the judicial forum," irrespective of the attributes of the arbitrable forum provided for by the arbitration agreement. This is precisely the type of generalized judicial hostility to arbitration that the FAA was enacted to overcome. The FAA does not countenance the *Ingle* court's brand of arbitration specific unconscionability. No matter what name it bears, unconscionability under *Ingle* is no longer a state law "that arose to govern issues concerning the validity, revocability and enforceability of contracts generally,"[156] and it is preempted by the FAA.

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151. Circuit City Stores v. Adams, 532 U.S. 105, 123 (2001).

152. *Ingle*, 328 F.3d at 1172 (quoting Kinney v. United Healthcare Servs., Inc., 70 Cal. App. 4th 1322, 1330 (Cal. Ct. App. 1999)).

153. *Id.* at 1174.

154. *Id.* This defense has not been applied in practice. *See* Circuit City Stores, Inc. v. Mantor, 335 F.3d 1101, 1109 (9th Cir. 2003) (stating that "perhaps under other circumstances we would find it necessary to remand to the district court to allow Circuit City to present evidence tending to rebut the presumption that its arbitration agreement is substantively unconscionable, we need not remand in this case").

155. General principles of California contract law do not allow a court to look behind facially mutual contract language to make an assessment of which party will bear the greater risk under a contract. *See* Appalachian Ins. Co. v. McDonnell Douglas Corp., 214 Cal. App. 3d 1 (Cal. Ct. App. 1989) (holding that a mutual waiver of liability in a contract for the use of a rocket to lift a communications satellite was not unconscionable when the satellite did not reach its desired orbit, thereby causing $105 million in damages on a $6 million contract).

156. Perry v. Thomas, 482 U.S. 483, 492 n.9 (1987).

2. *Mutuality in Arbitration Agreements: If Not for Suspicion of the Arbitral Forum, Why Is It Required?*

In *Ingle*, the Ninth Circuit created a completely new rule of unconscionability. The procedural application of the doctrine was changed to strike down an arbitration agreement. By requiring "mutuality" of obligation in arbitration agreements—and only arbitration agreements—California courts have applied a heightened standard of unconscionability in the arbitration context. In any assessment of unconscionability, the question of mutuality is a fair matter for consideration. It bears on the question of whether an agreement is so "one sided" as to "shock the conscience." But, mutuality of obligation is not, nor has it ever been, the benchmark for any general unconscionability analysis in California.

In *Armendariz*, the California Supreme Court added a gloss to the doctrine of unconscionability by reasoning that an arbitration agreement is substantively unconscionable when "it requires one contracting party, but not the other, to arbitrate all claims arising out of the same transaction or occurrence."[157] The court expressly acknowledged that the application of this mutuality requirement in its unconscionability analysis manifests itself in "forms peculiar to the arbitration context."[158] The *Armendariz* court believed that "it [was] unfairly one-sided for an employer . . . to impose arbitration on the employee as plaintiff but not to accept such limitations when it seeks to prosecute a claim against the employee, without at least some reasonable justification . . . based on 'business realities.'"[159] Absent a mutual obligation to arbitrate, the court believed that arbitration becomes a "means of maximizing employer advantage."[160] This is true irrespective of the substantive and procedural attributes of the arbitral forum agreed to by the parties. Such a rule expressly violates the United States Supreme Court's command that, at least irrespective of the attributes of the forum, "arbitration affects only the choice of forum, not substantive rights."[161] If not for an inherent bias or assumption that arbitration is less desirable—which is prohibited by the FAA—the issue of mutuality would not be relevant.

Not surprisingly, no lower court has yet to find any business reality sufficient to justify a departure from a strict requirement of "mutuality" in the text of an arbitration agreement. Indeed, California courts have gone so far as to strike down agreements with a sole—and facially mutual—carve-out for "injunctive relief from any court having jurisdiction with respect to any disputes or claims relating to or arising out of the misuse or appropriation of the [c]ompany's trade secrets or confidential and proprietary information."[162] While this strict require-

157. Armendariz v. Found. Health Psychcare Servs., Inc., 6 P.3d 669, 694 (Cal. 2000).
158. *Id.* at 692.
159. *Id.*
160. *Id.*
161. EEOC v. Luce, Forward, Hamilton & Scripps, 345 F.3d 742, 744-45 (9th Cir. 2003) (citing EEOC v. Waffle House, Inc., 534 U.S. 279, 296 n.10 (2002)). *See also* Gilmer v. Interstate/Johnson Lane Corp., 500 U.S. 20, 26 (1991).
162. Abramson v. Juniper Networks, Inc., 115 Cal. App. 4th 638, 665 (Cal. Ct. App. 2004) (quoting the employment contract at issue); Mercuro v. Super. Ct., 96 Cal. App. 4th 167, 176-77 (Cal. Ct. App. 2002); Ferguson v. Countrywide Credit Indus., 298 F.3d 778, 785 (9th Cir. 2003) (applying *Mercuro* and holding substantively unconscionable a facially mutual exclusion of "claims for injunctive and/or other equitable relief for intellectual property violations, unfair competition and/or the use and/or

ment of "mutuality" in the text of an arbitration agreement is less drastic than the *Ingle* holding, that even facially mutual agreements are not in fact mutual, it is nevertheless still preempted by the FAA.

First, and as a general matter, California law does not, outside of an arbitration context, require strict mutuality of obligation as a precondition to enforcement of contracts, so this is a "unique" rule that applies only in an arbitration setting.[163] Indeed, such a rule has been widely rejected.[164] Second, the requirement

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unauthorized disclosure of trade secrets or confidential information"); Flores v. Transamerica HomeFirst, Inc., 93 Cal. App. 4th 846, 853-54 (Cal. Ct. App. 2001) (holding that carve out for foreclosure proceedings in real estate contract is substantively unconscionable); Martinez v. Master Prot. Corp., 118 Cal. App. 4th 107, 115 (Cal. Ct. App. 2004) (citing to *Mercuro*); O'Hare v. Mun. Res. Consultants, 107 Cal. App. 4th 267, 273-74 (Cal. Ct. App. 2003) (carve out allowing employer, but not employee, to seek injunctive or equitable relief is unconscionable).

163. *Compare* Principal Mut. Life Ins. Co. v. Vars, Pave, McCord & Freedman, 65 Cal. App. 4th 1469, 1488-89 (Cal. Ct. App. 1998) (mortgage agreement provision enforceable despite unilateral nature; "Where sufficient consideration is present, mutuality is not essential."), Hillsman v. Sutter Cmty. Hosp., 153 Cal. App. 3d 743, 752 (Cal. Ct. App. 1984) (holding employment contract enforceable despite unilateral nature if consideration requirement is properly met, a "mutuality of obligation" is unneccessary), RESTATEMENT (SECOND) OF CONTRACTS § 79(c) (1981) (stating that "[i]f the requirement of consideration is met, there is no additional requirement of . . . 'mutuality of obligation'"), 2 JOSEPH M. PERILLO & HELEN HADJIYANNIKAS BENDER, CORBIN ON CONTRACTS § 6.1 (rev. ed. 1995) (noting that "[t]he concept of 'mutuality' is an appealing one. It seems to connote equality, fairness, justice . . . . But symmetry is not justice and the so-called requirement of mutuality of obligation is now widely discredited"), *and* 3 SAMUEL WILLISTON & RICHARD A. LORD, A TREATISE ON THE LAW OF CONTRACTS § 7.14 (4th ed. 1992), *with* Ting v. AT&T, 319 F.3d 1126, 1149 (9th Cir. 2003) (advising that "[i]n determining whether an arbitration agreement is sufficiently bilateral, courts assessing California law look beyond facial neutrality and examine the actual effects of the challenged provision") (citing Acorn v. Household Int'l, Inc., 211 F. Supp. 2d 1160, 1172 (N.D. Cal. 2002), *and* Szetela v. Discover Bank, 97 Cal. App. 4th 1094, 1101 (Cal. Ct. App. 2002).

164. *See, e.g.*, Barker v. Golf U.S.A., Inc., 154 F.3d 788, 791-92 (8th Cir. 1998) (stating that "under Oklahoma law, mutuality of obligation is not required for arbitration clauses so long as the contract as a whole is supported by consideration"); Doctor's Assocs., Inc. v. Distajo, 66 F.3d 438, 451-53 (2d Cir. 1995) (noting that "where the agreement to arbitrate is integrated into a larger unitary contract, the consideration for the contract as a whole covers the arbitration clause as well") (quoting W.L. Jorden & Co. v. Blythe Indus., 702 F. Supp. 282, 284 (N.D. Ga. 1988)); Hurdle v. Fairbanks Capital Corp., 2002 U.S. Dist. LEXIS 18357, at *12 (E.D. Pa. Sept. 18, 2002) (finding "sufficient, if unequal, consideration"); Morgan v. Bill Kay Chrysler Plymouth, 2002 U.S. Dist. LEXIS 18460, at *12 (N.D. Ill. July 17, 2002) (asserting that "even if Bill Kay is not obligated to arbitrate any claims, the contract is clearly supported by consideration on both sides"); Sparks v. Stone St. Capital, Inc., 2002 U.S. Dist. LEXIS 11808, at *14 (N.D. Tex. June 28, 2002) (noting that "[n]either federal nor Texas state law requires that an arbitration clause have mutuality of obligation, provided that the underlying contract is supported by adequate consideration"); Pridgen v. Green Tree Fin. Servicing Corp., 88 F. Supp. 2d 655, 659 (D. Miss. 2000) (declaring that because "mutuality of obligation is not required for a contract to be enforceable . . . the arbitration clause is not unenforceable"); Raesly v. Grand Housing, Inc., 105 F. Supp. 2d 562, 570 (D. Miss. 2000) (following *Pridgen*); Wright v. Circuit City Stores, Inc., 82 F. Supp. 2d 1279, 1284 (D. Ala. 2000) (finding that "Circuit City's promise to be bound by the arbitration process and results of employee disputes that are initiated by employees is sufficient consideration in this case"); Kelly v. UHC Mgmt. Co., 967 F. Supp. 1240, 1260 (D. Ala. 1997) (explaining that "[a]ssuming that [the parties' agreements] do not contain 'mutuality of obligation,' the court is of the opinion that such mutuality is not required for a valid arbitration agreement to exist. All that is required is consideration [and] [b]ecause the agreements do not lack consideration, they are enforceable contracts"); Latifi v. Sousa, 1996 U.S. Dist. LEXIS 19052, at *15 (N.D. Ala. Dec. 23, 1996) (explaining that "the [c]ourt is convinced that Alabama uses the unitary approach to consideration and does not impose any additional 'mutuality' requirement"); Design Benefit Plans, Inc. v. Enright, 940 F. Supp. 200, 205 (D. Ill. 1996) (asserting that "this court is of the opinion that the Illinois Supreme Court, if presented with the issue, would not find an arbitration clause, which compels one party to submit all disputes to arbitration but allows the other party the choice of pursuing arbitration or litigation, to be

of mutuality—when it is viewed apart from the specifics of the arbitral forum—reflects a firmly held "judicial hostility" towards arbitration. It rests on nothing less than an assumption that arbitration, just because it is arbitration, is less desirable than litigation.

Put another way, a typical unconscionability analysis requires a court to assess whether an agreement is so "one-sided" as to "shock the conscience."[165] California courts have invoked this test to invalidate what they perceive as nonmutual arbitration agreements, holding that "a unilateral arbitration agreement imposed by an employer without reasonable justification" is substantively unconscionable.[166] This is true without regard to any substantive evaluation of the arbitral forum contemplated by the agreement. The only way that such an agreement can be viewed as unconscionable is if the forum of arbitration is perceived as inferior to court. If this were not the assumption, there would be no reason to declare the agreement one-sided.

The FAA does not permit courts to make these types of inherently biased, and generalized, judgments about arbitration. Indeed, "while the deprivation of one's right to seek legal redress in a court might at first glance appear contrary to some stronger public policy, the Supreme Court has stated that an arbitral forum stands on equal footing with a court of law, insofar as the ability to resolve legal disputes is concerned."[167]

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invalid for lack of mutuality of obligation or remedy where the contract as a whole is otherwise supported by consideration on both sides"); Gadsden Budweiser Distrib. Co. v. Holland, 807 So. 2d 528, 531 (Ala. 2001) (declaring that "we do not find the arbitration provision to be unenforceable for a lack of 'mutuality of obligation'"); Ex parte McNaughton, 728 So. 2d 592, 596 (Ala. 1998) (finding that "United's provision of new at-will employment to McNaughton was sufficient consideration to make McNaughton's promise to arbitrate employment disputes under United's arbitration policy a binding agreement"); Rains v. Found. Health Sys. Life & Health, 23 P.3d 1249, 1255 (Colo. Ct. App. 2001) (finding that because consideration was present from each party "the arbitration provision is not unenforceable simply because it does not require defendant to arbitrate"); Avid Eng'g, Inc. v. Orlando Marketplace Ltd., 809 So. 2d 1, 4 (Fla. Dist. Ct. App. 2001) (holding that "[b]ecause there was sufficient consideration to support the entire contract, the arbitration provision was not void for lack of mutuality of obligation"); Bishop v. We Care Hair Dev. Corp., 738 N.E.2d 610, 623 (Ill. App. Ct. 2000) (finding that "[t]he fact that the parties agreed to allow We Care Hair to litigate any breach of the sublease is not itself fatal since parties do not have to agree to identical obligations"); Lackey v. Green Tree Fin. Corp., 498 S.E.2d 898, 905 (S.C. Ct. App. 1998) (declaring that "there is no requirement that the consideration for one party's obligation to arbitrate all issues under a contract be the other party's obligation to arbitrate all issues under that contract"); In re Firstmerit Bank, N.A., 52 S.W.3d 749, 757 (Tex. 2001) (determining that "an arbitration clause does not require mutuality of obligation, so long as the underlying contract is supported by adequate consideration" and stating that "[m]ost federal courts" have accepted this view).

165. Hicks v. Super. Ct., 115 Cal. App. 4th 77 (Cal. Ct. App. 2004) (stating that "[t]o be substantively unconscionable, a contractual provision must shock the conscience"); Kinney v. United Healthcare Servs., Inc., 70 Cal. App. 4th 1322, 1330 (Cal. Ct. App. 1999).

166. *See* Armendariz v. Found. Health Psychcare Servs., Inc., 6 P.3d 669, 693-94 (Cal. 2000); Abramson v. Juniper Networks, Inc., 115 Cal. App. 4th 638 (Cal. Ct. App. 2004).

167. Raasch v. NCR Corp., 254 F. Supp. 2d 847, 864 (D. Ohio 2003) (citing Rodriguez De Quijas v. Shearson/Am. Express, Inc., 490 U.S. 477, 487 (1989)) (stating that "[q]uite simply, the act of replacing an employee's access to the courts for airing employment-related disputes with access to an arbitral forum, provided it appears fair and impartial, cannot be viewed as a penalty or the like"). *See also* Green Tree Fin. Corp. v. Randolph, 531 U.S. 79, 89-90 (2000) (quoting *Rodriguez De Quijas*, 490 U.S. at 487, and stating "[w]e have likewise rejected generalized attacks on arbitration that rest on 'suspicion of arbitration as a method weakening the protections afforded in the substantive law to would be complainants'").

The United States Supreme Court precedent interpreting section 2 of the FAA forbids courts from submitting arbitration agreements to special, or "peculiar," scrutiny.[168] "The 'goals and policies' of the FAA . . . are antithetical to threshold limitations placed specifically and solely on arbitration provisions."[169] Indeed, courts may not even consider the fact that a contract to arbitrate is at issue in assessing whether the agreement is unconscionable.[170] The conclusion that California courts are doing just that is, quite frankly, inescapable.[171]

V. JUDICIAL ENFORCEMENT—OR, MORE OFTEN, NON-ENFORCEMENT—OF ARBITRATION AGREEMENTS UNDER CALIFORNIA LAW

A. Judicial Suspicions Abound

In addition to the clear cut examples discussed above, the hostility to arbitration by California courts comes in more subtle forms as well. For example, notwithstanding the dictates of the FAA, the California Supreme Court has explicitly acknowledged its suspicion of arbitration agreements and its deeply rooted doubts regarding the fairness of arbitration, particularly in an employment setting.[172] In *Armendariz v. Foundation Health Psychcare Services, Inc.*, the California Supreme Court stated that "[w]hile arbitration may have its advantages in terms of greater expedition, informality and lower cost, it also has, from the employee's

168. *See* 9 U.S.C. § 2 (2004).

169. Doctor's Assocs. v. Casarotto, 517 U.S. 681, 688 (1996).

170. *Id.* At least one decision, by a lone United States District Court Judge, has held that the *Armendariz* court's requirement of mutuality singles out arbitration for suspect status. Gray v. Conseco, Inc., 2000 U.S. Dist. LEXIS 14821 (D. Cal. Sept. 29, 2000) (disagreeing "with the California Supreme Court in so far as it held that its rule did not single out and impose a special burden on arbitration agreements [because] [u]nder California law, other non-mutual contract provisions are valid and are not unconscionable"). *See infra* Section IV (for full discussion of *Armendariz*).

171. In *Hull v. Norcom, Inc.*, the Eleventh Circuit, applying New York law, held that an employment arbitration agreement that allowed the employer (and only the employer) "to institute and prosecute proceedings in any court of competent jurisdiction . . . to obtain damages . . . or [injunctive relief]" was invalid for lack of consideration. 750 F.2d 1547, 1549-50 (11th Cir. 1985). The leading treatise on federal arbitration law contends that this decision, which has since been widely rejected, violates the FAA:

> The *Hull* case is incorrectly decided. Contrary to its assertion, the court did not decide the case by applying "general contract" principles of New York. There is, of course, no New York "general contract" principle that each provision in a contract must have its own consideration. The *Hull* court simply decided the case on the basis of New York arbitration law. New York law, according to the court, required arbitration clauses to have their own consideration. That law treated arbitration differently than would general New York contract law. This adverse discriminatory treatment is invalid under *Southland Corp. v. Keating*, and the court should have so held. If there was any doubt of this at the time of *Hull*, it has been removed by the language . . . from *Perry v. Thomas*.

2 IAN R. MACNEIL ET AL., FEDERAL ARBITRATION LAW: AGREEMENTS, AWARDS, & REMEDIES UNDER THE FEDERAL ARBITRATION ACT § 17:59 (Supp. 1999) (internal citations omitted). Of course, *Hull* involved a completely unilateral agreement, which is far more objectionable than the facially mutual agreements that are routinely struck down by California courts.

172. Armendariz v. Found. Health Psychcare Servs., Inc., 6 P.3d 669 (Cal. 2000).

point of view, potential disadvantages: waiver of a right to a jury trial,[173] limited discovery, and limited judicial review."[174]

In the court's view, arbitration is correspondingly advantageous to employers "not only because it reduces the cost of litigation, but also because it reduces the size of the award that an employee is likely to get, particularly if the employer is a 'repeat player' in the arbitration system."[175] The potential disadvantages that the California Supreme Court detects for employee litigants "even [in] a fair arbitration system" has compelled California courts to remain "particularly attuned to claims that employers with superior bargaining power have imposed one-sided, *substantively unconscionable* terms as part of an arbitration agreement."[176] As we show below, in the context of arbitration, there has been very little that California courts have not found unconscionable.[177]

1. Procedural Unconscionability

Procedural unconscionability focuses on the "oppression" or "surprise" of a contracting party due to unequal bargaining power.[178] "California courts have consistently held that where a party in a position of unequal bargaining power is presented with an offending clause without the opportunity for meaningful negotiation . . . procedural unconscionability [is] present."[179] In California, this usually takes the form of a contract of adhesion, which is imposed and drafted "by the party of superior bargaining strength [and] relegates to the subscribing party only the opportunity to adhere to the contract or reject it."[180]

In the context of arbitration, and in particular, in an employment setting, California courts have taken a paternalistic approach and stretched this doctrine well

173. *Id.* at 115. In a non-arbitration setting, a lone California appellate court recently held—and in so doing overruled prior decisions—that a contractual predispute waiver of a jury trial is unenforceable as a matter of law. Grafton Partners L.P. v. Super. Ct., 115 Cal. App. 4th 700, 704 (Cal. Ct. App. 2004). The California Supreme Court recently accepted review of this decision. 88 P.3d 24 (Cal. 2004).

174. *Armendariz*, 6 P.3d at 690. Outside of an employment context, the California Supreme Court has also resisted permitting arbitration of certain types of claims. In *Cruz v. PacifiCare Health Sys., Inc.*, the California Supreme Court held that claims for injunctive relief under the California Consumer Legal Remedies Act are not arbitrable. 30 Cal. 4th 303, 307 (Cal. 2003). The court rejected an argument that such a holding would violate the FAA, stating that the Supreme Court "has never directly decided whether a legislature may restrict a private arbitration agreement when it inherently conflicts with a public statutory purpose that transcends private interests." *Id.* at 313. Justice Chin, in a vigorous dissent (joined by two other justices), argued that the majority's holding was preempted by the FAA. *Id.* at 322 (Chin, J., dissenting). *See also* Broughton v. Cigna Healthplans of Cal., 21 Cal. 4th 1066 (Cal. 1999).

175. *Armendariz*, 6 P.3d at 690. The hostility expressed by the *Armendariz* court has, on at least one occasion, crept into federal decisions applying another state's law. *See, e.g.*, Lelouis v. W. Directory Co., 230 F. Supp. 2d 1214, 1220 (D. Or. 2001) (applying *Armendariz* standard of unconscionability to invalidate an arbitration agreement under Oregon law).

176. *Armendariz*, 6 P.3d at 690 (emphasis added).

177. In *Duffield*, the Ninth Circuit went as far as to hold that employees may not, as a condition of employment, be required to arbitrate claims arising under Title VII of the Civil Rights Act of 1964. Duffield v. Robertson Stephens & Co., 144 F.3d 1182, 1185 (9th Cir. 1998), *overruled by* EEOC v. Luce, Forward, Hamilton & Scripps, 345 F.3d 742, 744-45 (9th Cir. 2003).

178. Gutierrez v. Autowest, Inc., 114 Cal. App. 4th 77, 87 (Cal. Ct. App. 2003).

179. Ferguson v. Countrywide Credit Indus., 298 F.3d 778, 784 (9th Cir. 2002).

180. Graham v. Scissor-Tail, Inc., 28 Cal. 3d 807, 817 (Cal. 1981) (quoting Neal v. State Farm Ins. Cos., 188 Cal. App. 2d 690, 694 (Cal. Ct. App. 1961)).

beyond any logical formulation. In *Armendariz*, the court stated, "in the case of pre-employment arbitration contracts, the economic pressure exerted by employers on all but the most sought-after employees may be particularly acute, for the arbitration agreement stands between the employee and necessary employment, and few employees are in a position to refuse a job because of an arbitration requirement."[181]

Accordingly, courts applying California law have held that procedural unconscionability can be found even in cases in which the employee had "ample time to consider alternatives to [the employer's] terms of employment" and the contract was "written in plain English."[182] Furthermore, in an arbitration setting, courts have held that "whether the plaintiff had an opportunity to decline the defendant's contract and instead . . . enter into a contract with another party that does not [contain] the offending terms" has no bearing on whether the contract is procedurally unconscionable.[183] This is in stark contrast to non-arbitration cases, in which courts have held that the availability of alternative providers strips the contract of any element of procedural unconscionability.[184]

Courts applying California law have gone so far as to find procedural unconscionability in arbitration agreements in circumstances where the contract is, in any traditional sense, not presented on a take it or leave it basis.[185] In *Circuit City Stores, Inc. v. Mantor*, the Ninth Circuit held that an arbitration agreement was procedurally unconscionable despite the fact that the employee was given an opt-out form.[186] According to the court, the opt-out form was not enough to "save the agreement" because management had "impliedly and expressly pressured" the employee into signing it.[187] These actions, said the court, deprived the employee

181. *Armendariz*, 6 P.3d at 690. In reality, California courts have consistently held that procedural unconscionability can be found in an arbitration setting even with the most "sought after employees." Stirlen v. Supercuts, Inc., 51 Cal. App. 4th 1519, 1533 (Cal. Ct. App. 1997) (procedural unconscionability found in arbitration agreement between high level executive and company even when company sought out and "hired away" employee from another high level and highly compensated position); *Graham*, 28 Cal. 3d at 818, 831 (holding that Bill Graham, "the dominant rock music impresario of his generation," was subjected to a contract of adhesion in signing an arbitration agreement).

182. *Ferguson*, 298 F. 3d at 784.

183. *Id. See also* Ingle v. Circuit City Stores, Inc., 328 F.3d 1165, 1172 (9th Cir. 2003) (finding that the fact that employee had three days to consider the agreement had no bearing on the issue of procedural unconscionability); Szetela v. Discover Bank, 97 Cal. App. 4th 1094, 1100 (Cal. Ct. App. 2002).

184. Hicks v. Super. Ct., 115 Cal. App. 4th 77, 93 (Cal. Ct. App. 2004) ("comparable housing was available in the area, all supporting the view that the . . . agreement was not, in reality, a contract of adhesion").

185. *Szetela*, 97 Cal. App. 4th at 1100 ("even if the clause at issue here is not an adhesion contract, it can still be found unconscionable"); Pardee Constr. Co. v. Super. Ct., 100 Cal. App. 4th 1081, 1087 (Cal. Ct. App. 2002) (noting that "[i]n any event, even if the parties' agreements were deemed not to be adhesive, plaintiffs have established the judicial reference provisions of those agreements were unconscionable at the time such agreements were made"); Bolter v. Super. Ct., 87 Cal. App. 4th 900, 908 (Cal. Ct. App. 2001) (stating that "adhesive arbitration agreements are not per se unconscionable").

186. 335 F.3d 1101, 1107 (9th Cir. 2003). *But see* Circuit City Stores, Inc. v. Ahmed, 283 F.3d 1198, 1199-1200 (9th Cir. 2002) (holding that agreement in which employee is given an opportunity to "opt out" by "mailing in a simple one page form" and is "encouraged to . . . consult an attorney prior to deciding whether to participate in the program" is not procedurally unconscionable); Circuit City Stores, Inc. v. Najd, 294 F.3d 1104, 1108-09 (9th Cir. 2002) (reaching same conclusion as in *Ahmed*, under identical agreement).

187. *Mantor*, 335 F.3d at 1106.

of any "meaningful, reasonable choice" to reject the terms, rendering the agreement procedurally unconscionable.[188] Even in those cases where no evidence of procedural unconscionability is presented, courts have looked solely to the terms of the agreement to find unconscionability.[189]

One of the most perplexing California court decisions interpreting this element is *McManus v. CIBC World Markets Corp.*[190] The *McManus* court held that a form U-4, which is a required and SEC-approved Uniform Application for Securities Industry Registration or Transfer,[191] was a contract of adhesion vis-à-vis the employee and employer because it was imposed as a condition of employment with no opportunity to negotiate.[192] The court, however, failed even to consider that, if there were compulsion, it actually flowed from the mandate of the federal and California laws that required McManus to register with the NASD and NYSE as a prerequisite to working in the securities industry and not from his employer. The court also failed to acknowledge that the U-4, an SEC approved form, was not "drafted by the party seeking to enforce" the contract.[193]

The above applications of procedural unconscionability in an arbitration setting do not involve contracts permeated with "oppression" and "surprise,"[194] or contractual "terms [that] are hidden in a prolix printed form drafted by the party seeking to enforce [its] terms."[195] More accurately, they represent with exacting clarity, the manipulation by California courts of well settled contractual law as a means of expressing hostility to arbitration.

2. *Substantive Unconscionability*

Substantive unconscionability concerns "the terms of the agreement and whether those terms are 'so one-sided as to *shock the conscience.*'"[196] The collective conscience of courts applying California law is apparently quite delicate. Indeed, the list of contract terms held "substantively unconscionable" by courts applying California law in an arbitration setting is substantial.[197] Restrictions relating to the types of remedies and claims available,[198] the availability of appeals,[199] limits on the statute of limitations,[200] and the place and manner of arbitra-

188. *Id.*

189. O'Hare v. Mun. Res. Consultants, 107 Cal. App. 4th 267, 283 (Cal. Ct. App. 2003) (holding that lack of "extrinsic evidence about the negotiations, if any, preceding the executions of the 1991 employment contract . . . does not preclude a finding of procedural unconscionability").

190. 109 Cal. App. 4th 76 (Cal. Ct. App. 2003).

191. Execution of the Form U-4 is required by California state and federal law as a means of registering with the National Association of Securities Dealers (NASD) and the New York Stock Exchange (NYSE). CAL. CODE REGS. tit. 10, § 260.210 (2004).

192. *McManus*, 109 Cal. App. at 91.

193. Flores v. Transamerica HomeFirst, Inc., 93 Cal. App. 4th 846, 853 (Cal. Ct. App. 2001).

194. A & M Produce Co. v. FMC Corp., 135 Cal. App. 3d 473, 486 (Cal. Ct. App. 1982).

195. *Id.*

196. Kinney v. United Healthcare Servs., 70 Cal. App. 4th 1322, 1330 (Cal. Ct. App. 1999) (emphasis added).

197. Little v. Auto Stiegler, Inc., 29 Cal. 4th 1064 (Cal. 2003); Harper v. Ultimo, 113 Cal. App. 4th 1402, 1407 (Cal. Ct. App. 2003).

198. Armendariz v. Found. Health Psychcare Servs., Inc., 6 P.3d 669, 683 (Cal. 2000); *Harper*, 113 Cal. App. 4th at 1405; Ingle v. Circuit City Stores, 328 F.3d 1165, 1178-79 (9th Cir. 2003).

199. *Little*, 29 Cal. 4th at 1071-74 (holding provision allowing appellate review, at the request of either party, of awards exceeding $50,000 substantively unconscionable); Fittante v. Palm Springs

tion[201] have all been held substantively unconscionable based on the likelihood that the term in question would favor the drafter of the contract. Under analogous reasoning, arbitration agreements that bar class action suits,[202] require confidentiality,[203] and give one party the power to terminate the agreement unilaterally (on only one date per year with a thirty day notice)[204] have been found substantively unconscionable as well. For example, in *Ting v. AT&T*, a confidentiality requirement contained in an arbitration agreement was held unconscionable based on the reasoning that "confidentiality provisions usually favor companies over individuals."[205]

Terms requiring that filing fees[206] or other arbitration costs be borne by a non-drafting party (even if mutual),[207] and even in an indirect manner, are particularly disfavored. For example, in *Ferguson v. Countrywide Credit Industries*, the court stated that "a fee allocation scheme which requires the employee to split the arbi-

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Motors, Inc., 105 Cal. App. 4th 708, 725-26 (Cal. Ct. App. 2003); Saika v. Gold, 49 Cal. App. 4th 1074, 1076-77 (Cal. Ct. App. 1996) (refusing to enforce appeal provision in agreement between doctor and patient, which provided that either party could seek a trial de novo of any award over $25,000).

200. *Compare* Stirlen v. Supercuts, Inc., 51 Cal. App. 4th 1519, 1542 (Cal. Ct. App. 1997) (finding that application of one year statute of limitations to claims to which a longer period would otherwise apply favors the employer), *Ingle*, 328 F. 3d at 1175 (holding that one year statute of limitations contained in agreement is substantively unconscionable), Martinez v. Master Prot. Corp., 118 Cal. App. 4th 107, 117-18 (Cal. Ct. App. 2004) (holding that six month statute of limitations is substantively unconscionable), *with* Soltani v. Western & Southern Life Ins. Co., 258 F.3d 1038 (9th Cir. 2001). In *Soltani*, in a non-arbitration setting, the Ninth Circuit held that a contractual shortening of the statute of limitations (to six months) is not substantively unconscionable. *Id.* California state decisions in a non-arbitration setting have reached similar conclusions. *See* Han v. Mobil Oil Corp., 73 F.3d 872, 877 (9th Cir. 1995) (stating that "California permits contracting parties to agree upon a shorter limitations period for bringing an action than prescribed by statute, so long as the time allowed is reasonable"); West v. Henderson, 227 Cal. App. 3d 1578, 1581 (Cal. Ct. App. 1991) (finding six month contractual limitations provision in a lease not unconscionable, despite lack of mutuality); Capehart v. Heady, 206 Cal. App. 2d 386, 389 (Cal. Ct. App. 1962) (concluding that three month limitation period in lease was not unreasonable); Beeson v. Schloss, 183 Cal. 618, 624 (Cal. 1920) (finding six month limitation reasonable in employment contract); Hambrecht & Quist Venture Partners v. Am. Med. Int'l, Inc., 38 Cal. App. 4th 1532 (Cal. Ct. App. 1995).

201. Bolter v. Super. Ct., 87 Cal. App. 4th 900, 911 (Cal. Ct. App. 2001) (holding that, in the context of a franchise agreement, a requirement that an arbitration take place in franchisor's home state of Utah is substantively unconscionable, but severing the lone offending provision from the agreement).

202. Ingle v. Circuit City Stores, Inc., 328 F.3d 1165, 1176 (9th Cir. 2003) (holding that facially mutual prohibition on arbitrator "consolidating claims of different persons" is substantively unconscionable); Ting v. AT&T, 319 F.3d 1126, 1150 (9th Cir. 2003) (holding that mutual ban on class actions is substantively unconscionable); Szetela v. Discover Bank, 97 Cal. App. 4th 1094, 1094 (Cal. Ct. App. 2002) (mutual clause barring class actions held substantively unconscionable).

203. *Ting*, 319 F.3d at 1151-52.

204. *Ingle*, 328 F.3d at 1179 (holding unconscionable provision allowing employer to alter or terminate the agreement on "December 31st of any year upon giving thirty calendar days notice").

205. *Ting*, 319 F.3d at 1151.

206. *Ingle*, 328 F.3d at 1177 (holding that a $75 filing fee is unconscionable because it is not the "type of expense that the employee would be required to bear in federal court" and there is no waiver available for indigent complainants); Circuit City Stores, Inc. v. Mantor, 335 F.3d 1101, 1108 (9th Cir. 2003) (holding that a $75 filing fee (the same fee at issue in *Ingle*) is unfairly one-sided even if there is a fee waiver available); Ferguson v. Countrywide Credit Indus., Inc., 298 F.3d 778, 786 (9th Cir. 2003) (invalidating $125 filing fee payable to the National Arbitration Forum); Guttierez v. Autowest, Inc., 114 Cal. App. 4th 77, 89-90 (Cal. Ct. App. 2003) (holding that requiring a filing fee in a consumer contract renders an agreement substantively unconscionable); Martinez v. Master Prot. Corp., 118 Cal. App. 4th 107, 115-16 (Cal. Ct. App. 2004).

207. O'Hare v. Mun. Res. Consultants, 107 Cal. App. 4th 267, 282-83 (Cal. Ct. App. 2003).

trator's fees with the employer would alone render an arbitration agreement substantively unconscionable."[208] The court declared that "the only valid fee provision is one in which an employee is not required to bear *any* expense beyond what would be required to bring the action in court."[209]

In *O'Hare v. Municipal Resource Consultants*, a California appellate court went so far as to hold unconscionable a provision that incorporated the mutual and well respected rules of the American Arbitration Association (AAA).[210] The AAA rules directed that the parties share the costs of arbitration unless agreed or the law requires otherwise.[211] The fact that the employer in *O'Hare* later agreed to pay all the costs was viewed by the court as irrelevant because this was merely an unaccepted offer to modify the contract.[212] The fact that the "law" did in fact require the employer to shoulder all costs of the arbitration was also glossed over by the court.[213]

Mutual limits on discovery in employment arbitration agreements have also been held objectionable based on the assumption that an employer has superior access to information and a decreased need for depositions.[214] Finally, as noted in the preceding section above, strict "mutuality" is required under California law.[215]

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208. *Ferguson*, 298 F.3d at 785.

209. *Id.* at 786.

210. 107 Cal. App. 4th at 279-80. The AAA is a well established (nearly eighty years old) not-for-profit agency which administers dispute resolution services (i.e., arbitration and mediation). For more information, see the AAA's website at www.adr.org. The AAA follows the Due Process Protocol, which was the product of an ABA task force assembled to create standards for fair arbitration of employment disputes. *Prototype Agreement on Job Bias Dispute Resolution*, 1995 DLR 91 (BNA), May 11, 1995, at D-34. The ABA task force consisted of employer, union and employee representatives of the ABA Labor & Employment Section, the American Arbitration Association, the Federal Mediation & Conciliation Service, American Civil Liberties Union, the National Employment Lawyers Association, the Society of Professionals in Dispute Resolution, and the National Academy of Arbitrators.

211. *O'Hare*, 107 Cal. App. 4th at 279-80. A difficult problem in arbitration cases in California is that what the law requires varies from day-to-day (and certainly year-to-year) and is constantly changing. Yet, despite this fact, courts have consistently applied their "new" arbitration decisions retroactively, meaning that arbitration agreements that were often lawful when drafted are routinely struck down as unconscionable at a later date. *See* Blake v. Ecker, 93 Cal. App. 4th 728, 733 (Cal. Ct. App. 2001) (determining that *Armendariz* applies retroactively); Abramson v. Juniper Networks, Inc., 115 Cal. App. 4th 638, 661 (Cal. Ct. App. 2004) (determining that *Little v. Auto Stiegler, Inc.*, 29 Cal. 4th 1064 (Cal. 2003) applies retroactively). These decisions appear to conflict with the general principle that whether or not a contract is unconscionable is assessed as of the date the parties enter into the contract. Am. Software Inc. v. Ali, 46 Cal. App. 4th 1386, 1391 (Cal. Ct. App. 1996).

212. *O'Hare*, 107 Cal. App. 4th at 280. The logic of the court's conclusion is ostensibly grounded in traditional contract law. The court reasoned that "such a willingness can be seen at most as an offer to modify the contract; an offer that was never accepted. No existing rule of contract law permits a party to resuscitate a legally defective contract merely by offering to change it." *Id.* (quoting Armendariz v. Found. Health Psychcare Servs., Inc., 6 P.3d 669, 697 (Cal. 2000)); Stirlen v. Supercuts, Inc., 51 Cal. App. 4th 1519, 1535-36 (1997)). *See also* Mercuro v. Super. Ct., 96 Cal. App. 4th 167, 181 (Cal. Ct. App. 2002).

213. *O'Hare*, 107 Cal. App. 4th at 279.

214. Ferguson v. Countrywide Credit Indus., 298 F.3d 778, 786-87 (9th Cir. 2003) (holding that the provision "appears to favor [employer] at the expense of its employees," while not invalidating provision placing limits on discovery); *O'Hare*, 107 Cal. App. 4th at 280-82.

215. In reality, courts have consistently required more that just mutual contractual language. For example, in *Abramson v. Juniper Networks, Inc.*, the court held that an arbitration agreement which carved out exceptions for claims relating to trade secrets, confidential information, and other intellectual property, was substantively unconscionable despite the fact that it applied equally to both parties. 115 Cal. App. 4th 638, 665-66 (Cal. Ct. App. 2004). *See also Ferguson*, 298 F.3d at 784-85 (holding

Whether or not these contractual terms are "unfair" in some general sense, they are a far cry from the overtly oppressive contracts traditionally policed by courts under the doctrine of unconscionability—i.e., they do not "shock the conscience."[216]

3. *The "Unwaivable" Protections*

The California Supreme Court in *Armendariz* announced a set of "minimum requirements" that must be satisfied as a prerequisite for the arbitration of certain types of employment claims.[217] The *Armendariz* requirements are: (1) no limitation of available remedies; (2) adequate discovery; (3) a written arbitration decision setting forth, however briefly, the essential findings and conclusions on which the decision is based; and (4) all expenses unique to arbitration are to be borne by the employer.[218] These requirements go beyond those mandated by the FAA or the California Arbitration Act. These requirements have been held to apply to the following claims: the California Fair Employment and Housing Act,[219] common law wrongful discharge claims,[220] and claims under California Labor Code sections 230.8 and 970.[221]

The *Armendariz* Court justified these requirements based, in part, on the policies embodied in California Civil Code section 1668, which prohibits contracts that exempt an individual of responsibility for a violation of law, and section 3513, which prohibits waivers of laws established for public reasons.[222] The court reasoned that a longstanding ground for refusing to enforce a contract term is that it would force a party to forgo unwaivable public rights.[223] The court further justified its position that arbitration may not be used to waive legal protections based on dicta in the United States Supreme Court decision in *Mitsubishi Motors Corp.*, which provided that a party arbitrating a statutory claim "does not forgo the substantive rights afforded by the statute [but] only submits to their resolution in an arbitral . . . forum."[224] The California Supreme Court, in effect, concluded that the

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that arbitration agreement which "specifically exclud[ed] claims for workers' compensation or unemployment compensation benefits, injunctive and/or other equitable relief for intellectual property violations, unfair competition and/or the use and/or unauthorized disclosure of trade secrets or confidential information" was unfairly one-sided).

216. *Marshall v. Pontiac* is an example of a rare decision in which an employment arbitration agreement was enforced as written. 287 F. Supp. 2d 1229 (D. Cal. 2003).

217. Armendariz v. Found. Health Psychcare Servs., Inc., 6 P.3d 669 (Cal. 2000). In establishing the minimum requirements, the *Armendariz* court relied on the D.C. Circuit's decision in *Cole v. Burns International Security*, 105 F.3d 1465 (D.C. Cir. 1997). Unlike the California courts, however, the D.C. Circuit Court declined to extend the *Cole* requirements to apply to state common law claims that implicate public policy, stating that there was "no basis" for extending *Cole* to non-statutory claims. Brown v. Wheat First Sec., Inc., 257 F.3d 821, 825 (D.C. Cir. 2001).

218. *See Armendariz*, 6 P.3d at 682-90.

219. *See generally id.*

220. Little v. Auto Stiegler, Inc., 29 Cal. 4th 1064, 1076-77 (Cal. 2003).

221. Mercuro v. Super. Ct., 96 Cal. App. 4th 167, 180 (Cal. Ct. App. 2002) (concluding that "the five essentials of an arbitration agreement discussed in *Armendariz* apply to [the] claims under FEHA and [the California] Labor Code").

222. *Armendariz*, 6 P.3d 669, 680-81.

223. *Id.*

224. *Id.* at 679 (alteration in original) (quoting Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc., 473 U.S. 614, 628 (1985)).

dicta in *Mitsubishi Motors Corp.* provided an additional ground for holding arbitration agreements unenforceable—when arbitration compels a party to forgo their substantive rights.[225] The minimum requirements, therefore, were designed by the *Armendariz* court as a preventative measure to preclude any possibility that the arbitration of a claim will undermine unwaivable rights.

By far the most controversial requirement imposed by the *Armendariz* court is the cost provision, which requires an employer to bear all costs that are unique to arbitration.[226] This requirement stands in conflict with the United States Supreme Court decision in *Green Tree Financial Corp.-Alabama v. Randolph*.[227] The *Randolph* decision declared that silence in an arbitration agreement with respect to cost is wholly insufficient to render an agreement unenforceable because relying on a mere "risk" of prohibitive costs to invalidate an arbitration agreement is a far "too speculative" justification that would undermine the liberal federal policy favoring arbitration agreements.[228]

Notwithstanding *Randolph*, the California Supreme Court reaffirmed its cost provision in *Little v. Auto Stiegler, Inc.*[229] The *Little* court concluded that the FAA does not require state courts to adopt the same means as federal courts to ensure that public rights are protected. Moreover, even if it did, its cost provision was derived from state contract law, which the court contends is not preempted by the FAA.[230] The California Supreme Court has failed to recognize that by presuming that its requirements are necessary for the vindication of unwaivable rights in an arbitral forum, it is exhibiting the hostility and suspicion to arbitration that the FAA was enacted to prevent.[231]

VI. CONCLUSION

There is much that can be said about the benefits and detriments of arbitration. That is not the intended subject of this article. Indeed, we do not pretend to know what is "best" for society when it comes to arbitration of disputes. For present purposes, we accept the FAA—and its interpretation by the United States Supreme Court—at face value. In so doing, the conclusion that California courts—and the Ninth Circuit—are imposing their own biases against arbitration

225. *Id.*

226. The risk that excessive costs in the arbitral forum may, in some circumstances, result in a de facto waiver of the right to bring a claim was noted by California courts years before *Armendariz*. *See* Spence v. Omnibus Indus., 44 Cal. App. 3d 970, 977 (Cal. Ct. App. 1975) (stating that "a contractor may not use [an arbitration] provision in a contract such as this to effectively deny such home owner an opportunity to press a damage claim against him").

227. 531 U.S. 79, 80-81 (2000).

228. *Id.*

229. 29 Cal. 4th 1064, 1082-85 (Cal. 2003).

230. *Id.* Justice Baxter argued that the court should overrule the *Armendariz* per se rule regarding arbitration costs and adopt the fact based test from *Randolph*. *Id.* at 1086-89 (Baxter, J., concurring and dissenting) (Chin, J. and Brown, J., joined). Justice Brown in the dissenting portion of his separate opinion, noted that "this court appears to be 'chipping away at' United States Supreme Court precedents broadly construing the scope of the FAA 'by indirection' despite the high court's admonition against doing so . . . ." *Id.* at 1095. The court also urged "the high court to clarify once and for all whether our approach to arbitration law comports with its precedents." *Id.*

231. The Supreme Court itself has cautioned against these types of sweeping generalizations. Shearson/Am. Express v. McMahon, 482 U.S. 220, 232 (1987).

is inescapable. Whether that bias is overt or cloaked in the guise of a generally applicable contract rule is, from a legal perspective, irrelevant. In either case, it is precisely the bias the FAA was enacted to overcome and it is preempted by the FAA. Of course, the United States Supreme Court will have the last word on this issue, but a regard for the complexity of these issues and the fact that, at some point, that review will come, would be a prudent course of action for the lower courts.