BEWARE OF ARBITRATION CLAUSES THAT ARE UNFORCEABLE BECAUSE THEY ARE DEEMED UNCONSCIONABLE

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Many businesses attempt to limit their legal exposure by inserting mandatory arbitration clauses into their contractual agreements. While this can be a good idea, there are cautionary tales on how such clauses should be written and presented when negotiating agreements. Not all arbitration clauses are enforceable by the courts.

For example, in *Goodridge v. KDF Automotive Group, Inc*., 2012 WL 3635279 (Cal.App. 2012), the California Court of Appeal denied a petition to compel arbitration of a lawsuit filed by the purchaser of a pre-owned automobile. The Court decided that the arbitration clause in the purchase contract was unconscionable, and therefore unenforceable.

In purchasing the vehicle, the consumer was presented with a "stack of preprinted form documents" and was told simply where to sign or initial each document. He was not given the opportunity to read them in full, or to negotiate any of their preprinted terms. He was told that this was a "take it or leave it" deal. A key fact was that the auto dealership did not inform the buyer that the reverse side of the one-page contract contained an arbitration clause in fine print, and he did not see it before signing the document.

A few months later, the buyer filed a class action complaint against the dealer, alleging among things unfair business practices, fraudulent misrepresentation and negligent misrepresentation. The dealership answered the complaint and did not assert any right to arbitrate the dispute as an affirmative defense. Only after several months of litigation did the dealership finally file a petition to compel arbitration, arguing that the U.S. Supreme Court had recently decided in *AT&T Mobility, LLC v. Concepcion*, 131 S.Ct. 1740 (2011) that "unconscionability is no longer a valid objection to an arbitration agreement."

The trial court denied the petition because it found that the arbitration clause in the purchase agreement was unconscionable. The decision was upheld on appeal.

Despite the *AT&T Mobile* decision, Federal and California courts may refuse to enforce an arbitration provision if the facts indicate that it should be deemed unconscionable. If there is reason to revoke the agreement on such grounds as fraud or duress, the courts will do so. See, e.g., *Ishkanian v. CLS Transportation Los Angeles, LLC*, 206 Cal.App.4th 949, 956 (2012) – decided by the California Court of Appeal after the *AT&T Mobile* case.

The public policy in California strongly favors arbitration. It is a "speedy and relatively inexpensive means of dispute resolution." The important question, therefore, is what constitutes unconscionability with respect to enforcing – or denying – a specific arbitration clause. The *Goodridge* Court defined unconscionability as follows:

> Unconscionability generally includes an absence of meaningful choice by one party together with contract terms that are unreasonably favorable to the other party. Alternatively stated, unconscionability has both procedural and substantial elements. To refuse to enforce a contract for unconscionability, a court generally must find the contract is both procedurally and substantively unconscionable.

The Court further defined "procedural unconscionability" as oppression or surprise, such as might be found in a contract of adhesion which is both imposed and drafted by the party with superior bargaining position. "Substantive unconscionability" exists when the provision is deemed overly harsh or one-sided, i.e., it falls outside the reasonable expectations of the non-drafting party. Some courts have held that it must also shock the conscience.

This is a sliding scale analysis. To be deemed unconscionable, an arbitration provision need not be equally deficient both procedurally and substantially. The more substantively oppressive the provision, the less evidence of procedural unconscionability is required, and vice versa.

In this *Goodridge* case, both the trial court and the Court of Appeal determined that the arbitration clause was procedurally unconscionable because it was presented on a "take it or leave it" basis and was very inconspicuous on the form. There was also surprise because the consumer had no opportunity to review it or initial it. The courts determined that the provision was substantively unconscionable as well. The parties' rights were written as if they were bilateral, but in reality they really benefitted the dealership more than the purchaser. Because both the trial court and the Court of Appeal found that there was ample evidence of both types of unconscionability, the arbitration provision was deemed unenforceable and severed the entire arbitration provision from the purchase agreement.

We encourage you to consider these guidelines carefully when drafting or reviewing any arbitration provision. Arbitration is certainly a preferred form of alternate dispute resolution, but it has its limitations when a basic sense of fundamental fairness is violated.