Unconscionability

C. UNCONSCIONABILITY

The opinion in *Lucy v. Zehmer*, as you will recall, notes in passing that the agreed-upon price was fair in relation to the value of the farm. This point was relevant because the plaintiffs were asking the court for specific performance, that the Zehmers be compelled to complete the sale. As you will see in Chapter 6, specific performance, an uncommon remedy in Common Law except for land transactions, is granted in equity, and equity courts have traditionally declined to grant specific performance if they regarded an agreement as grossly unfair, particularly because of inequality of exchange. This conventional criterion was called unconscionability.

Although specific performance was not usually available in sale of goods cases, there were a few precedents in which unconscionability had also been used for them. A good example was *Campbell Soup Co. v. Wentz*, 172 F.2d 80 (3d Cir. 1948). In June, 1947, Campbell purchased carrots from several farmers for prices ranging from $23 to $30 per ton, depending on date of delivery. After the sale, the price of carrots shot upward to about $90 per ton in January, 1948. The farmers, seeking to profit, sold their carrots elsewhere and terminated their contracts with Campbell, which then sought specific performance. The decision rejects this remedy because Campbell's contracts were excessively one-sided. As the Court says, "We are not suggesting that the contract is illegal. Nor are we suggesting any excuse for the grower in this case who has deliberately broken an agreement entered into with Campbell. We do think, however, that a party who has offered and succeeded in getting an agreement as tough as this one is, should not come to a chancellor and ask court help in the enforcement of its terms. That equity does not that, it should be noted, applies the rule to a transaction that occurred before the enactment of the UCC for the jurisdiction.

WILLIAMS v. WALKER–THOMAS FURNITURE CO.

United States Court of Appeals for the District of Columbia Circuit, 1965.
121 U.S. App. D.C. 315, 350 F.2d 445.

WRIGHT, J. Appellee, Walker–Thomas Furniture Company, operates a retail furniture store in the District of Columbia. During the period from 1957 to 1962 each appellant in these cases purchased a number of household items from Walker–Thomas, for which payment was to be made in installments. The terms of each purchase were contained in a printed form contract which set forth the value of the purchased item and purported to lease the item to appellant for a stipulated monthly rent payment. The contract then provided, in substance, that title would remain in Walker–Thomas until the total of all the monthly payments made equaled the stated value of the item, at which time appellants could take title. In the event of a default in the payment of any monthly installment, Walker–Thomas could repossess the item.

The contract further provided that "the amount of each periodical installment payment to be made by [purchaser] to the Company under this present lease shall be inclusive of and not in addition to the amount of each installment payment to be made by [purchaser] under such prior leases, bills or accounts; and *all payments now and hereafter made by [purchaser] shall be credited pro rata on all outstanding leases, bills and accounts* due the Company by [purchaser] at the time each such payment is made." (Emphasis added.) The effect of this rather obscure provision was to keep a balance due on every item purchased until the balance due on all items, whenever purchased, was liquidated. As a result, the debt incurred at the time of purchase of each item was secured by the right to repossess all the items previously purchased by the same purchaser, and each new item purchased automatically became subject to a security interest arising out of the previous dealings.

On May 12, 1962, appellant Thorne purchased an item described as a Daveno, three tables, and two lamps, having total stated value of $391.10. Shortly thereafter, he defaulted on his monthly payments and appellee sought to replevy all the items purchased since the first transaction in 1958. Similarly, on April 17, 1962, appellant Williams bought a stereo set of stated value of $514.95.[10] She too defaulted shortly thereafter, and appellee sought to replevy all the items purchased since December, 1957. The Court of General Sessions granted judgment for appellee. The District of Columbia Court of Appeals affirmed, and we granted appellants' motion for leave to appeal to this court.

10. At the time of this purchase her account showed a balance of $164 still owing from her prior purchases. The total of all the purchases made over the years in question came to $1,800. The total payments amounted to $1,400.

unashamed

Prominent sound ...

Activists judge — conservative / liberal

Appellants' principal contention, rejected by both the trial and the appellate courts below, is that these contracts, or at least some of them, are unconscionable and, hence, not enforceable. In its opinion in *Williams v. Walker-Thomas Furniture Company*, 198 A.2d 914, 916 (1964), the District of Columbia Court of Appeals explained its rejection of this contention as follows: "Appellant's second argument presents a more serious question. The record reveals that prior to the last purchase appellant had reduced the balance in her account to $164. The last purchase, a stereo set, raised the balance due to $678. Significantly, at the time of this and the preceding purchases, appellee was aware of appellant's financial position. The reverse side of the stereo contract listed the name of appellant's social worker and her $218 monthly stipend from the government. Nevertheless, with full knowledge that appellant had to feed, clothe and support both herself and seven children on this amount, appellee sold her a $514 stereo set.

"We cannot condemn too strongly appellee's conduct. It raises serious questions of sharp practice and irresponsible business dealings. A review of the legislation in the District of Columbia affecting retail sales and the pertinent decisions of the highest court in this jurisdiction disclose, however, no ground upon which this court can declare the contracts in question contrary to public policy. We note that were the Maryland Retail Installment Sales Act, Art. 83 §§ 128–153, or its equivalent, in force in the District of Columbia, we could grant appellant appropriate relief. We think Congress should consider corrective legislation to protect the public from such exploitive contracts as were utilized in the case at bar."

We do not agree that the court lacked the power to refuse enforcement to contracts found to be unconscionable. In other jurisdictions, it has been held as a matter of common law that unconscionable contracts are not enforceable.[11] While no decision of this court so holding has been found, the notion that an unconscionable bargain should not be given full enforcement is by no means novel. In *Scott v. United States*, 79 U.S. (12 Wall.) 443, 445, 20 L. Ed. 438 (1870), the Supreme Court stated: "* * * If a contract be unreasonable and unconscionable, but not void for fraud, a court of law will give to the party who sues for its breach damages, not according to its letter, but only such as he is equitably entitled to. * * *"

Since we have never adopted or rejected such a rule, the question here presented is actually one of first impression.

Congress has recently enacted the Uniform Commercial Code, which specifically provides that the court may refuse to enforce a contract which it finds to be unconscionable at the time it was made. 28 D.C.CODE § 2–302 (Supp. IV 1965). The enactment of this section,

UCC justify

middle class

general ~~moral~~ ... necessary

she does not have a meaningful choice (pick up)

unfair process

- procedural +
- substantive unconscionability => unfair term

middle class can go to other shop!

repossessing the goods does not cover the costs to do it

- drugs
- private

11. *Campbell Soup Co. v. Wentz*, 3 Cir., 172 F.2d 80 (1948); *Indianapolis Morris Plan Corporation v. Sparks*, 132 Ind.App. 145, 172 N.E.2d 899 (1961); *Henningsen v. Bloomfield Motors, Inc.*, 32 N.J. 358, 161 A.2d 69, 84–96, 75 A.L.R.2d 1 (1960). Cf. 1 CORBIN, CONTRACTS § 128 (1963).

Řadí vyjádřený uncons. pouze substantive unfairness.

which occurred subsequent to the contracts here in suit, does not mean that the common law of the District of Columbia was otherwise at the time of enactment, nor does it preclude the court from adopting a similar rule in the exercise of its powers to develop the common law for the District of Columbia. In fact, in view of the absence of prior authority on the point, we consider the congressional adoption of § 2–302 persuasive authority for following the rationale of the cases from which the section is explicitly derived. Accordingly, we hold that where the element of unconscionability is present at the time a contract is made, the contract should not be enforced.

Unconscionability has generally been recognized to include an absence of meaningful choice on the part of one of the parties together with contract terms which are unreasonably favorable to the other party. Whether a meaningful choice is present in a particular case can only be determined by consideration of all the circumstances surrounding the transaction. In many cases the meaningfulness of the choice is negated by a gross inequality of bargaining power.[12] The manner in which the contract was entered is also relevant to this consideration. Did each party to the contract, considering his obvious education or lack of it, have 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? Ordinarily, one who signs an agreement without full knowledge of its terms might be held to assume the risk that he has entered a one-sided bargain. But when a party of little bargaining power, and hence little real choice, signs a commercially unreasonable contract with little or no knowledge of its terms, it is hardly likely that his consent, or even an objective manifestation of his consent, was ever given to all the terms. In such a case the usual rule that the terms of the agreement are not to be questioned should be abandoned and the court should consider whether the terms of the contract are so unfair that enforcement should be withheld.

In determining reasonableness or fairness, the primary concern must be with the terms of the contract considered in light of the circumstances existing when the contract was made. The test is not simple, nor can it be mechanically applied. The terms are to be considered "in the light of the general commercial background and the commercial needs of the particular trade or case." Corbin suggests the test as being whether the terms are "so extreme as to appear unconscionable according to the mores and business practices of the time and place." 1

12. . . . Inquiry into the relative bargaining power of the two parties is not an inquiry wholly divorced from the general question of unconscionability, since a one-sided bargain is itself evidence of the inequality of the bargaining parties. This fact was vaguely recognized in the common law doctrine of intrinsic fraud, that is, fraud which can be presumed from the grossly unfair nature of the terms of the contract. See the oft-quoted statement of Lord Hardwicke in *Earl of Chesterfield v. Janssen*, 28 Eng. Rep. 82, 100 (1751): "* * * [Fraud] may be apparent from the intrinsic nature and subject of the bargain itself; such as no man in his senses and not under delusion would make * * *." . . .

CORBIN, op. cit. supra Note 2.[13] We think this formulation correctly states the test to be applied in those cases where no meaningful choice was exercised upon entering the contract.

Because the trial court and the appellate court did not feel that enforcement could be refused, no findings were made on the possible unconscionability of the contracts in these cases. Since the record is not sufficient for our deciding the issue as a matter of law, the cases must be remanded to the trial court for further proceedings.

So ordered.

DANAHER, J., DISSENTING. The District of Columbia Court of Appeals obviously was as unhappy about the situation here presented as any of us can possibly be. Its opinion in the Williams case, quoted in the majority text, concludes: "We think Congress should consider corrective legislation to protect the public from such exploitive contracts as were utilized in the case at bar."

My view is thus summed up by an able court which made no finding that there had actually been sharp practice. Rather the appellant seems to have known precisely where she stood.

There are many aspects of public policy here involved. What is a luxury to some may seem an outright necessity to others. Is public oversight to be required of the expenditures of relief funds? A washing machine, e.g., in the hands of a relief client might become a fruitful source of income. Many relief clients may well need credit, and certain business establishments will take long chances on the sale of items, expecting their pricing policies will afford a degree of protection commensurate with the risk. Perhaps a remedy when necessary will be found within the provisions of the "Loan Shark" law, D.C.CODE §§ 26–601 et seq. (1961).

I mention such matters only to emphasize the desirability of a cautious approach to any such problem, particularly since the law for so long has allowed parties such great latitude in making their own contracts. I dare say there must annually be thousands upon thousands of installment credit transactions in this jurisdiction, and one can only speculate as to the effect the decision in these cases will have.

I join the District of Columbia Court of Appeals in its disposition of the issues.

Notes and Discussion

1. The Offending Clause. Read the language of the crucial clause carefully. What was the purpose of this clause? (The opinion describes it as "rather obscure," apparently implying that it was not unintelligible, at least.) It is not probable that ordinary consumers would have understood the

13. . . . The traditional test as stated in *Greer v. Tweed*, [N.Y.C.P.] 13 Abb.Pr. N.S. [427 (1872)], at 429, is "such as no man in his senses and not under delusion would make on the one hand, and as no honest or fair man would accept, on the other."

clause, assuming that they read it. How did the clause operate in Ora Lee Williams's case?

This clause, called a cross-collateral or (more derogatorily) a "dragnet" clause, is not atypical of the kinds of clauses that are used in standardized consumer contracts.

2. **Some Background.** Judge Wright quotes the lower court opinion noting that Williams was a welfare recipient with seven children. Why is this information relevant to the outcome? Would the case be substantially different if Williams had been a woman of means? What social assumptions underlie the decision in this lawsuit?

A detailed study of the facts leading up to this case showed that from 1957 to 1962 Williams had made sixteen purchases of furniture and household appliances from Walker–Thomas, and each time had signed a contract containing the same clause. In late 1962 Williams owed a total of $444 on her purchases, but, because of earlier payments, the *pro rata* amount owed on many of them was quite small: $0.25 on the first item purchased (price: $45.65), $0.03 on the second (price: $13.21), and so on. A significant balance was outstanding on only three of the sixteen items purchased. See Skilton and Helstad, Protection of the Installment Buyer of Goods under the Uniform Commercial Code, 65 Mich.L.Rev. 1465, 1477 (1967). For additional information on the case, see Colby, What Did the Doctrine of Unconscionability Do to the Walker–Thomas Furniture Co., 34 Conn.L.Rev. 625 (2002).

It is worth conjecturing about how Williams and others succeeded in bringing their cases to this level.

3. **Applying § 2–302.** How does Judge Wright escape the objection that the UCC was not in force at the time of this transaction?

Wright's formulation of the unconscionability doctrine ("an absence of meaningful choice on the part of one of the parties together with contract terms which are unreasonably favorable to the other party") has acquired classic status. Note that two elements are involved: first, a palpable defect in the bargaining process, such that one party is at a sharp disadvantage; second, evidence in the bargain itself of the consequences of that disadvantage. In later cases these two elements are referred to as procedural and substantive unconscionability, respectively. Wright further insists that the unconscionability must be present when the contract was made. Does he also recognize Walker–Thomas's right, under § 2–302(2), "to present evidence as to [the clause's] commercial setting, purpose and effect"?

4. **On Remand.** If this case were to be retried, what is the likely outcome? It is not an inevitable conclusion that Walker–Thomas had engaged in what the Court of Appeals condemns as "sharp practice and irresponsible business dealings." Perhaps Walker–Thomas could show that, given Williams' general credit position, it was likely to lose money if it sold on terms less draconian than these. Would a finding of unconscionability then mean, in effect, that Walker–Thomas was legally prevented from selling stereos to poor customers?

Could Walker–Thomas show that other retailers in the same market resort to similar devices, and that almost all statutes regulating installment sales do not nullify a cross-collateral clause? (Both these propositions were

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Could Walker–Thomas show that other retailers in the same market resort to similar devices, and that almost all statutes regulating installment sales do not nullify a cross-collateral clause? (Both these propositions were the contract is between businessmen in a commercial setting. Courts have rarely found a clause to be unconscionable in a commercial contract." *Imaging Fin. Serv. v. Graphic Arts Servs., Inc.*, 172 F.R.D. 322, 327 (N.D. Ill. 1997) (citation omitted). Exceptions have mainly come when inequity is particularly apparent. For instance, in *Moscatiello v. Pittsburgh Contractors Equipment Co.*, 407 Pa.Super. 363, 595 A.2d 1190 (1991), inconspicuous remedy-limiting clauses in a contract for the sale of a paving machine were held unconscionable because the buyer lacked experience with the industry and the seller's business practices, and the seller had not explained the limitations.

3. **Damages.** For the 266,050 pounds that were useable, the trial court awarded Langemeier the difference between the contract price ($0.14) and the re-sale price ($0.12). This calculation ignores, as it seems, the popcorn that was irretrievably spoiled by the freeze. Langemeier had claimed over $46,000 in damages, which would include the additional losses he wished to shift onto National Oats. Why should he not have been able to get them?

ARMENDARIZ v. FOUNDATION HEALTH PSYCHCARE SERVICES, INC.

Supreme Court of California, 2000.
24 Cal.4th 83, 6 P.3d 699, 99 Cal.Rptr.2d 745.

MOSK, J. In this case, we consider a number of issues related to the validity of a mandatory employment arbitration agreement, i.e., an agreement by an employee to arbitrate wrongful termination or employment discrimination claims rather than filing suit in court, which an employer imposes on a prospective or current employee as a condition of employment. The employees in this case claim that employees may not be compelled to arbitrate antidiscrimination claims brought under the California Fair Employment and Housing Act (FEHA) (Gov. Code, § 12900 et seq.) We conclude that such claims are in fact arbitrable *if* the arbitration permits an employee to vindicate his or her statutory rights. As explained, in order for such vindication to occur, the arbitration must meet certain minimum requirements, including neutrality of the arbitrator, the provision of adequate discovery, a written decision that will permit a limited form of judicial review, and limitations on the costs of arbitration. min

The employees further claim that several provisions of the arbitration agreement are unconscionable, both because they fail to meet these minimum requirements and because the arbitration agreement is not bilateral. We conclude that the agreement possesses a damages limitation that is contrary to public policy, and that it is unconscionably unilateral.

Finally, the employees contend that the presence of these unconscionable provisions renders the entire arbitration agreement unenforceable. The employer argues that even if some of the provisions are unconscionable or contrary to public policy, the proper remedy is to

arbitration, why? Motives.
- cheaper
- choice of arbiters (not to get the crazy arbiters)
- no jury (sympathy → ↑damages)
- to avoid class-actions

California only — | not in N.Y. may happen judgment like this!
possible

strike or restrict those clauses pursuant to Civil Code section 1670.5,[14] and to enforce the rest of the arbitration agreement. The trial court chose the employees' preferred solution of refusing to enforce the arbitration agreement, but the Court of Appeal sided with the employer and enforced the agreement minus the one provision it found unconscionable. We conclude, for reasons explained below, that the arbitration agreement is unenforceable and that therefore the Court of Appeal's judgment must be reversed.

I. Statement Of Facts And Procedural Issues

Marybeth Armendariz and Dolores Olague–Rodgers (hereafter the employees) filed a complaint for wrongful termination against their former employer, Foundation Health Psychcare Services, Inc. (hereafter the employer). The complaint and certain documents filed in support of the employer's petition to compel arbitration provide us with the basic factual background of this case. In July and August of 1995, the employer hired the employees in the "Provider Relations Group" and they were later given supervisory positions with annual salaries of $38,000. On June 20, 1996, they were informed that their positions were being eliminated and that they were being terminated. During their year of employment, they claim that their supervisors and coworkers engaged in sexually based harassment and discrimination. The employees alleged that they were "terminated ... because of their perceived and/or actual sexual orientation (heterosexual)."[15]

Both employees had filled out and signed employment application forms, which included an arbitration clause pertaining to any future claim of wrongful termination. Later, they executed a separate employment arbitration agreement, containing the same arbitration clause. The clause states in full: "I agree as a condition of my employment, that in the event my employment is terminated, and I contend that such termination was wrongful or otherwise in violation of the conditions of employment or was in violation of any express or implied condition, term or covenant of employment, whether founded in fact or in law, including but not limited to the covenant of good faith and fair dealing, or otherwise in violation of any of my rights, I and Employer agree to submit any such matter to binding arbitration pursuant to the provisions of title 9 of Part III of the California Code of Civil Procedure, commencing at section 1280 et seq. or any successor or replacement statutes. I and Employer further expressly agree that in any such arbitration, my exclusive remedies for violation of the terms, conditions or covenants of employment shall be limited to a sum equal to the wages

ONEROUS

NO FRONT
NO CONS.
NO REST

14. [Eds.: This Civil Code provision tracks the language of UCC § 2–302, but it is applicable to all contracts, not just to sales of goods.]

15. [Eds.: According to "Courts Question Rules Barring Suits by Workers," an article by Maura Dolan in the *Los Angeles Times* for August 23, 2000, the two employees "said they were harassed and discriminated against by gay supervisors because they are heterosexual. They said their lesbian and gay managers made derogatory remarks about heterosexuals in their presence and then demoted them from their supervisory jobs."]

At will, I sue my employee:
– steal security (trade contracts...)
– trade secrets

– how do enforce it?
– penalty?
– to frighten the people!

Unconsc. → I. Unilaterality (Substantive) + Damages(
II. Adhesion (Procedural)

S unfairness
P

I would have earned from the date of any discharge until the date of the arbitration award. I understand that I shall not be entitled to any other remedy, at law or in equity, including but not limited to reinstatement and/or injunctive relief."

The employees' complaint against the employer alleges a cause of action for violation of the FEHA[16] and three additional causes of action for wrongful termination based on tort and contract theories of recovery. The complaint sought general damages, punitive damages, injunctive relief, and the recovery of attorney fees and costs of suit.

The employer countered by filing a motion for an order to compel arbitration pursuant to Code of Civil Procedure section 1281.2. The parties submitted declarations in support of, and in opposition to, the motion. Relying on *Stirlen v. Supercuts, Inc.* (1997) 51 Cal.App.4th 1519 [60 Cal.Rptr.2d 138], the trial court denied the motion on the ground that the arbitration provision in question was an unconscionable contract. The trial court first found that the arbitration agreement was an "adhesion contract." It also found that several of the provisions of the contract are "so one-sided as to 'shock the conscience.' " In particular, it singled out the fact that only employees who file claims against an employer are required to arbitrate their claims, but not vice versa. Second, the agreement limits damages to backpay, precluding damages available for statutory antidiscrimination claims and tort damages, such as punitive damages. The trial court also mentioned the supposed lack of discovery under the arbitration agreement. It concluded: "Given the overall unfairness of the provision," this was not an appropriate case for striking the unlawful provisions of the arbitration agreement; instead it invalidated the entire agreement.

After the employer filed a timely appeal, the Court of Appeal reversed. The court concluded that the contract was indeed one of adhesion and that the damages provision was unconscionable and contrary to public policy. But for reasons elaborated below, the Court of Appeal held, contrary to the trial court, that the rest of the arbitration agreement should be enforced. It also determined that because the agreement incorporated the California Arbitration Act (CAA), adequate discovery, pursuant to Code of Civil Procedure section 1283.05, was available.

We granted review.

II. Discussion....

B. The Applicability of the FAA and the CAA

The Federal Arbitration Act (FAA) (9 U.S.C. § 1 et seq.) incorporates a strong federal policy of enforcing arbitration agreements, including agreements to arbitrate statutory rights. (See *Broughton v. Cigna*

16. Same-sex harassment has been held to be unlawful under the FEHA. (*Mogilefsky v. Superior Court* (1993) 20 Cal.App.4th 1409, 1418 [26 Cal.Rptr.2d 116].)

Healthplans (1999) 21 Cal.4th 1066, 1074–1075 [90 Cal.Rptr.2d 334, 988 P.2d 67] (Broughton), and cases cited therein.) . . .

In short, even assuming that the FAA does not apply to employment contracts, our inquiry into the enforceability of the arbitration agreement at issue in this case entails the same inquiry under the CAA as the FAA: Are there reasons, based on general contract law principles, for refusing to enforce the present arbitration agreement? In the present case, the answer turns on whether and to what extent the arbitration agreement was unconscionable or contrary to public policy, questions to which we now turn.

C. *Arbitration of FEHA Claims*

The United States Supreme Court's dictum that a party, in agreeing to arbitrate a statutory claim, "does not forgo the substantive rights afforded by the statute [but] only submits to their resolution in an arbitral . . . forum" (*Mitsubishi Motors*, supra, [Eds.: *Mitsubishi Motors v. Soler Chrysler–Plymouth*, 473 U.S. 614, 105 S.Ct. 3346 (1985),] 473 U.S. at p. 628 [105 S.Ct. at p. 3354]) is as much prescriptive as it is descriptive. That is, it sets a standard by which arbitration agreements and practices are to be measured, and disallows forms of arbitration that in fact compel claimants to forfeit certain substantive statutory rights.

Of course, certain statutory rights can be waived. (*Bickel v. City of Piedmont* (1997) 16 Cal.4th 1040, 1048–1049 [68 Cal.Rptr.2d 758, 946 P.2d 427], abrogated with regard to its construction of the Permit Streamlining Act [Stat. 1998, ch. 283, § 5].) But arbitration agreements that encompass ***unwaivable*** statutory rights must be subject to particular scrutiny. First, Civil Code section 1668 states: "All contracts which have for their object, directly or indirectly, to exempt anyone from responsibility for his own fraud, or willful injury to the person or property of another, or violation of law, whether willful or negligent, are against the policy of the law." "Agreements whose object, directly or indirectly, is to exempt [their] parties from violation of the law are against public policy and may not be enforced." (*In re Marriage of Fell* (1997) 55 Cal.App.4th 1058, 1065 [64 Cal.Rptr.2d 522].) Second, Civil Code section 3513 states, "Anyone may waive the advantage of a law intended solely for his benefit. But a law established for a public reason cannot be contravened by a private agreement." (See *In re Marriage of Fell*, supra, 55 Cal.App.4th at p. 1064; *Bickel v. City of Piedmont*, supra, 16 Cal.4th at pp. 1048–1049 [rights under statute may be waived by agreement when public benefit is incidental to the legislation's primary purpose].)

There is no question that the statutory rights established by the FEHA are "for a public reason." "The broad goal of the FEHA is set forth at [Government Code] section 12920, which states in pertinent part: 'It is hereby declared as the public policy of this state that it is necessary to protect and safeguard the right and opportunity of all persons to seek, obtain, and hold employment without discrimination or abridgement on account of race, religious creed, color, national origin, ancestry, physical handicap, medical condition, marital status, sex or age.' " (*Rojo v. Kliger* (1990) 52 Cal.3d 65, 72–73 [276 Cal.Rptr. 130, 801 P.2d 373].) As we stated in *Rojo*: "The public policy against sex discrimination and sexual harassment in employment, moreover, is plainly one that 'inures to the benefit of the public at large rather than to a particular employer or employee.' [Citation.] No extensive discussion is needed to establish the fundamental public interest in a workplace free from the pernicious influence of sexism. So long as it exists, we are all demeaned." (Id. at p. 90, italics omitted; see also *Stevenson v. Superior Court* (1997) 16 Cal.4th 880, 897 [66 Cal.Rptr.2d 888, 941 P.2d 1157] [recognizing that the FEHA's age discrimination provisions similarly incorporate fundamental public policy].) It is indisputable that an employment contract that required employees to waive their rights under the FEHA to redress sexual harassment or discrimination would be contrary to public policy and unlawful.

In light of these principles, it is evident that an arbitration agreement cannot be made to serve as a vehicle for the waiver of statutory rights created by the FEHA. . . .

The employees argue that arbitration contains a number of shortcomings that will prevent the vindication of their rights under the FEHA. In determining whether arbitration is considered an adequate forum for securing an employee's rights under FEHA, we begin with the extensive discussion of this question in *Cole v. Burns Intern. Security Services* (D.C. Cir. 1997) 105 F.3d 1465 [323 U.S.App.D.C. 133] (*Cole*), in the context of Title VII claims. In that case, the employee, a security guard, filed Title VII claims against his former employer alleging racial discrimination and harassment. He had signed an arbitration form committing himself to arbitrate such claims. . . .

Based on *Gilmer*, supra, [Eds.: *Gilmer v. Interstate/Johnson Lane Corp.*,] 500 U.S. 20 [, 111 S.Ct. 1647 (1991)], and on the basic principle of nonwaivability of statutory civil rights in the workplace, the *Cole* court formulated five minimum requirements for the lawful arbitration of such rights pursuant to a mandatory employment arbitration agreement. Such an arbitration agreement is lawful if it "(1) provides for neutral arbitrators, (2) provides for more than minimal discovery, (3) requires a written award, (4) provides for all of the types of relief that would otherwise be available in court, and (5) does not require employees to pay either unreasonable costs or any arbitrators' fees or expenses as a condition of access to the arbitration forum. Thus, an employee who is made to use arbitration as a condition of employment 'effectively may vindicate [his or her] statutory cause of action in the arbitral forum.'" (*Cole*, supra, 105 F.3d at p. 1482, italics omitted.)

Except for the neutral arbitrator requirement, which we have held is essential to ensuring the integrity of the arbitration process (*Graham v. Scissor–Tail, Inc.* (1981) 28 Cal.3d 807, 825 [171 Cal.Rptr. 604, 623 P.2d 165] (Scissor–Tail), and is not at issue in this case, the employees claim that the present arbitration agreement fails to measure up to the Cole requirements enumerated above. We consider below the validity of those requirements and whether they are met by the employer's arbitration agreement.

1. Limitation of Remedies

The principle that an arbitration agreement may not limit statutorily imposed remedies such as punitive damages and attorney fees appears to be undisputed. We suggested as much in *Broughton* when we held that an agreement to arbitrate a statutory claim implicitly incorporates "the substantive and remedial provisions of the statute" so that parties to the arbitration would be able to vindicate their " ' "statutory cause of action in the arbitral forum." ' " (*Broughton*, supra, 21 Cal.4th at p. 1087.) Similarly, in *Graham Oil v. ARCO Products Co.* (9th Cir. 1995) 43 F.3d 1244 (*Graham Oil*), the court refused to enforce an arbitration agreement between a petroleum franchiser and franchisee that did not allow for the punitive damages and attorney fees remedies available under the Petroleum Marketing Practices Act, because both of these remedies are "important to the effectuation of the PMPA's policies." (*Graham Oil*, supra, 43 F.3d at p. 1248.)

As stated, the arbitration agreement in this case provides in part: "I and Employer further expressly agree that in any such arbitration, my exclusive remedies for violation of the terms, conditions or covenants of employment shall be limited to a sum equal to the wages I would have earned from the date of any discharge until the date of the arbitration award. I understand that I shall not be entitled to any other remedy, at law or in equity, including but not limited to reinstatement and/or injunctive relief." . . . The employees claim that the agreement compels them to arbitrate statutory claims without affording the full range of statutory remedies, including punitive damages and attorney fees to a prevailing plaintiff, available under the FEHA. . . .

The employer does not contest that the damages limitation would be unlawful if applied to statutory claims, but instead contends that the limitation applies only to contract claims, pointing to the language in the penultimate sentence that refers to "my exclusive remedy for violation of the terms, conditions or covenants of employment. . . ." Both the trial court and the Court of Appeal correctly rejected this interpretation. While the above quoted language is susceptible to the employer's interpretation, the final sentence— "I understand that I shall not be entitled to any other remedy. . . ."—makes clear that the damages limitation was all-encompassing. We conclude this damages limitation is contrary to public policy and unlawful.

[Eds.: The Court goes on to determine that the employer has implicitly agreed to allow adequate discovery and to pay arbitration fees. The Court also determines that it is premature to declare that the judicial review process is invalid. Therefore these are not adequate grounds for declaring the arbitration agreement invalid on grounds of public policy.]

D. Unconscionability of the Arbitration Agreement

1. General Principles of Unconscionability

In the previous part of this opinion, we focused on the minimum requirements for the arbitration of unwaivable statutory claims. In this part, we will consider objections to arbitration that apply more generally to any type of arbitration imposed on the employee by the employer as a condition of employment, regardless of the type of claim being arbitrated. These objections fall under the rubric of unconscionability.

We explained the judicially created doctrine of unconscionability in *Scissor-Tail*, supra [Eds: *Graham v. Scissor-Tail, Inc.*, 171 Cal.Rptr. 604, 623 P.2d 165 (1981)], 28 Cal.3d 807. Unconscionability analysis begins with an inquiry into whether the contract is one of adhesion. (Id. at pp. 817–819.) "The term [contract of adhesion] signifies a standardized contract, which, imposed and drafted by the party of superior bargaining strength, relegates to the subscribing party only the opportunity to adhere to the contract or reject it." (*Neal v. State Farm Ins. Cos.* (1961) 188 Cal.App.2d 690, 694 [10 Cal.Rptr. 781].) If the contract is adhesive, the court must then determine whether "other factors are present which, under established legal rules-legislative or judicial-operate to render it [unenforceable]." (*Scissor-Tail*, supra, 28 Cal.3d at p. 820, fn. omitted.) "Generally speaking, there are two judicially imposed limitations on the enforcement of adhesion contracts or provisions thereof. The first is that such a contract or provision which does not fall within the reasonable expectations of the weaker or 'adhering' party will not be enforced against him. [Citations.] The second—a principle of equity applicable to all contracts generally—is that a contract or provision, even if consistent with the reasonable expectations of the parties, will be denied enforcement if, considered in its context, it is unduly oppressive or 'unconscionable.' "(Ibid.) Subsequent cases have referred to both the "reasonable expectations" and the "oppressive" limitations as being aspects of unconscionability. (*A & M Produce Co. v. FMC Corp.* (1982) 135 Cal.App.3d 473, 486–487 [186 Cal.Rptr. 114, 38 A.L.R.4th 1] (A & M Produce Co.).)

In 1979, the Legislature enacted Civil Code section 1670.5, which codified the principle that a court can refuse to enforce an unconscionable provision in a contract. (*Perdue v. Crocker National Bank* (1985) 38 Cal.3d 913, 925 [216 Cal.Rptr. 345, 702 P.2d 503].) As section 1670.5, subdivision (a) states: "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 as to avoid any unconscionable result." . . .

As explained in *A & M Produce Co.*, supra, 135 Cal.App.3d 473, "unconscionability has both a 'procedural' and a 'substantive' element," the former focusing on " 'oppression' " or " 'surprise' " due to unequal bargaining power, the latter on " 'overly harsh' " or " 'one-sided' " results. (Id. at pp. 486–487.) "The prevailing view is that [procedural and substantive unconscionability] must both be present in order for a court to exercise its discretion to refuse to enforce a contract or clause under the doctrine of unconscionability." (*Stirlen v. Supercuts, Inc.*, supra, 51 Cal.App.4th at p. 1533 (*Stirlen*).) But they need not be present in the same degree. "Essentially a sliding scale is invoked which disregards the regularity of the procedural process of the contract formation, that creates the terms, in proportion to the greater harshness or unreasonableness of the substantive terms themselves." (15 Williston on Contracts (3d ed. 1972) § 1763A, pp. 226–227; see also *A & M Produce Co.*, supra, 135 Cal.App.3d at p. 487.) In other words, the more substantively oppressive the contract term, the less evidence of procedural unconscionability is required to come to the conclusion that the term is unenforceable, and vice versa.

2. *Unconscionability and Mandatory Employment Arbitration*

Applying the above principles to this case, we first determine whether the arbitration agreement is adhesive. There is little dispute that it is. It was imposed on employees as a condition of employment and there was no opportunity to negotiate.

Moreover, in the case of preemployment 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. While arbitration may have its advantages in terms of greater expedition, informality, and lower cost, it also has, from the employee's point of view, potential disadvantages: waiver of a right to a jury trial, limited discovery, and limited judicial review. Various studies show that arbitration is advantageous to employers not only because it reduces the costs 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. (Bingham, *Employment Arbitration: The Repeat Player Effect* (1997) 1 Employee Rts. & Employment Poly. J. 189; Schwartz, supra, 1997 Wis. L.Rev. at pp. 60–61.) It is perhaps for this reason that it is almost invariably the employer who seeks to compel arbitration. (See Schwartz, supra, 1997 Wis. L.Rev. at pp. 60–63.)

Arbitration is favored in this state as a voluntary means of resolving disputes, and this voluntariness has been its bedrock justification.... Given the lack of choice and the potential disadvantages that even a fair arbitration system can harbor for employees, we must be particularly attuned to claims that employers with superior bargaining power have imposed one-sided, substantively unconscionable terms as part of an arbitration agreement.... With this in mind, we turn to the employees' specific unconscionability claims.

Aside from FEHA issues discussed in the previous part of this opinion, the employees contend that the agreement is substantively unconscionable because it requires only employees to arbitrate their wrongful termination claims against the employer, but does not require the employer to arbitrate claims it may have against the employees. In asserting that this lack of mutuality is unconscionable, they rely primarily on the opinion of the Court of Appeal in *Stirlen*, supra, 51 Cal.App.4th 1519. The employee in that case was hired as a vice-president and chief financial officer; his employment contract provided for arbitration " 'in the event there is any dispute arising out of [the employee's] employment with the Company,' "including "the termination of that employment." (*Stirlen*, supra, 51 Cal.App.4th at p. 1528.) The agreement specifically excluded certain types of disputes from the scope of arbitration, including those relating to the protection of the employer's intellectual and other property and the enforcement of a postemployment covenant not to compete, which were to be litigated in state or federal court. (Ibid.) The employee was to waive the right to challenge the jurisdiction of such a court. (Ibid.) The arbitration agreement further provided that the damages available would be limited to " 'the amount of actual damages for breach of contract, less any proper offset for mitigation of such damages.' " (Id. at p. 1529.) When an arbitration claim was filed, payments of any salary or benefits were to cease " 'without penalty to the Company,' " pending the outcome of the arbitration. (Id. at p. 1528.)

The *Stirlen* court concluded that the agreement was one of adhesion, even though the employee in question was a high-level executive, because of the lack of opportunity to negotiate. (*Stirlen*, supra, 51 Cal. App.4th at pp. 1533–1534.) The court then concluded that the arbitration agreement was substantively unconscionable. (Id. at p. 1541.) ... The employee pursuing claims against the employer had to bear not only with the inherent shortcomings of arbitration-limited discovery, limited judicial review, limited procedural protections-but also significant damage limitations imposed by the arbitration agreement. (Id. at pp. 1537–1540.) The employer, on the other hand, in pursuing its claims, was not subject to these disadvantageous limitations and had written into the agreement special advantages, such as a waiver of jurisdictional objections by the employee if sued by the employer. (Id. at pp. 1541–1542.)

The *Stirlen* court did not hold that all lack of mutuality in a contract of adhesion was invalid. "We agree a contract can provide a 'margin of safety' that provides the party with superior bargaining strength a type of extra protection for which it has a legitimate commercial need without being unconscionable. [Citation.] However, unless the 'business realities' that create the special need for such an advantage are explained in the contract itself, which is not the case here, it must be factually established." (*Stirlen*, supra, 51 Cal.App.4th at p. 1536.) The *Stirlen* court found no "business reality" to justify the lack of mutuality, concluding that the terms of the arbitration clause were " ' "so extreme as to appear unconscionable according to the mores and business practices of the time and place." ' " (Id. at p. 1542.) ...

Given the disadvantages that may exist for plaintiffs arbitrating disputes, it is unfairly one-sided for an employer with superior bargaining power 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 for such one-sidedness based on "business realities." As has been recognized " 'unconscionability turns not only on a "one-sided" result, but also on an absence of "justification" for it.' " (*A & M Produce Co.*, supra, 135 Cal.App.3d at p. 487.) If the arbitration system established by the employer is indeed fair, then the employer as well as the employee should be willing to submit claims to arbitration. Without reasonable justification for this lack of mutuality, arbitration appears less as a forum for neutral dispute resolution and more as a means of maximizing employer advantage. Arbitration was not intended for this purpose....

The employer cites a number of cases that have held that a lack of mutuality in an arbitration agreement does not render the contract illusory as long as the employer agrees to be bound by the arbitration of employment disputes. (*Michalski v. Circuit City Stores, Inc.* (7th Cir. 1999) 177 F.3d 634; *Johnson v. Circuit City Stores* (4th Cir. 1998) 148 F.3d 373, 378.) We agree that such lack of mutuality does not render the contract illusory, i.e., lacking in mutual consideration. We conclude, rather, that in the context of an arbitration agreement imposed by the employer on the employee, such a one-sided term is unconscionable. Although parties are free to contract for asymmetrical remedies and arbitration clauses of varying scope, ... the doctrine of unconscionability limits the extent to which a stronger party may, through a contract of adhesion, impose the arbitration forum on the weaker party without accepting that forum for itself.

A contrary conclusion was reached by the Alabama Supreme Court in *Ex Parte McNaughton* (Ala. 1998) 728 So.2d 592, 598–599. In that case, the employer required the employee to submit claims to arbitration, but expressly reserved for itself a choice of the arbitral or judicial forum. Two justices of the Alabama Supreme Court had stated in *Northcom, Ltd. v. James* (Ala. 1997) 694 So.2d 1329, 1338, that such arrangement would be invalid under Alabama's "mutuality of remedy" doctrine as well as the doctrine of unconscionability. The *McNaughton* court repudiated that view. It criticized the *Northcom* dictum as singling out arbitration for disfavor: "Although the doctrine of unconscionability/mutuality of remedy purportedly could apply in the nonarbitration context, as suggested in the main opinion in *Northcom*, it directly depends on arbitration for its application: 'The element of unconscionability in the context of an arbitration clause is supplied by the fact that, by agreeing to arbitrate, a party waives his right to "a remedy by due process of law" ... and his "right of trial by jury"....' *Northcom*, 694 So.2d at 1338–39 (citations omitted). [Citation.] ('[W]hile paying lip-service to the notion that [the doctrine of unconscionability/mutuality of remedy] "is equally true as to any unconscionable term of a contract of adhesion," ... the [lead opinion in *Northcom*] relies on the uniqueness of the concept of arbitration under Alabama law to support the [doctrine].') At bottom, this approach assigns a suspect status to arbitration agreements. Doing so flies in the face of *Doctor's Associates*, 517 U.S. at 687, 116 S.Ct. 1652, where the Supreme Court of the United States explicitly stated that '[c]ourts may not ... invalidate arbitration agreements under state laws applicable only to arbitration provisions.' (Emphasis omitted.) Accordingly, we expressly reject the *Northcom* dictum regarding the doctrine of unconscionability/mutuality of remedy." (*McNaughton*, supra, 728 So.2d at pp. 598–599, bracketed text in internal quote added in *McNaughton*.)

We disagree that enforcing "a modicum of bilaterality" in arbitration agreements singles out arbitration for suspect status. The *Stirlen* court correctly rejected a similar criticism: "Some California courts have been [loath] to apply the doctrine of unconscionability articulated in *Scissor–Tail*, supra, 28 Cal.3d 807 to arbitration agreements subject to the FAA on the ground that the opinion in that case 'weav[es] together principles of adhesion contracts and state statutes governing the neutrality of arbitrators,' and the United States Supreme Court has taught 'that a court may not rely upon anything that is unique to an agreement to arbitrate when assessing unconscionability of an agreement governed by the FAA.' (*Heily v. Superior Court* (1988) 202 Cal.App.3d 255, 260 [248 Cal.Rptr. 673].) However, while the form of unconscionability involved in *Scissor–Tail* related to arbitration—the nonneutrality of the arbitrator—the fundamental principles set forth by the Supreme Court in that case relate to unconscionability in general, not simply to arbitration agreements." (Stirlen, supra, 51 Cal.App.4th at p. 1551.)

We agree with the *Stirlen* court that the ordinary principles of unconscionability may manifest themselves in forms peculiar to the arbitration context. One such form is an agreement requiring arbitration only for the claims of the weaker party but a choice of forums for the claims of the stronger party. The application of this principle to arbitration does not disfavor arbitration. It is no disparagement of arbitration to acknowledge that it has, as noted, both advantages and disadvantages. The perceived advantages of the judicial forum for plaintiffs include the availability of discovery and the fact that courts and juries are viewed as more likely to adhere to the law and less likely than arbitrators to "split the difference" between the two sides, thereby lowering damages awards for plaintiffs. (See Haig, Corporate Counsel's Guide: Legal Development Report on Cost–Effective Management of Corporate Litigation (1999) 610 PLI/Lit. 177, 186–187 ["a company that believes it has a strong legal and factual position may want to avoid arbitration, with its tendency to 'split the difference,' in favor of a judicial forum where it may be more likely to win a clear-cut victory"]; see also Schwartz, supra, 1997 Wis. L.Rev. at pp. 64–65.) An employer may accordingly consider a court to be a forum superior to arbitration when it comes to vindicating its own contractual and statutory rights, or may consider it advantageous to have a choice of arbitration or litigation when determining how best to pursue a claim against an employee. It does not disfavor arbitration to hold that an employer may not impose a system of arbitration on an employee that seeks to maximize the advantages and minimize the disadvantages of arbitration for itself at the employee's expense. On the contrary, a unilateral arbitration agreement imposed by the employer without reasonable justification reflects the very mistrust of arbitration that has been repudiated by the United States Supreme Court in *Doctors' Associates, Inc. v. Casarotto*, supra, 517 U.S. 681, and other cases. We emphasize that if an employer does have reasonable justification for the arrangement—i.e., a justification grounded in something other than the employer's desire to maximize its advantage based on the perceived superiority of the judicial forum-such an agreement would not be unconscionable. Without such justification, we must assume that it is.

Applying these principles to the present case, we note the arbitration agreement was limited in scope to employee claims regarding wrongful termination. Although it did not expressly authorize litigation of the employer's claims against the employee, as was the case in *Stirlen* . . ., such was the clear implication of the agreement. Obviously, the lack of mutuality can be manifested as much by what the agreement does not provide as by what it does. (Cf. *24 Hour Fitness, Inc. v. Superior Court* (1998) 66 Cal.App.4th 1199, 1205, 1212–1213 [78 Cal.Rptr.2d 533] [employee arbitration clause in personnel handbook found not to be unconscionable where it pertains to " 'any dispute aris[ing] from your employment' "].)

This is not to say that an arbitration clause must mandate the arbitration of all claims between employer and employee in order to avoid invalidation on grounds of unconscionability. Indeed, as the employer points out, the present arbitration agreement does not require arbitration of all conceivable claims that an employee might have against an employer, only wrongful termination claims. But an arbitration agreement imposed in an adhesive context lacks basic fairness and mutuality if it requires one contracting party, but not the other, to arbitrate all claims arising out of the same transaction or occurrence or series of transactions or occurrences. The arbitration agreement in this case lacks mutuality in this sense because it requires the arbitration of employee-but not employer-claims arising out of a wrongful termination. An employee terminated for stealing trade secrets, for example, must arbitrate his or her wrongful termination claim under the agreement while the employer has no corresponding obligation to arbitrate its trade secrets claim against the employee.

The unconscionable one-sidedness of the arbitration agreement is compounded in this case by the fact that it does not permit the full recovery of damages for employees, while placing no such restriction on the employer. Even if the limitation on FEHA damages is severed as contrary to public policy, the arbitration clause in the present case still does not permit full recovery of ordinary contract damages. The arbitration agreement specifies that damages are to be limited to the amount of backpay lost up until the time of arbitration. This provision excludes damages for prospective future earnings, so-called front pay, a common and often substantial component of contractual damages in a wrongful termination case.... The employer, on the other hand, is bound by no comparable limitation should it pursue a claim against its employees.

The employer in this case, as well as the Court of Appeal, claim the lack of mutuality was based on the realities of the employees' place in the organizational hierarchy. As the Court of Appeal stated: "We ... observe that the wording of the agreement most likely resulted from the employees' position within the organization and may reflect the fact that the parties did not foresee the possibility of any dispute arising from employment that was not initiated by the employee. Plaintiffs were lower-level supervisory employees, without the sort of access to proprietary information or control over corporate finances that might lead to an employer suit against them."

The fact that it is unlikely an employer will bring claims against a particular type of employee is not, ultimately, a justification for a unilateral arbitration agreement. It provides no reason for categorically exempting employer claims, however rare, from mandatory arbitration. Although an employer may be able, in a future case, to justify a unilateral arbitration agreement, the employer in the present case has not done so.

E. Severability of Unconscionable Provisions

The employees contend that the presence of various unconscionable provisions or provisions contrary to public policy leads to the conclusion that the arbitration agreement as a whole cannot be enforced. The employer contends that, insofar as there are unconscionable provisions, they should be severed and the rest of the agreement enforced.

As noted, Civil Code section 1670.5, subdivision (a) provides that "[i]f 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 as to avoid any unconscionable result." Comment 2 of the Legislative Committee comment on section 1670.5, incorporating the comments from the Uniform Commercial Code, states: "Under this section the court, in its discretion, may refuse to enforce the contract as a whole if it is permeated by the unconscionability, or it may strike any single clause or group of clauses which are so tainted or which are contrary to the essential purpose of the agreement, or it may simply limit unconscionable clauses so as to avoid unconscionable results." (Legis. Com. com., 9 West's Ann. Civ. Code (1985 ed.) foll. § 1670.5, p. 494 (Legislative Committee comment).)

Thus, the statute appears to give a trial court some discretion as to whether to sever or restrict the unconscionable provision or whether to refuse to enforce the entire agreement. But it also appears to contemplate the latter course only when an agreement is "permeated" by unconscionability. We could discover no published cases in California that address directly the question of when a trial court abuses its discretion by refusing to enforce an entire agreement, as the trial court did in this case, nor precisely what it means for an agreement to be permeated by unconscionability. But there is a good deal of statutory and case law discussing the related question of when it is proper to sever illegal contract terms-a subject to which we will now turn.

Civil Code section 1598 states that "[w]here a contract has but a single object, and such object is unlawful, whether in whole or in part, or wholly impossible of performance, or so vaguely expressed as to be wholly unascertainable, the entire contract is void." Civil Code section 1599 states that "[w]here a contract has several distinct objects, of which one at least is lawful, and one at least is unlawful, in whole or in part, the contract is void as to the latter and valid as to the rest." In *Keene v. Harling* (1964) 61 Cal.2d 318, 320–321 [38 Cal.Rptr. 513, 392 P.2d 273] (*Keene*), we elaborated on those provisions: " 'Whether a contract is entire or separable depends upon its language and subject matter, and this question is one of construction to be determined by the court according to the intention of the parties. If the contract is divisible, the first part may stand, although the latter is illegal. [Citation.]' [Citations.] It has long been the rule in this state that ' "When the transaction is of such a nature that the good part of the consideration can be separated from that which is bad, the Courts will make the distinction, for the ... law ... [divides] according to common reason; and having made that void that is against law, lets the rest stand." ' " (Fn. omitted; see also *Birbrower, Montalbano, Condon & Frank v. Superior Court* (1998) 17 Cal.4th 119, 137–139 [70 Cal.Rptr.2d 304, 949 P.2d 1] (*Birbrower*) [holding severable legal from illegal portions of attorney fee agreement].)

In *Keene*, the plaintiffs contended that a transaction to buy coin-operated machines should be voided in its entirety because a small number of those machines were illegal " 'bingo-type' pinball machines." (*Keene*, supra, 61 Cal.2d at p. 320.) Instead, we held that because the value of the illegal machines could be quantified, the legal and illegal consideration could be apportioned and the latter severed from the contract. (Id. at pp. 322–323.) . . .

The Keene court also cited several examples in which the illegality was not severable. (See *Keene*, supra, 61 Cal.2d at pp. 321–322.) In *Mill and Lumber Co. v. Hayes* (1888) 76 Cal. 387 [18 P. 391], the defendant agreed to sell the plaintiff 2,000,000 feet of lumber at a certain price and to refrain from selling to any other buyer. The court, in invalidating the agreement, stated: "The very essence and mainspring of the agreement—the illegal object—'was to form a combination among all the manufacturers of lumber at or near Felton for the sole purpose of increasing the price of lumber, limiting the amount thereof to be manufactured, and give plaintiff control of all lumber manufactured,' etc. [¶] This being the inducement to the agreement, and the sole object in view, it cannot be separated and leave any subject-matter capable of enforcement.... [¶] ... [¶] The good cannot be separated from the bad, or rather the bad enters into and permeates the whole contract, so that none of it can be said to be good, and therefore the subject of an action." (Id. at p. 393.) . . .

In this case, two factors weigh against severance of the unlawful provisions. First, the arbitration agreement contains more than one unlawful provision; it has both an unlawful damages provision and an unconscionably unilateral arbitration clause. Such multiple defects indicate a systematic effort to impose arbitration on an employee not simply as an alternative to litigation, but as an inferior forum that works to the employer's advantage. In other words, given the multiple unlawful provisions, the trial court did not abuse its discretion in concluding that the arbitration agreement is permeated by an unlawful purpose. . . .

Second, in the case of the agreement's lack of mutuality, such permeation is indicated by the fact that there is no single provision a court can strike or restrict in order to remove the unconscionable taint from the agreement. Rather, the court would have to, in effect, reform the contract, not through severance or restriction, but by augmenting it with additional terms. Civil Code section 1670.5 does not authorize such reformation by augmentation, nor does the arbitration statute. Code of Civil Procedure section 1281.2 authorizes the court to refuse arbitration if grounds for revocation exist, not to reform the agreement to make it lawful. Nor do courts have any such power under their inherent limited authority to reform contracts. . . . Because a court is unable to cure this unconscionability through severance or restriction and is not permitted to cure it through reformation and augmentation, it must void the entire agreement.

Moreover, whether an employer is willing, now that the employment relationship has ended, to allow the arbitration provision to be mutually applicable, or to encompass the full range of remedies, does not change the fact that the arbitration agreement as written is unconscionable and contrary to public policy. 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." (*Stirlen*, supra, 51 Cal.App.4th at pp. 1535–1536, fn. omitted.) . . .

As discussed, courts will generally sever illegal provisions and enforce a contract when nonenforcement will lead to an undeserved benefit or detriment to one of the parties that would not further the interests of justice. (See *Benyon v. Garden Grove Medical Group*, supra [Eds.: 100 Cal.App.3d 698, 713, 161 Cal.Rptr. 146 (1980)], 100 Cal.App.3d at p. 713.) In *Benyon* . . . the interests of justice would obviously not have been furthered by nonenforcement. The same considerations are not found in the present case.

III. Disposition

The judgment of the Court of Appeal upholding the employer's petition to compel arbitration is reversed, and the cause is remanded to the Court of Appeal with directions to affirm the judgment of the trial court.

[Eds.: A concurring opinion is omitted.]

Notes and Discussion

1. **Mandatory Arbitration in Employment Contracts.** The plaintiffs were seeking to vindicate a statutory right. The defendant, their former employer, sought to use a mandatory arbitration clause, which the employees had separately signed, in order to compel them to arbitrate this claim. The Court concludes that the damage limitation clause is "contrary to public policy and unlawful" (review this finding in the light of the previous section of your casebook), but that otherwise the arbitration clause is permissible and does allow the plaintiffs to pursue their statutory claim.

Nonetheless, the Court finds the entire arbitration clause unconscionable and unenforceable. We think the Court might be overreacting to the "unilateral" formulation of the arbitration clause. Look carefully at the opposing arguments made by the California Court of Appeals and the Alabama Supreme Court.

With the *Armendariz* decision, compare this conclusion from the Final Report of the Dunlop Commission on the Future of Worker–Management Relations 59 (1994): "The public rights embedded in state and federal employment law—such as freedom from discrimination in the workplace and minimum wage and overtime standards—are an important part of the social and economic protections of the nation. Employees required to accept binding arbitration of such disputes would face what for many would be an inappropriate choice: give up your right to go to court or give up your job.... Binding arbitration agreements should not be enforceable as a condition of employment." The Dunlop Commission was formed in 1993 by the Secretaries of Labor and Commerce to examine current employment practices in the United States, as part of an effort to enhance productivity and labor-management cooperation. The Commission also recommended that arbitration procedures must provide for neutral arbitrators, ready employee access to information on procedures, fair cost-sharing, the employee's right to independent representation, a range of remedies equal to those available through litigation, written opinions by the arbitrator, and sufficient judicial review to ensure conformity with governing laws. Id. at 56–57. Similarly, the National Academy of Arbitrators, in Arbitration 1997: The Next Fifty Years 312 (1998), "opposes mandatory arbitration as a condition of employment when it requires waiver of direct access to either a judicial or administrative forum for the pursuit of statutory rights."

Should courts wait for legislation in this area, or should they instead pick up the flag of unconscionability and lead the charge?

2. **The "Sliding Scale" of Unconscionability.** The California Supreme Court begins its analysis by examining whether the contract was one of adhesion. Why should reviews of fundamental fairness be limited to contracts of adhesion? Compare *Harper v. Ultimo*, 113 Cal.App.4th 1402, 7 Cal.Rptr.3d 418, 425 (2003): "[Y]ou can show procedural unconscionability by a showing of adhesion, but it is not the only way. There will be cases, like

this one, where procedural unconscionability is obvious without the need to establish that the contract is one of adhesion."

Having found adhesion in the *Armendariz* case, the Court passes on to examine the arbitration provision. Two doctrines are available: reasonable expectations (see *C & J Fertilizer, Inc. v. Allied Mutual Insurance Co.* in Chapter 3.E); and unconscionability. What is the difference between these two doctrines? Why does the Court prefer the latter?

As to unconscionability, the Court accepts "[t]he prevailing view" that both procedural and substantive unconscionability must be present "in order for a court to exercise its discretion to refuse to enforce a contract or clause under the doctrine of unconscionability." This distinction, which derives from Arthur Leff, Unconscionability and the Code–The Emperor's New Clause, 115 U. Pa. L. Rev. 485 (1967), is summed up by Prof. Murray: *Procedural* unconscionability ("bargaining naughtiness") is "the manner in which the contract was negotiated," while "*[s]ubstantive* unconscionability ... is concerned with whether the obligations assumed were unreasonably favorable to one of the parties." John Edward Murray, Jr., Murray on Contracts § 96 at 555–556 (4th ed. 2001). The distinction obviously resembles that drawn by Judge Wright in *Williams v. Walker–Thomas*: "an absence of meaningful choice on the part of one of the parties [= procedural unconscionability] together with contract terms which are unreasonably favorable to the other party [= substantive unconscionability]."

Nonetheless, says the Court, both elements "need not be present in the same degree": "a sliding scale is invoked which disregards the regularity of the procedural process of the contract formation, that creates the terms, in proportion to the greater harshness or unreasonableness of the substantive terms themselves." (The Court is quoting Williston here.)

There is no obvious irregularity in contract formation in this case, beyond the bare fact that it was a contract of adhesion. Should all contracts of adhesion be treated as *prima facie* suspect?

3. **Unconscionability at the Edges of the Scale.** Surely no court would find a contract unconscionable because it was unfairly arrived at, even if its terms were completely fair. On the other hand, courts might find terms unconscionable because of their harshness, even though there is no detectable inequity in the process of formation, true?

Consider the following argument: "[T]he principle of freedom of contract ... demand[s] that the reasons invoked for not enforcing the contract be of one of two sorts. Either there must be proof of some defect in the process of contract formation (be it duress, fraud or undue influence); or there must be, but only within narrow limits, some incompetence of the party against whom the agreement is to be enforced.... Yet when the doctrine of unconscionability is used in its substantive dimension, be it in a commercial or consumer context, it serves only to undercut the private right of contract in a manner that is apt to do more social harm than good. The result of the analysis is the same even if we view the question of unconscionability from the lofty perspective of public policy...." Richard Epstein, *Unconscionability: A Critical Reappraisal*, 18 J. Law & Econ. 293, 315 (1975).

4. **A Multi-Pronged Test?** Would it be preferable to replace current unconscionability analysis with a more complex test that weighed many different factors? In *Davis v. M.L.G. Corp.*, 712 P.2d 985, 991 (1986), the Colorado Supreme Court gave a seven-part test: "(1) a standardized agreement executed by parties of unequal bargaining strength; (2) a lack of opportunity to read or become familiar with the document before signing it; (3) use of fine print in the portion of the contract containing the provision; (4) absence of evidence that the provision was commercially reasonable or should have been reasonably anticipated; (5) the terms of the contract, including substantive unfairness; (6) the relationship of the parties, including factors of assent, unfair surprise and notice; and (7) all the circumstances surrounding the formation of the contract, including its commercial setting, purpose and effect." (Citations omitted.) But this list may be too complicated to produce predictable results.

5. **The *Scissor–Tail* Decision.** Bill Graham, an experienced promoter and producer of musical concerts, entered four contracts with the musician Leon Russell related to four appearances on a projected concert tour. The contracts were all prepared on an identical form provided by the American Federation of Musicians (AFM), of which Russell was a member. A dispute broke out between Graham and Russell about whether losses from one concert could be offset by profits from another. The contracts contained a provision whereby "the parties will submit every claim, dispute, controversy or difference involving the musical services arising out of or connected with this contract and the engagement covered thereby for determination by the International Executive Board of the [AFM] or a similar board of an appropriate local thereof and such determination shall be conclusive, final and binding upon the parties." Will a court compel Graham to arbitrate his dispute under this clause? Is it relevant that Graham is a seasoned businessman? That he has previously signed thousands of such AFM contracts? See *Graham v. Scissor–Tail, Inc.*, 28 Cal.3d 807, 171 Cal.Rptr. 604, 623 P.2d 165 (1981) (holding the arbitration provision unconscionable), a decision to which the Court refers in *Armendariz*. How are these two cases different?

6. **Criticism of *Armendariz*.** The *Armendariz* decision, which opened the floodgates to a tide of lawsuits alleging unconscionability in employment and other contracts, has been widely followed (especially in California) but has not escaped criticism. For example, it was rejected by the Texas Supreme Court in a case involving a retail installment financing agreement that required the buyers to arbitrate all claims, but allowed the lenders to use the courts to "enforce its security interest, recover the buyers' loan obligation, and foreclose." *In re FirstMerit Bank, N.A.*, 52 S.W.3d 749, 752 (Tex. 2001). The decision observes: "The [plaintiffs] also argue that the agreement's terms are unconscionable because they force the weaker party to arbitrate their claims, while permitting the stronger party to litigate their claims. They point us to decisions in other jurisdictions that have found this type of clause to be unconscionable. Most federal courts, however, have rejected similar challenges on the grounds that an arbitration clause does not require mutuality of obligation, so long as the underlying contract is supported by adequate consideration. In any event, the basic test for unconscionability is whether, given the parties' general commercial background and the commercial needs of the particular trade or case, the clause involved

is so one-sided that it is unconscionable under the circumstances existing when the parties made the contract. The principle is one of preventing oppression and unfair surprise and not of disturbing allocation of risks because of superior bargaining power. Here, the Arbitration Addendum allows the bank to seek judicial relief to enforce its security agreement, recover the buyers' monetary loan obligation, and foreclose. Given the weight of federal precedent and the routine nature of mobile home financing agreements, we find that the Arbitration Addendum in this case, by excepting claims essentially protecting the bank's security interest, is not unconscionable. We also recognize that the plaintiffs are free to pursue their unconscionability defense in the arbitral forum." Id. at 757 (citations omitted). Many jurisdictions are apparently of a similar opinion.

As for academic reaction, see, e.g., Susan Randall, *Judicial Attitudes Toward Arbitration and the Resurgence of Unconscionability*, 52 Buffalo L. Rev. 185, 186–187 (2004), who argues that: "[J]udges use an arbitration-specific version of the unconscionability doctrine to avoid the Federal Arbitration Act. First, judges currently find arbitration agreements unconscionable at twice the rate of nonarbitration agreements. . . .Second, judges find unconscionable specific features of arbitration agreements, such as forum selection clauses and confidentiality requirements, which are routinely enforced as unobjectionable in nonarbitration agreements. Other features of arbitration agreements often found unconscionable in the arbitration context but not generally considered unconscionable are punitive damages limitations and cost-splitting provisions. . . .Third, the statements of a few outspoken judges provide direct evidence that at least some judges dislike arbitration . . ."

Prof. Randall continues: "Under the rule of *Armendariz*, parties to an arbitration contract cannot, unlike parties to other types of contracts or parties to arbitration contracts in other jurisdictions, expect judicial enforcement of their contract. California courts treat arbitration agreements differently precisely because they are arbitration agreements, in direct contradiction of the Federal Arbitration Act. Despite the California Supreme Court's protestations to the contrary, the Federal Arbitration Act in fact preempts *Armendariz* and its progeny." Id. at 209.

This logic is accepted by, e.g., Judge Easterbrook in *Oblix v. Winiecki*, 374 F.3d 488, 491–492 (7th Cir. 2004) ("no state can apply to arbitration (when governed by the Federal Arbitration Act) any novel rule" that would make the arbitration clause subject to a higher standard than other clauses of the contract). But California has stuck to its guns; see *Little v. Auto Stiegler, Inc.*, 29 Cal.4th 1064, 63 P.3d 979, 130 Cal.Rptr.2d 892 (2003) (*inter alia*, rejecting the preemption argument).

Credit card contracts: continuing offer to pay the credit —
- long term contract
- business environment changes, (?) changes —

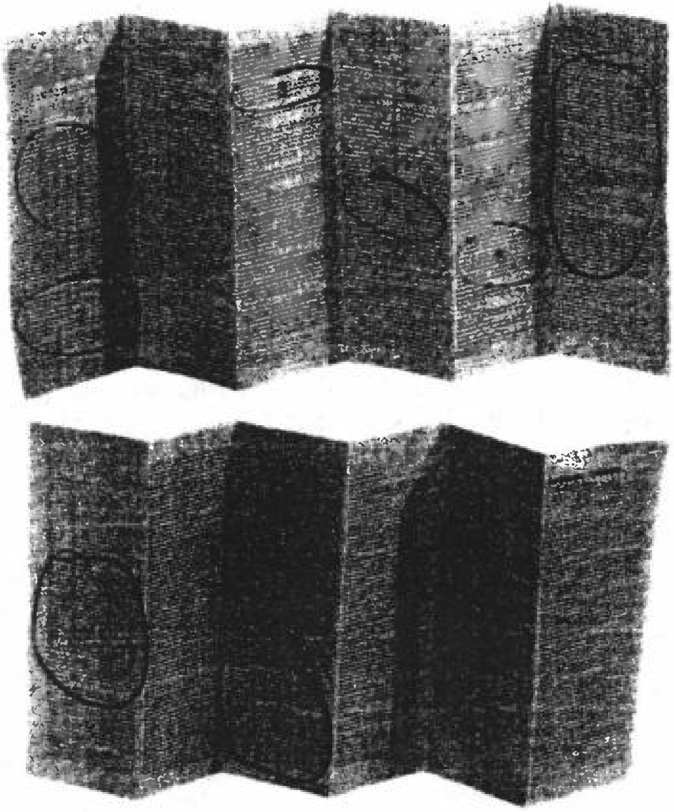
continuing offer

I can cancel that all time

THE NEW YORK TIMES NATIONAL SUNDAY, NOVEMBER 21, 2004

Fine Print

The detailed agreement that comes with a new credit card contains provisions that can add hefty fees, penalties and higher interest rates. A look at some of the important sections of a typical contract.



Both sides of a cardholder agreement from Chase Manhattan Bank, a unit of J. P. Morgan Chase, dated October 2004.

The New York Times/Photograph by Tony Cenicola

1 SPENDING LIMITS AND CREDIT LINE There is no preset spending limit, but each charge will be evaluated based on the cardholder's credit history and the lender's understanding of the cardholder's current finances. The credit line may be increased, reduced or canceled at any time.

2 AUTHORIZING CHARGES Any request to use the card may be rejected for any reason, including:
- the account is in default
- the company suspects fraud.

3 APPLYING PAYMENTS If there is more than one interest rate on the account, payments will go toward paying off the balance with the lowest rate first. Interest continues compounding on the balance with the higher rate.

4 DEFAULT RATES The highest rate *(28.49%)* may be charged if the cardholder is late making a payment to any creditor; this can include phone and utility bills, car payments and the like — even if credit card payments are made on time.

5 GRACE PERIOD If the balance is zero at the start of the billing period, the cardholder does not have to pay finance charges on purchases if the balance is paid in full again by the next due date. If not, interest accrues from the time of purchase.

6 FEES In addition to an annual fee, a fee may be charged for:
- late payment *($35)*
- bounced or unsigned check *($35)*
- copy of a statement *($5)*
- payment by phone *($14.95)*

7 RIGHT TO SUE Any dispute between the cardholder and the issuer may be resolved only by binding arbitration. The cardholder cannot take the issuer to court or be included in a class-action suit against the company.

8 TERMS OF AGREEMENT May be changed at any time for any reason. The cardholder will receive notice by mail. The changes will affect the current balance; use of the card constitutes acceptance of the new terms.

BANK ONE v. COATES

United States District Court, Southern District of Mississippi, 2001.
125 F.Supp.2d 819.

LEE, J. ...On October 20, 1999, the defendant herein, along with thirty-seven others, filed suit in the Circuit Court of the Second Judicial District of Bolivar County, Mississippi, against several defendants, in-

Federal statute: - credit card companies must return money if the customer did not received the item paid

cluding Bank One, alleging claims stemming from his purchase of a home satellite system. In that lawsuit, defendant, who financed his purchase of the satellite system through a revolving credit card plan with Bank One, asserts various claims against Bank One involving alleged improper actions on Bank One's part in connection with such financing....

Motion To Compel Arbitration

The Credit Application and Security Agreement executed by defendant in connection with his purchase and financing of the satellite dish system recites, directly above the signature line, as follows: "I acknowledge that this application is subject to approval of credit and acceptance by Bank One at its principal office in Dayton, Ohio and that any credit extended pursuant hereto is extended by Bank One from its principal office in Dayton, Ohio. If this application is approved, I [the applicant] agree to abide by the terms of the account Agreement and Disclosure Statement which shall be issued by Bank One from time to time."

The credit application was accompanied by a Revolving Credit Card Plan and Disclosure Statement and Cardmember Agreement, paragraph 12 of which purports to define how the agreement may be amended, stating as follows: "12. AMENDMENT: We may change or amend the terms of this Agreement upon fifteen (15) days prior written notice if required by law. Any changed or amended fee, charge, interest rate, FINANCE CHARGE, ANNUAL PERCENTAGE RATE, or minimum payment amount, whether increased or decreased, may be effective to both the outstanding Account Balance and future transactions."

On March 8, 1998, Bank One sent a notice to its cardmembers, including defendant, announcing a proposed modification to the cardmember agreement. This notice proposed that the cardmember agreement would be modified by adding the following clause requiring arbitration of any disputes between Bank One and the cardmember: "ARBITRATION: Any claim, dispute or controversy ("Claim") by either you or us against the other, or against the employees, agents or assigns of the other, arising from or relating in any way to this Agreement or your Account, including Claims regarding the applicability of this arbitration clause or the validity of the entire Agreement, shall be resolved by binding arbitration by the National Arbitration Forum, under the Code of Procedure in effect at the time the Claim is filed. Rules and forms of the National Arbitration Forum may be obtained and Claims may be filed at any National Arbitration Forum Office, www.arb-forum.com, or P.O. Box 50191, Minneapolis, Minnesota 55405, telephone 1–800–474–2371. Any arbitration hearing at which you appear will take place at a location within the federal judicial district that includes your billing address at the time the Claim is filed. This arbitration agreement is made pursuant to a transaction involving interstate commerce, and shall be governed by the Federal Arbitration Act, 9 U.S.C. Sections 1–16. Judgment upon any arbitration award may be entered in any court having jurisdiction. * * *

"IN THE ABSENCE OF THIS ARBITRATION AGREEMENT YOU AND WE MAY OTHERWISE HAVE HAD A RIGHT OR OPPORTUNITY TO LITIGATE CLAIMS THROUGH A COURT, AND/OR TO PARTICIPATE OR BE REPRESENTED IN LITIGATION FILED IN COURT BY OTHERS, BUT EXCEPT AS OTHERWISE PROVIDED ABOVE, ALL CLAIMS MUST NOW BE RESOLVED THROUGH ARBITRATION."

Cardmembers were given the option of rejecting this arbitration provision contained in the notice, failing which the agreement would become effective April 15, 1998. The procedure for rejecting the arbitration provision was set forth in the notice, as follows: "EFFECTIVE DATE/NON-ACCEPTANCE INSTRUCTIONS. The changes in terms summarized above will become effective April 15, 1998. If you do not wish to accept the new terms, **you must notify us** in writing of your decision on or before April 15, 1998. Please include your name, address and account number on the correspondence and mail it to: Bank One, P.O. Box 276, Dayton, OH 45401. Giving us this notice will not constitute any changes to your current obligation to pay off any outstanding balance on your account under your prior terms."

Defendant did not notify Bank One that he would not accept the terms of the arbitration provision as set forth in the amendment notice.

Defendant does not dispute any of these facts, nor does he challenge Bank One's assertion that the language of the arbitration clause in the amendment notice would cover his claims against Bank One. He maintains, however, that he is not bound by the arbitration "agreement" inasmuch as he, in fact, never agreed to it and as the agreement is in substance unfair and unconscionable.

Congress provided in the Federal Arbitration Act (FAA) that a written agreement to arbitrate in a contract involving interstate commerce "shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract." 9 U.S.C. § 2. The effect of this section is "to create a body of federal substantive law of arbitrability, applicable to any arbitration agreement within the coverage of the Act." *Moses H. Cone [Memorial Hospital v. Mercury Construction Corp.]*, 460 U.S. at 24, 103 S. Ct. at 941. In accordance with Section 4 of the FAA, "if a party to an agreement refuses to arbitrate, the opposing party may bring an action to compel arbitration, and after hearing the parties the court 'being satisfied that the making of the agreement for arbitration or the failure to comply therewith is not in issue,' shall direct the parties to arbitrate." *Bhatia v. Johnston*, 818 F.2d 418, 421 (5th Cir. 1987) (quoting 9 U.S.C. § 4); 9 U.S.C. § 4 ("A party aggrieved by the alleged failure, neglect, or refusal of another to arbitrate under a written agreement for arbitration may petition any United States district court which [would have subject matter jurisdiction under Title 28] for an order directing that such

Right to the jury trial...

→ Only when you go the court! First you have to get to the court.

arbitration proceed in the manner provided for in such agreement."). If, on the other hand, " 'the making of the arbitration agreement or the failure ... to perform the same be in issue, the court shall proceed summarily to the trial thereof.' " Id. (quoting § 4).

The Fifth Circuit has explained that "in adjudicating a motion to compel arbitration under the Federal Arbitration Act, courts generally conduct a two-step inquiry. The first step is to determine whether the parties agreed to arbitrate the dispute in question. This determination involves two considerations: (1) whether there is a valid agreement to arbitrate between the parties; and (2) whether the dispute in question falls within the scope of that arbitration agreement....

"The second step is to determine 'whether legal constraints external to the parties' agreement foreclosed the arbitration of those claims.' " *Webb v. Investacorp, Inc.*, 89 F.3d 252, 257–58 (5th Cir. 1996) (citations omitted).

When deciding the broader issue of whether the parties agreed to arbitrate the dispute in question, "the court must look to the body of federal arbitration law," *Bhatia*, 818 F.2d at 421, which recognizes that "the question of arbitrability [is to] be addressed with a 'healthy regard for the federal policy favoring arbitration,' with doubts regarding the scope of the agreement resolved in favor of arbitration," id. (quoting *Moses H. Cone*, 460 U.S. at 24–25, 103 S. Ct. at 941). As to the more specific issue of whether there is a valid agreement to arbitrate, " 'courts generally ... should apply ordinary state-law principles that govern the formation of contracts'," *Webb*, 89 F.3d at 257 (quoting *First Options of Chicago, Inc. v. Kaplan*, 514 U.S. 938, 115 S. Ct. 1920, 1924, 131 L. Ed. 2d 985 (1995)), but in doing so, must give "due regard ... to the federal policy favoring arbitration," id.... At the same time, however, the court may grant relief to a party opposing arbitration where he presents "well supported claims that the agreement to arbitrate resulted from the sort of fraud or overwhelming economic power that would provide grounds 'for the revocation of any contract'," *Mitsubishi Motors* [*Corp. v. Soler Chrysler–Plymouth, Inc.*], 473 U.S. at 627, 105 S. Ct. 3346 (quoting 9 U.S.C. § 2); ...

In the case at bar, defendant advances a variety of arguments in support of his contention that the arbitration agreement is unenforceable, most of which relate to his insistence that he never clearly and unmistakably agreed to arbitration. In this vein, defendant argues that the arbitration provision is unenforceable because defendant's cardholder agreement with Bank One was procured by fraud; because Bank One could not lawfully add (or "slip in") an arbitration clause via amendment to the cardholder agreement; and because defendant did not clearly and unmistakably agree to arbitrate and thereby waive his right to a jury trial. Defendant also submits that the subject arbitration agreement is substantively unconscionable and for that reason unenforceable. The court will address these arguments in turn ...

DEFENSES TO ARBITRATION

Fraud

Defendant argues, without elaboration, that because he has alleged that the contract at issue was procured by fraud and under the law "a contract procured by fraud in fact is void and cannot be enforced," then it follows that the arbitration provision is unenforceable—or at least it cannot be summarily determined without further development of the facts that the arbitration provision is enforceable. In other words, defendant argues that he was fraudulently induced to sign the credit application and suggests that the arbitration clause is for that reason unenforceable.[17] However, the law on this point is clear: "Only if the allegation of fraud goes specifically to the making of the agreement to arbitrate must a district court address the merits of the fraud claim. The district court does not address 'claims of fraud in the inducement of the contract generally.'" *Snap-On Tools* [*Corp. v. Mason*], 18 F.3d [1261 (5th Cir. 1994),] at 1268 (citing *Prima Paint Corp. v. Flood & Conklin Mfg. Co.*, 388 U.S. 395, 404, 87 S. Ct. 1801, 1806, 18 L. Ed. 2d 1270 (1967); see *Prima Paint*, 388 U.S. at 403–04, 87 S. Ct. at 1805–06 ("If the claim is fraud in the inducement of the arbitration clause itself—an issue which goes to the 'making' of the agreement to arbitrate—the federal court may proceed to adjudicate it. But the statutory language does not permit the federal court to consider claims of fraud in the inducement of the contract generally.").[18]

Although the law on this point is clear, defendant suggests that because he is alleging fraud in the *factum*, not fraud in the inducement, then his claim is not subject to resolution via arbitration. The court cannot agree. Even assuming that the facts averred by defendant could correctly be categorized as fraud in the *factum* rather than in the inducement, the Fifth Circuit has specifically rejected this distinction as a basis for assessing the arbitrability of a claim of fraud relating to the contract generally as opposed to fraud relating to the procurement of an agreement to arbitrate. In *R.M. Perez & Associates, Inc. v. Welch*, 960 F.2d 534, 538 (5th Cir. 1992), the court said, "Those plaintiffs alleging fraud insist that the fraud constitutes fraud in the *factum* rather than fraud in the inducement. They argue that the distinction between fraud in the *factum* and fraud in the inducement is determinative of whether they can be compelled to arbitrate. We disagree that the type of fraud alleged is determinative of arbitrability. Under *Prima Paint Corp. v. Flood and Conklin Mfg. Co.*, 388 U.S. 395, 404, 87 S. Ct. 1801, 1806, 18

17. According to defendant, while he may have signed the credit card application, he was misled into signing it and no one ever explained the document to him. In an affidavit accompanying his response to the motion to compel, defendant asserts that "the salesperson I dealt with did not inform me that I was signing for a credit card from Bank One."

18. This principle is not limited to allegations of fraud but extends to other defenses alleged to render a contract void. See *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Haydu*, 637 F.2d 391, 398 & n.11 (5th Cir. Unit B Feb. 1981) (holding that to render arbitration clause unenforceable, coercion and duress must relate specifically to the clause rather than to the contract as a whole).

Jury abandoned in England!

L. Ed. 2d 1270 (1967), and its progeny, the central issue in a case like this is whether the plaintiffs' claim of fraud relates to the making of the arbitration agreement itself or to the contract as a whole.... If the fraud relates to the arbitration clause itself, the court should adjudicate the fraud claim. If it relates to the entire agreement, then the Federal Arbitration Act requires that the fraud claim be decided by an arbitrator....

Unconscionability

Contrary to defendant's insinuation, and as this court has recognized, arbitration agreements are not inherently unconscionable ... ; and so in order to avoid an arbitration agreement on the basis of unconscionability, the party resisting arbitration must show that the particular arbitration provision is unconscionable and hence unenforceable. Under Ohio law, which is made applicable by the terms of the cardholder agreement, "unconscionability is determined by reference to the relative benefit of the bargain to the parties at the time of its making, the nature of the methods employed in negotiating it, and the relative bargaining power of the parties.... To establish that an agreement is unconscionable, the complaining party must demonstrate: 1) substantive unconscionability, by showing that the contract terms are unfair and unreasonable, and 2) procedural unconscionability, by showing that the circumstances surrounding the contract were so unfair as to cause there to be no voluntary meeting of the minds. ..." *Parsley v. Terminix Int'l Co.*, No. C–3–97–394, 1998 WL 1572764 (S.D. Ohio Sept. 15, 1998).

Procedural Unconscionability

Though perhaps not couched in terms of procedural unconscionability, defendant does argue that the circumstances surrounding the addition of the arbitration provision to the parties' alleged contract were so unfair as to compel a conclusion that there was no voluntary meeting of the minds. That is, despite language in the original cardmember agreement purporting to allow Bank One to "change or amend the terms of this Agreement upon fifteen (15) days prior written notice if required by law," defendant insists that he was not sufficiently apprised of the arbitration provision and that it would thus be unconscionable to order him bound by its terms. More specifically, defendant complains that the original cardholder agreement—which he characterizes as a lengthy, single-spaced document filled with "legalese"—said nothing about arbitration. It did include "one tiny paragraph" that purported to allow Bank One to change the terms of the agreement, but according to defendant, that paragraph gave no indication that the agreement could be changed to add an arbitration provision. Defendant further complains that the notice later sent by Bank One to its account holders was, like the original agreement, in a single-spaced, small-typed format which, according to defendant's version of the document, described several changes in the cardholder agreement, including mandatory arbitration;

and as described by defendant, the arbitration provision was itself "difficult to understand and filled with legalese."

The question for the court on the issue of procedural unconscionability is whether "the insertion of the arbitration provision into the contract was done in a procedurally unfair manner." Parsley, 1998 WL 1572764, at *5. Having considered this issue in light of the record in this cause, the court concludes that it was not.

A review of the cardholder agreement discloses that the document is indeed rather lengthy, with a font that could be accurately characterized as small, if not "tiny." The font, however, is legible, and consistent throughout the document. Moreover, the agreement does recite, as defendant acknowledges, that the agreement can be amended from time to time by Bank One upon notification to defendant.

Nevertheless, defendant suggests that he could not reasonably have understood that Bank One could, or have anticipated that it would amend the agreement to add an arbitration agreement, since the original agreement did not mention arbitration at all and since the "amendment" provision referenced only changes to payments, charges, fees and the interest rate, suggesting that these were the only types of amendments that could be made.[19] The agreement, though, stated simply, unambiguously and without limitation, that Bank One could "change or amend the terms of the Agreement."

Given, then, that the original cardholder agreement permitted amendments, the arbitration provision is not rendered unenforceable simply by virtue of the fact that Bank One undertook to add the arbitration provision via amendment. Consistent with the terms of the original agreement, Bank One could validly amend its agreement to add an arbitration clause, just as it could have amended the agreement to add or change any other term on the agreement.... Indeed, Ohio Banking statutes specifically authorize amendments, stating that, "subject to any requirements under applicable federal law, a bank and a borrower may specify in their agreement any terms and conditions for modifying or amending the agreement."). Ohio Rev. Stat. § 1109.20(D). Still, if the manner in which Bank One added the provision was procedurally unfair, the agreement could be found to be unconscionable and unenforceable. But the court is not persuaded that it was unfair.

Bank One sent a notification of the amendment to all its cardholders, and specifically gave them the option of rejecting the arbitration provision. Although defendant asserts that he does not recall having received the notification of amendment, he does not specifically take issue with Bank One's assertion that the amendment notification documents were in fact sent to each of its cardholders, including the defen-

19. Defendant presumably would agree that he could reasonably have anticipated that Bank One might amend the agreement to change terms relating to payments and charges, since the "amendment" provision of the cardholder agreement specifically referenced the possibility of a "changed or amended fee, charge, interest rate, FINANCE CHARGE, ANNUAL PERCENTAGE RATE, or minimum payment amount."

dant. Furthermore, defendant does not deny that the notice gave him the opportunity to reject the arbitration provision and that he failed to do so. Several courts have enforced arbitration agreements under similar circumstances.

For example, in *Herrington v. Union Planters Bank*, 113 F. Supp. 2d 1026 (S.D. Miss. 2000), in the face of undisputed evidence that the plaintiffs' original deposit account agreements provided that the terms and conditions of their accounts could change in the future upon sufficient notice, that the plaintiffs were given notice that their accounts were being revised to include an arbitration clause and that they continued to use their accounts after the effective date of the arbitration clause, the plaintiffs argued in response to the defendant bank's motion to compel arbitration that they did not agree to arbitrate, and that the bank had tried to "slip in" an arbitration agreement without adequately informing them that the terms of their original agreements had changed.

The court rejected their position, stating, "After reviewing the letter and revised deposit agreement, the Court finds that the plaintiffs were sufficiently notified that the terms and conditions of their accounts would change effective May 1, 1998. The plaintiffs' apparent failure to read the revisions to their accounts is irrelevant to the issue of whether they agreed to arbitrate or are subject to those changes. See *Hill v. Gateway 2000, Inc.*, 105 F.3d 1147, 1148–50 (arbitration clause in the terms and conditions of purchase was binding on purchaser even if he did not read the arbitration clause). . . .

"The plaintiffs accepted the terms of the arbitration agreement by continuing to utilize their accounts. . . . The plaintiffs could have simply declined to accept the arbitration by terminating their account before the effective date of the amendment. Because they continued performance under the revised deposit agreements after May 1, 1998, the Court finds that the plaintiffs agreed to arbitrate their disputes with [the bank]." Id. at 1031, 1032.

Similarly, in *Stiles v. Home Cable Concepts, Inc.*, 994 F. Supp. 1410 (M.D. Ala. 1998), the court enforced an arbitration provision added to a credit card agreement via amendment where the original agreement provided that it was subject to change, the plaintiff acknowledged that he had received notice of the amendment and he agreed that he had failed to return the postage-paid card provided by the company for customers who chose to reject the arbitration provision. The plaintiff in Stiles asserted that he failed to reject the arbitration provision because the amendment was not explained to him so that he could understand what it meant, and he therefore did not understand the rights he was forfeiting by not rejecting the arbitration provision. Id. at 1414. The court was "somewhat unsure how to take" the plaintiff's objection that the arbitration clause was invalid because he did not understand it, and thus deferred to "the principle of basic contract law that unilateral mistakes by a party do not invalidate the contract." Id. at 1417. Then turning to the specific issue of alleged unconscionability, the court concluded that, "Far from being unconscionable, the procedure to which Stiles objects is specifically sanctioned by the law which applies to this contract. The procedure used is permissible under Utah law.... Stiles has not contended that AGFC failed to comply with this statutory procedure [allowing a change in terms upon fifteen days' advance notice if the contract provides that the creditor may change terms of the agreement from time to time]." Id. at 1417; ...

In support of his charge that the arbitration provision is not enforceable, defendant directs the court to *Badie v. Bank of America*, 67 Cal. App. 4th 779, 79 Cal. Rptr. 2d 273 (Cal. Ct. App. 1998), in which the court refused to enforce an arbitration clause that the lender attempted to add via amendment. In *Badie*, however, in contrast to the situation presented in *Herrington*, *Stiles* and the case sub judice, the court found that the original agreement did not authorize new or amended terms, and the plaintiffs were not given the option of rejecting the arbitration clause.

In this case, the document sent to defendant notifying him of the addition of the arbitration clause did not, as defendant states, include several amendments but rather addressed the singular topic of the arbitration clause, and began with the heading "IMPORTANT NOTICE." The language of the notice was clear as to the defendant's choice to accept or reject the arbitration clause; and the arbitration clause itself was not filled with "legalese" as defendant claims, but was instead clear. It provided that all claims and disputes between the parties would be resolved through arbitration, rather than litigation, identified the arbitral forum and provided a web site and telephone number to call for information on the governing arbitration procedures. The most that can be said in favor of defendant's claim of unconscionability is that the print in the amendment notice was small. Nevertheless, it was, as with the original agreement, consistent and legible. Accordingly, the court will not invalidate the agreement simply because the print was small.

Waiver of Jury Trial Rights

Defendant contends that because the arbitration clause constitutes a waiver of his Seventh Amendment right to a jury trial, then the plaintiff must demonstrate that there was a "clear and unmistakable" waiver of this right. But that is not so. "[A] valid arbitration provision, which waives the right to resolve a dispute through litigation in a judicial forum, implicitly waives the attendant right to a jury trial." *Marsh v. First USA Bank*, N.A., 103 F. Supp. 2d 909, 921 (N.D. Tex. 2000). "The Seventh Amendment does not confer the right to a trial, but only the right to have a jury hear the case once it is determined that the litigation should proceed before a court. If the claims are properly before an arbitral forum pursuant to an arbitration agreement, the jury trial right vanishes." Id....

Substantive Unconscionability

Defendant herein submits three bases upon which he contends that the arbitration agreement is substantively unconscionable, namely that the costs he would have to bear to arbitrate effectively render an arbitral forum inaccessible; that it denies him certain remedies; and that the arbitration agreement designates a biased arbitrator.

Defendant asserts that because the arbitration agreement requires each party to bear its own expenses, including attorney's fees, regardless of who prevails, it would impose a substantial financial burden on him to arbitrate, and the arbitration agreement thus stands as a substantial barrier to the adequate resolution of their claims. He also claims, without explanation, that the arbitration provision precludes certain remedies that would be available to him in a judicial forum. Defendant's position on these points is not well taken.

The arbitration agreement provides that the arbitration will be conducted under the Code of Procedure of the National Arbitration Forum (NAF). Rule 20 of the NAF Code of Procedure expressly provides that the "Arbitrators may grant any remedy or relief allowed by applicable substantive law and based on a Claim, Response, or Request properly submitted by a Party under this Code." Thus, any relief available to defendant in a judicial forum would also be available in arbitration. . . .

And while defendant insinuates that the fees he might have to pay for arbitration could effectively deny him access to the arbitral forum, he has provided no factual basis for such an assertion. In *Green Tree Financial v. Randolph*, 531 U.S. 79, 121 S. Ct. 513, 148 L. Ed. 2d 373 (2000), the Supreme Court recognized that "the existence of large arbitration costs could preclude a litigant . . . from effectively vindicating her federal statutory rights in the arbitral forum." 121 S. Ct. at 522. The Court went on to hold, though, that "where . . . a party seeks to invalidate an arbitration agreement on the ground that arbitration would be prohibitively expensive, that party bears the burden of showing the likelihood of incurring such costs." Id.

Defendant's statement that he would be required to bear his own expenses, including attorney's fees, no matter who prevails, is not well founded. The NAF Code of Procedure authorizes the award of attorney's fees to a prevailing party. And as regards the payment of costs and fees, the NAF Code of Procedure includes a "Fee Schedule" which sets filing and hearing fees by reference to the amount of a plaintiff's claim. For example, for claims under $5,000, the fee schedule provides for a filing fee of $49 and an administrative fee of $225; and for claims under $15,000, the filing fee is $100 and the administrative fee $425. The NAF Fee Schedule also states that "an individual who is indigent and cannot afford to pay a fee may not have to pay a Consumer Small Claim fee." And finally, the Fee Schedule states that the "arbitrator may order the losing party to pay the fees paid by the prevailing party." In light of these provisions, defendant's contention that the agreement does not provide him an adequate arbitral forum as an alternative to a judicial forum must be rejected. . . .

Defendant's charge as to NAF bias in favor of banking institutions is fundamentally premised on the notion that Bank One has the burden to demonstrate the chosen arbitral forum's impartiality. But as Bank One notes, it is the party resisting arbitration that bears the burden of demonstrating that the arbitration agreement is unenforceable.... In any event, the rules governing the conduct of NAF arbitrations belie defendant's speculation that suspected bias by the NAF has any realistic potential for affecting decisions of arbitrators in NAF arbitrations. In this regard, the court observes that the NAF does not conduct the arbitration itself, but rather appoints independent third-party arbitrators who actually conduct the proceedings; and those arbitrators may not be officers or directors of the NAF, they must take an oath to be "independent and neutral" and they must disclose any circumstances that might constitute a conflict of interest. Further, "to safeguard fairness, [the NAF Code of Procedure] provides that each of the parties may exercise one peremptory strike of a proposed arbitrator and each has unlimited challenges for cause. All legal remedies and injunctive relief are available to the parties. Any party may request a written opinion of the arbitrator's ruling." *Marsh* [*v. First USA Bank*], 103 F. Supp. 2d at 925. Given these safeguards, the court does not consider that there exists any valid basis for contesting arbitration on this basis and the court is not persuaded that there otherwise exists any basis for finding the agreement to be unconscionable. See *Stiles*, 994 F. Supp. at 1417 (enforcing arbitration clause where plaintiff "had not shown what it is that is so objectionable about the arbitration which he is required to undertake."); *Marsh*, 103 F. Supp. 2d at 920 (noting that "while the arbitration provision may have been presented in a take-it-or-leave-it manner, the Court cannot say that it is so lopsided in Defendant's favor as to be oppressive or prejudicial. The arbitration provision standing alone does not present an opportunity for one party to gain an unfair advantage over the other in arbitration, any more than the inclusion of a forum selection clause would impede a just result in a court of law.").

In summary, the court is not persuaded that there exists any basis upon which it should refuse to enforce the arbitration provision at issue and therefore, the court concludes that Bank One's motion to compel arbitration should be granted.

Conclusion

Based on the foregoing, it is ordered that defendant's motions for joinder and dismissal, for discovery and for abstention are denied, and it is further ordered that Bank One's motion to compel arbitration is granted.

judge

ability to

§ 2-302. Unconscionable Contract or Clause.

(1) 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 as to avoid any unconscionable result.

judge

both comm. & consumer

(2) When it is claimed or appears to the court that the contract or any clause thereof may be unconscionable the parties shall be afforded a reasonable opportunity to present evidence as to its commercial setting, purpose and effect to aid the court in making the determination.

the terms why it is fair

Official Comment

Prior Uniform Statutory Provision: None.

Purposes:

1. This section is intended to make it possible for the courts to police explicitly against the contracts or clauses which they find to be unconscionable. In the past such policing has been accomplished by adverse construction of language, by manipulation of the rules of offer and acceptance or by determinations that the clause is contrary to public policy or to the dominant purpose of the contract. This section is intended to allow the court to pass directly on the unconscionability of the contract or particular clause therein and to make a conclusion of law as to its unconscionability. The basic test is whether, in the light of the general commercial background and the commercial needs of the particular trade or case, the clauses involved are so one-sided as to be unconscionable under the circumstances existing at the time of the making of the contract. Subsection (2) makes it clear that it is proper for the court to hear evidence upon these questions. The principle is one of the prevention of oppression and unfair surprise (Cf. Campbell Soup Co. v. Wentz, 172 F.2d 80, 3d Cir. 1948) and not of disturbance of allocation of risks because of superior bargaining power. The underlying basis of this section is illustrated by the results in cases such as the following:

Kansas City Wholesale Grocery Co. v. Weber Packing Corporation, 93 Utah 414, 73 P.2d 1272 (1937), where a clause limiting time for complaints was held inapplicable to latent defects in a shipment of catsup which could be discovered only by microscopic analysis; Hardy v. General Motors Acceptance Corporation, 38 Ga. App. 463, 144 S.E. 327 (1928), holding that a disclaimer of warranty clause applied only to express warranties, thus letting in a fair implied warranty; Andrews Bros. v. Singer & Co. (1934 CA) 1 K.B. 17, holding that where a car with substantial mileage was delivered instead of a "new" car, a disclaimer of warranties, including those "implied," left unaffected an "express obligation" on the description, even

Commercial - General : UNUSUAL ?

Obscure : EXCEPTIONAL ?

though the Sale of Goods Act called such an implied warranty; New Prague Flouring Mill Co. v. G. A. Spears, 194 Iowa 417, 189 N.W. 815 (1922), holding that a clause permitting the seller, upon the buyer's failure to supply shipping instructions, to cancel, ship, or allow delivery date to be indefinitely postponed 30 days at a time by the inaction, does not indefinitely postpone the date of measuring damages for the buyer's breach, to the seller's advantage; and Kansas Flour Mills Co. v. Dirks, 100 Kan. 376, 164 P. 273 (1917), where under a similar clause in a rising market the court permitted the buyer to measure his damages for non-delivery at the end of only one 30 day postponement; Green v. Arcos, Ltd. (1931 CA) 47 T.L.R. 336, where a blanket clause prohibiting rejection of shipments by the buyer was restricted to apply to shipments where discrepancies represented merely mercantile variations; Meyer v. Packard Cleveland Motor Co., 106 Ohio St. 328, 140 N.E. 118 (1922), in which the court held that a "waiver" of all agreements not specified did not preclude implied warranty of fitness of a rebuilt dump truck for ordinary use as a dump truck; Austin Co. v. J. H. Tillman Co., 104 Or. 541, 209 P. 131 (1922), where a clause limiting the buyer's remedy to return was held to be applicable only if the seller had delivered a machine needed for a construction job which reasonably met the contract description; Bekkevold v. Potts, 173 Minn. 87, 216 N.W. 790, 59 A.L.R. 1164 (1927), refusing to allow warranty of fitness for purpose imposed by law to be negated by clause excluding all warranties "made" by the seller; Robert A. Munroe & Co. v. Meyer (1930) 2 K.B. 312, holding that the warranty of description overrides a clause reading "with all faults and defects" where adulterated meat not up to the contract description was delivered.

2. Under this section the court, in its discretion, may refuse to enforce the contract as a whole if it is permeated by the unconscionability, or it may strike any single clause or group of clauses which are so tainted or which are contrary to the essential purpose of the agreement, or it may simply limit unconscionable clauses so as to avoid unconscionable results.

3. The present section is addressed to the court, and the decision is to be made by it. The commercial evidence referred to in subsection (2) is for the court's consideration, not the jury's. Only the agreement which results from the court's action on these matters is to be submitted to the general triers of the facts.

Definitional Cross Reference:

"Contract". Section 1–201.

Damages