



2006

# Unconscionability Found: A Look at Pre-Dispute Mandatory Arbitration Agreements 10 Years after Doctor's Associates, Inc. v. Casarotto

Sandra F. Gavin

*Visiting Associate Professor, Rutgers School of Law, Camden, New Jersey.*

Follow this and additional works at: <https://engagedscholarship.csuohio.edu/clevstrev>

 Part of the [Law Commons](#)

**How does access to this work benefit you? Let us know!**

---

## Recommended Citation

Sandra F. Gavin, *Unconscionability Found: A Look at Pre-Dispute Mandatory Arbitration Agreements 10 Years after Doctor's Associates, Inc. v. Casarotto*, 54 Clev. St. L. Rev. 249 (2006)  
available at <https://engagedscholarship.csuohio.edu/clevstrev/vol54/iss3/3>

This Article is brought to you for free and open access by the Law Journals at EngagedScholarship@CSU. It has been accepted for inclusion in Cleveland State Law Review by an authorized editor of EngagedScholarship@CSU. For more information, please contact [library.es@csuohio.edu](mailto:library.es@csuohio.edu).

## ARTICLES

### UNCONSCIONABILITY FOUND: A LOOK AT PRE-DISPUTE MANDATORY ARBITRATION AGREEMENTS 10 YEARS AFTER *DOCTOR'S ASSOCIATES, INC. V. CASAROTTO*

SANDRA F. GAVIN<sup>1</sup>

I. INTRODUCTION .....	249
II. ARBITRATION HOSTILITY.....	251
III. THE FAA: BEYOND NEUTRALITY – EVOLUTION OF THE “SUPER ENFORCEABLE CONTRACT” .....	252
IV. DOCTOR’S ASSOCIATES, INC. V. CASAROTTO.....	256
V. UNCONSCIONABILITY FOUND UNDER STATE LAW .....	258
VI. CONCLUSION.....	270

#### I. INTRODUCTION

Pre-dispute mandatory arbitration agreements eviscerate the Seventh Amendment right to trial by jury and the rule of law; however, this contractual waiver of judicial process is expressly authorized by the Federal Arbitration Act (FAA).<sup>2</sup> Over the past few decades the Supreme Court has stretched the contractual approach in application of the FAA so that “mandatory arbitration clauses have become not merely favorites, but darlings of the courts.”<sup>3</sup> While it can be argued that little basis in contract law exists to exempt mandatory pre-dispute agreements from general contract principles, special contract rules peculiar to arbitration have developed concurrently over this period of time.

General contract construction principles indicate that the party seeking to prove the agreement bears the burden of proof. However, the Supreme Court has repeatedly noted “that the party resisting arbitration bears the burden of proving that the claims at issue are unsuitable for arbitration.”<sup>4</sup> Further, the Court recently expressly construed an ambiguous agreement in favor of arbitration by holding “we should not, on the basis of ‘mere speculation’ [determine in advance] that an arbitrator might interpret these ambiguous agreements in a manner that casts their

---

<sup>1</sup> Advocacy Program Director and Visiting Associate Professor, Rutgers School of Law, Camden, New Jersey.

<sup>2</sup> 9 U.S.C. §§ 1-16 (1994).

<sup>3</sup> Charles L. Knapp, *Taking Contracts Private: The Quiet Revolution in Contract Law*, 71 *FORDHAM L. REV.* 761, 776 (2002).

<sup>4</sup> See *Green Tree Fin. Corp.-Ala. v. Randolph*, 531 U.S. 79, 91 (2000) (referring to its “prior holdings” on the burden of proof with regard to this rule of construction and holding that the party resisting arbitration on grounds that it would be too expensive likewise “bears the burden of showing the likelihood of incurring such costs”).

enforceability into doubt . . . .”<sup>5</sup> These contract construction principles favoring arbitration are doctrines unique to arbitration contract law and were cited last year by a federal appellate court in affirming a motion to compel arbitration for race discrimination claims.<sup>6</sup>

The arbitration contract award is likewise treated differently on appeal. Unlike lower court awards, which can be successfully appealed for either errors of law or significant misinterpretation of the facts, arbitral decisions are subject to a more limited review and typically can be vacated on far more limited grounds.<sup>7</sup> Arbitrators can and do enter awards that do not reflect application of the rule of common law or even statutory law. The low rate of challenges to arbitral decisions is due in part to the fact that once an arbitrator has issued an award it is quite difficult to vacate.<sup>8</sup>

If the true purpose of Section 2 of the FAA is “to make arbitration agreements as enforceable as other contracts, but not more so,”<sup>9</sup> an argument can be made that, when arbitration clauses are involved, federal courts have in effect gone beyond promoting neutrality in contracting and have created a special class of “super enforceable” contracts. These “super enforceable” arbitration agreements get the “but more so” treatment as a result of the Supreme Court’s repeated interpretation of the FAA in a manner to counter the judiciary’s historical mistrust of arbitration.<sup>10</sup>

This article first explores the Supreme Court’s initially reluctant application of the FAA’s contract approach to enforceability of arbitration agreements which lasted well into the early 1980s. It, then, examines federal preemption of state law and the evolution of the arbitration contract as we know it today. Finally, it looks at the application of defenses that exist “at law or in equity for the revocation of contracts” as applied over the past ten years following the Court’s decision in *Doctor’s Assocs., Inc. v. Casarotto*. This author examines a decade of decisional law and finds a new doctrine of arbitration jurisprudence developing under the FAA that is sensitive to the unique concerns raised by adhesion arbitration agreements. Whether the courts are inappropriately stretching the unconscionability defense is matter of speculation.<sup>11</sup>

---

<sup>5</sup> *Pacificare Health Sys., Inc. v. Book*, 538 U.S. 401, 406-07 (2003) (compelling arbitration of a RICO claim and permitting the arbitrator to decide in the first instance whether the agreement barring “punitive damages” also barred the treble damages allowed under the RICO statute).

<sup>6</sup> *See Booker v. Robert Half Int’l, Inc.*, 413 F.3d 77, 81 (D.C. Cir. 2005).

<sup>7</sup> *See generally Wilko v. Swan*, 346 U.S. 427, 436-37 (1953) (stating in dictum, “the interpretations of the law by the arbitrators in contrast to the manifest disregard are not subject, in the federal courts, to judicial review for error . . .”).

<sup>8</sup> *See generally Pierre Lalive, Enforcing Awards, in 60 YEARS OF ICC ARBITRATION: A LOOK AT THE FUTURE* 317, 319 (1984).

<sup>9</sup> *Prima Paint Corp. v. Flood & Conklin Mfg. Co.*, 388 U.S. 395, 404 (1967).

<sup>10</sup> *See Allied-Bruce Terminex Cos., Inc. v. Dobson*, 513 U.S. 265, 270 (1995).

<sup>11</sup> STEPHEN B. GOLDBERG ET AL., *DISPUTE RESOLUTION: NEGOTIATION, MEDIATION, AND OTHER PROCESSES* 265 (4th ed. 2003) (“Judicial receptivity to unconscionability arguments suggests that courts, at least in the arbitration area, may be stretching the unconscionability definition in order to invalidate arbitration agreements.”).

## II. ARBITRATION HOSTILITY

Arbitration is probably as old as human society.<sup>12</sup> As early as the thirteenth century, merchants in England were resolving their disputes outside the common law.<sup>13</sup> In the early days of the Republic merchants in England and America voluntarily submitted matters of trade to arbitration, preferring this dispute resolution process over the common law courts. This preference continued well into the nineteenth century.<sup>14</sup> Despite its historical legitimacy as a private process for dispute resolution, early English judicial decisions demonstrate reluctance to enforce private agreements. The earliest judicial hostility<sup>15</sup> reflected a concern for the defense of judges' turf. This concern was first articulated in a 1746 decision by a King's Bench court in a ruling proclaiming that such agreements wrongly "oust" properly constituted courts of their jurisdiction.<sup>16</sup> Commentators have advanced two primary reasons for this "ouster doctrine." The first suggested a concern for the lack of procedural safeguards that could potentially result in a miscarriage of justice. The second, more cynical theory, opined judicial reluctance to enforce arbitration agreements on greed, arguing that private arbitration was seen as an economic threat to English judges, whose incomes often depended on the fees from disputants. In England, Parliament responded to commercial interests as early as 1684 by enacting an arbitration statute authorizing judicial enforcement of properly executed arbitration agreements. The ouster doctrine traveled across the Atlantic and remained the common law rule in the United States until the early twentieth

---

<sup>12</sup> See generally Sabra A. Jones, *Historical Development of Commercial Arbitration in the United States*, 12 MINN. L. REV. 240, 242-43 (1928) (reporting that arbitration was practiced in Athens and Rome).

<sup>13</sup> See JULIUS H. COHEN, *COMMERCIAL ARBITRATION AND THE LAW* 2 (1918) (quoting then-Senator Elihu Root's address to the American Bar Association in 1914); Soia Mentschikoff, *Commercial Arbitration*, 61 COLUM. L. REV. 846, 854-55 (1961).

<sup>14</sup> See generally MORTON J. HORWITZ, *THE TRANSFORMATION OF AMERICAN LAW: 1780-1860* (1977).

<sup>15</sup> In this article the phrase "hostility" refers to enforcement of agreements to arbitrate. Judicial doctrine was generally not "hostile" to enforcing completed arbitration awards. See *Kulukundis Shipping Co. v. Amtorg Trading Corp.*, 126 F.2d 978, 983 (2d Cir. 1942); see also IAN R. MACNEIL, *AMERICAN ARBITRATION LAW: REFORMATION-NATIONALIZATION-INTERNALIZATION* 20 (1992) (reporting that prior to an arbitration award, one party could unilaterally revoke the arbitrator's authority, even after the arbitration hearing); Thomas E. Carbonneau, *The Reception of Arbitration in United States Law*, 40 ME. L. REV. 263, 267 (1988) (noting that at one time courts in the United States would not enforce an agreement to arbitrate until the arbitrator had issued the award).

<sup>16</sup> *Kill v. Hollister*, 95 Eng. Rep. 532 (K.B. 1746).

century.<sup>17</sup> Judges adopted that hostility with little examination.<sup>18</sup> Most American courts deemed such agreements to arbitrate as revocable at the will of either party.<sup>19</sup>

In America, purely *executory* agreements to arbitrate had little contractual force. Parties could refuse to honor such agreements and could revoke them at any time. The doctrine of specific performance did not apply to agreements to arbitrate existing or future disputes. Common law courts did not recognize arbitration agreements as grounds to bar common law actions.<sup>20</sup> In theory, damages could be sought for breach of contract, but judicial hostility prevailed and only nominal damages were recognized.<sup>21</sup>

Despite American courts' refusal to apply contract law to enforce arbitration agreements, many parties submitted disputes to arbitration on a voluntary basis. Arbitration satisfied a need for expert, speedy, informal and inexpensive resolution of disputes while litigation did not. Merchants of many trade types preferred arbitration over common law suits, however enforcement of the agreement to arbitrate depended on mutual assent.(add a footnote) If a trade member wanted to ignore the agreement, as *Tobey v. County of Bristol* reveals, the party seeking enforcement would get no help from the courts. General contract law was inapplicable. In the 1920s, business and commercial entities (frustrated by the court's unwillingness to order specific performance of agreements to arbitrate) joined to lobby for legislative change.<sup>22</sup> It was around this time that legislatures began to enact laws specifically aimed at the enforcement of arbitration agreements.

### III. THE FAA: BEYOND NEUTRALITY - EVOLUTION OF THE "SUPER ENFORCEABLE" ARBITRATION CONTRACT

The FAA was passed in 1925 to counter this judicial mistrust of arbitration.<sup>23</sup> Congress enacted the United States Arbitration Act (USAA) (now called the Federal Arbitration Act or FAA).<sup>24</sup> The original assumption was that the FAA applied only

---

<sup>17</sup> See CARRIE J. MENKEL-MEADOW ET AL., *DISPUTE RESOLUTION: BEYOND THE ADVERSARIAL MODEL* 481 (2005).

<sup>18</sup> See LAURA J. COOPER ET AL., *ADR IN THE WORKPLACE* 31 (2000) ("Traditionally, courts have been hostile to arbitration, viewing it as an institution that would deprive the courts of their jurisdiction.").

<sup>19</sup> See, e.g., *Kulukundis Shipping Co.*, 126 F.2d at 979 (providing an opinion summarizing the common law); see also *United States Asphalt Ref. Co. v. Trinidad Lake Petroleum Co.*, 222 F. 1006 (S.D.N.Y. 1915).

<sup>20</sup> See *Tobey v. County of Bristol*, 23 Fed. Cas. 1313 (1845); *Kulukundis Shipping Co.*, 126 F.2d at 983.

<sup>21</sup> See *Munson v. Straits of Dover S.S Co.*, 102 F. 926, 928 (2d Cir. 1900) (awarding only nominal damages for a breach of agreement to arbitrate reasoning that judicial process is "theoretically at least, the safest and best devised by the wisdom and experience of mankind").

<sup>22</sup> See generally Julius H. Cohen & Kenneth Dayton, *The New Federal Arbitration Law*, 12 VA. L. REV. 265 (1926) (summarizing the business interests at the time behind the movement for early statutory reform).

<sup>23</sup> See *Allied-Bruce Terminex Cos.*, 513 U.S. at 270.

<sup>24</sup> 9 U.S.C. §§ 1-14 (1999).

in federal courts.<sup>25</sup> If this assumption proved true, states would remain free to refuse contractual enforcement of agreements to arbitrate by legislation or interpretation of state common law. Application of the FAA in state courts was seen as a threat to the many state common and statutory laws hostile to arbitration. This view was grounded in the fact that the FAA had been broadly interpreted to apply to any “contract evidencing a transaction in commerce.”<sup>26</sup>

We begin by reviewing the somewhat innocuous language of Section 2 of the FAA which provides:

A written provision in any . . . contract evidencing a transaction involving commerce to settle by arbitration a controversy thereafter arising out of such contract or transaction, or the refusal to perform the whole or any part thereof, . . . shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract.<sup>27</sup>

The passage of the act did not immediately translate into judicial acceptance or adoption of the mandate that arbitration contracts were to be enforced “save upon such grounds that exist at law or equity for the revocation of any contract.”<sup>28</sup> Following the enactment of the FAA the Supreme Court and lower courts remained somewhat suspicious (if not hostile) to arbitration. Courts failed to uniformly embrace the mandate of Section 2 that arbitration contracts were to be “enforceable” and treated like “any contract” and often hesitated to grant motions to compel arbitration in circumstances they felt were inappropriate.

It would take several decades for the Supreme Court to embrace arbitration and to fully support a contractual approach in matters involving arbitration. In 1983, the Court in *Moses H. Cone Mem’l Hosp. v. Mercury Constr. Corp.* reaffirmed the contractual approach in a case involving an arbitration clause in a construction contract.<sup>29</sup> The Court also went a step beyond encouraging mere neutrality by creating a presumption in favor of arbitration,<sup>30</sup> Justice Brennan opined for the majority:

[Q]uestions of arbitrability must be addressed with a healthy regard for the federal policy favoring arbitration . . . The Arbitration Act establishes that, as a matter of federal law, any doubts concerning the scope of arbitrable issues should be resolved in favor of arbitration, whether the

---

<sup>25</sup> IAN R. MACNEIL ET AL., FEDERAL ARBITRATION LAW §§ 10.2, 10.3.1, 10.3.2 (1995).

<sup>26</sup> 9 U.S.C. § 2 (2000); *See generally Allied-Bruce Terminex Cos.*, 513 U.S. at 269-70 (demonstrating that the scope of the FAA’s coverage has been broadly interpreted to correspond with Congress’ power under the Commerce Clause); *Circuit City Stores, Inc. v. Adams*, 532 U.S. 105 (2001) (interpreting FAA’s § 1 exclusion to apply only to transportation workers, thereby limiting the role states could play in regulating arbitration).

<sup>27</sup> 9 U.S.C. § 2.

<sup>28</sup> *Id.*

<sup>29</sup> *Moses H. Cone Mem’l Hosp. v. Mercury Constr. Corp.*, 460 U.S. 1 (1983).

<sup>30</sup> *Id.* at 24-25.

problem at hand is the construction of the contract language itself or an allegation of waiver, delay, or a like defense to arbitrability.<sup>31</sup>

It is significant to note that although Justice Brennan in the majority opinion referenced this policy “favoring” arbitration as if it were a longstanding judicial philosophy, the policy is nowhere to be found in previous Court decisions;<sup>32</sup> however, post-*Cone* it was cited as settled law.<sup>33</sup> Despite this articulated presumption, the contract approach was not uniformly applied in all cases involving arbitration clauses. However, by 1984 the Court reiterated its policy favoring arbitration and struck a final blow to the lack of enforcement of arbitration contracts by the states. In *Southland Corp. v. Keating*,<sup>34</sup> the Court took on the issue of whether a state could refuse to enforce an agreement to arbitrate between a franchisor and franchise notwithstanding a state law invalidating such agreements. The Court held that the FAA created a federal body of substantive law as part of its “national policy”<sup>35</sup> favoring arbitration.

For decades, special defenses were utilized by courts refusing to compel arbitration of statutory claims. In *Wilko v. Swan*,<sup>36</sup> a buyer of securities sued a seller for fraud under Section 12(2) of the Securities Act of 1933. The Supreme Court refused to compel arbitration despite the arbitration clause in the sales contract, holding instead that the clause was void as an invalid waiver of the substantive law created by the securities statute. Lower courts subsequently applied this special “public policy” defense to enforcement of arbitration agreements under the FAA when statutory claims were at issue.<sup>37</sup>

Three decades later, between 1985 and 1989, the Court in the *Mitsubishi* Trilogy, approved compulsory arbitration in statutory claims involving securities, antitrust and racketeering; they explicitly overruled *Wilko*.<sup>38</sup> “[W]e are well past the time when judicial suspicion of the desirability of arbitration and of the competence of arbitral tribunals inhibited the development of arbitration as an alternative means of dispute resolution.”<sup>39</sup> The *Mitsubishi* Court, in an attempt to put an end to any lingering “judicial suspicion” of arbitration, again interpreted the FAA as creating a

---

<sup>31</sup> *Id.*

<sup>32</sup> See generally Jean Sternlight, *Debunking the Supreme Court's Preference For Binding Arbitration*, 74 WASH. U. L.Q. 637, 660-61 (1996) (characterizing this enunciated philosophy as a “myth” swayed or at least influenced by a desire to conserve judicial resources).

<sup>33</sup> See *infra* notes 38-39 and accompanying text.

<sup>34</sup> *Southland Corp. v. Keating*, 465 U.S. 1, 16-17 (1984).

<sup>35</sup> *Id.* at 10-11.

<sup>36</sup> *Wilko v. Swan*, 346 U.S. 427 (1953), *overruled by Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*, 473 U.S. 614 (1985).

<sup>37</sup> See, e.g., *A. & E. Plastik Pak Co. v. Monsanto Co.*, 396 F.2d 710, 716 (9th Cir. 1968); *Am. Safety Equip. Corp. v. J. P. Maguire & Co.*, 391 F.2d 821, 827-28 (2d Cir. 1968).

<sup>38</sup> See *Rodriguez de Quijas v. Shearson/Am. Express, Inc.*, 490 U.S. 477, 479-80, 486 (1989); *Shearson/Am. Express, Inc. v. McMahon*, 482 U.S. 220, 238, 242 (1987); *Mitsubishi*, 473 U.S. at 616, 640.

<sup>39</sup> *Mitsubishi*, 473 U.S. at 626-27.

presumption of arbitrability with regard to whether arbitration is permitted under a particular statutory claim.<sup>40</sup>

The 1991 landmark decision in *Gilmer v. Interstate/Johnson Lane Corp.*<sup>41</sup> illustrates just how far the Court had come since its refusal to apply the FAA to contracts involving the Securities Act in *Wilko*. In *Gilmer*, the Supreme Court held that in the employment context, it would enforce a pre-dispute arbitration agreement signed by a non-union employee as a condition of employment when a federal statutory employment claim was at issue.<sup>42</sup> Although the holding in *Gilmer* expressly applied only to claims brought under the federal Age Discrimination and Employment Act (ADEA), “the lower federal courts have compelled arbitration of claims arising under virtually all federal employment statutes, state employment statutes, and state common law doctrines.”<sup>43</sup> This 1991 decision “precipitated a veritable stampede by employers to fashion agreements with their employees to submit employment disputes to binding arbitration.”<sup>44</sup> This “stampede” has continued in the employment field and has expanded into all areas of consumer law.<sup>45</sup>

In summary, it can be argued that the current arbitration contract construction policy is the child of the federal judiciary’s relentless efforts to counteract historical hostility to arbitration. Although the gestation of this policy took decades, by the mid-1990s Justice Trieweler of the Montana Supreme Court, in upholding a state law which conditioned enforceability of arbitration clauses on compliance with a “first page” notice requirement, spoke for many state court judges when he wrote in a specially concurring opinion that the federal judiciary “perverted the purpose of the FAA from one to accomplish judicial neutrality, to one of open hostility to any legislative effort[s]” designed to promote contractual fairness when arbitration clauses were involved.<sup>46</sup> In 1996, the Supreme Court invalidated this Montana notice statute in *Casarotto*;<sup>47</sup> however, Justice Trieweler’s opinion published in 1994 reflects the tension between state and federal judges on this issue at that time:

To those federal judges who consider forced arbitration as the panacea for their “heavy case loads” and who consider the reluctance of state courts to buy into the arbitration program as a sign of intellectual inadequacy, I would like to explain a few things . . . In Montana, we are reasonably civilized and have a sophisticated system of justice which has evolved

---

<sup>40</sup> *Id.* (holding that the statutory claim will be presumed arbitrable absent explicit evidence that Congress intended to preclude arbitration under the statute in question).

<sup>41</sup> *Gilmer v. Interstate/Johnson Lane Corp.*, 500 U.S. 20 (1991).

<sup>42</sup> *Id.* at 35.

<sup>43</sup> COOPER ET AL., *supra* note 18, at 557.

<sup>44</sup> William M. Howard, *Arbitrating Employment Discrimination Claims: Do You Really Have To? Do You Really Want To?*, 43 DRAKE L. REV. 255, 255 (1994).

<sup>45</sup> *See infra* Part IV.

<sup>46</sup> *Casarotto v. Lombardi*, 886 P.2d 931, 941 (Mont. 1994) (Trieweler, J., specially concurring), *rev’d*, *Doctor’s Assocs., Inc. v. Casarotto*, 517 U.S. 681 (1996).

<sup>47</sup> *Casarotto*, 517 U.S. at 688-89.



over time and which we continue to develop for the primary purpose of assuring fairness to those people who are subject to its authority . . . What I would like the people in the federal judiciary, especially at the appellate level, to understand is that due to their misinterpretation of congressional intent when it enacted the Federal Arbitration Act, and due to their naive assumption that arbitration provisions and choice of law provisions are knowingly bargained for, all of these procedural safeguards and substantive laws are easily avoided by any party with enough leverage to stick a choice of law and an arbitration provision in its pre-printed contract and require the party with inferior bargaining power to sign it . . . [I]f the Federal Arbitration Act is to be interpreted as broadly as some of the decisions from our federal courts would suggest, then it presents a serious issue regarding separation of powers. What these interpretations do, in effect, is permit a few major corporations to draft contracts regarding their relationship with others that immunizes them from accountability under the laws of the states where they do business, and by the courts in those states . . . These insidious erosions of state authority and the judicial process threaten to undermine the rule of law as we know it . . . Nothing in our jurisprudence appears more intellectually detached from reality and arrogant than the lament of federal judges who see this system of imposed arbitration as “therapy for their crowded dockets.” These decisions have perverted the purpose of the FAA from one to accomplish judicial neutrality, to one of open hostility to any legislative effort to assure that unsophisticated parties to contracts of adhesion at least understand the rights they are giving up.<sup>48</sup>

Other voices questioned the broad interpretation of the FAA,<sup>49</sup> however, the Supreme Court continued down the path articulated by Justice Brennan in *Cone*<sup>50</sup> when *Casarotto* reached it in 1996.

#### IV. DOCTOR’S ASSOCIATES, INC. V. CASAROTTO

In *Casarotto*, the Supreme Court again enhanced enforceability of arbitration agreements when it held that the preemptive scope of the FAA applied to the Montana statute. Montana law, at the time, declared “an arbitration clause unenforceable unless ‘[n]otice that [the] contract is subject to arbitration’ is ‘typed in

---

<sup>48</sup> *Casarotto*, 886 P.2d at 939-41.

<sup>49</sup> See, e.g., *Allied-Bruce Terminex Cos.*, 513 U.S. at 282 (O’Connor, J., concurring) (“I have long adhered to the view, discussed below, that Congress designed the Federal Arbitration Act to apply only in federal courts.”); Richard M. Alderman, *Pre-Dispute Mandatory Arbitration in Consumer Contracts: A Call for Reform*, 38 HOUS. L. REV. 1237 (2001); Anne Brafford, *Arbitration Clauses in Consumer Contracts of Adhesion: Fair Play or Trap for the Weak and Unwary?*, 21 IOWA J. CORP. L. 331 (1996); Margaret M. Harding, *The Clash Between Federal and State Arbitration Law and the Appropriateness of Arbitration as a Dispute Resolution Process*, 77 NEB. L. REV. 397 (1998); Johanna Harrington, *To Litigate or Arbitrate? No Matter—The Credit Card Industry is Deciding for You*, 2001 J. DISP. RESOL. 101 (2001).

<sup>50</sup> *Moses H. Cone Mem’l Hosp.*, 460 U.S. at 1.

underlined capital letters on the first page of the contract.”<sup>51</sup> The arbitration clause in *Casarotto* did not comply with the statute because it was on page nine and in ordinary type. This case is a prime example of lower courts resisting the efforts of the Supreme Court to support binding arbitration in all areas of law. The case history shows that the Montana Supreme Court twice voided the arbitration clause before the Supreme Court made a final ruling that the clause was invalid.

*Casarotto* involved a Subway sandwich shop standard form franchise agreement requiring all claims relating to the agreement to be arbitrated by the American Arbitration Association in Connecticut. When a dispute arose, the franchisees brought suit in a Montana state court, alleging state-law contract and tort claims. The franchisor sought to stop litigation pending arbitration pursuant to the arbitration clause on page nine of the agreement and successfully moved to stay the state court litigation pending arbitration. The Montana Supreme Court reversed the stay holding that the Montana Statute rendered the arbitration clause unenforceable. The question for the Supreme Court was whether Montana’s law was compatible with the FAA or whether it conflicted and was therefore displaced or preempted by the federal statute. The Supreme Court reversed the Montana court’s decision finding preemption “because the State’s law conditions the enforceability of arbitration agreements on compliance with a special notice requirement not applicable to contracts generally.”<sup>52</sup> However, the Court also affirmed its contract approach to arbitration agreements holding:

Section 2 of the FAA provides that written arbitration agreements “shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for revocation of *any* contract.” 9 U. S. C. § 2 . . . (citations omitted) . . . the text of § 2 declares that state law may be applied “*if* that law arose to govern issues concerning the validity, revocability, and enforceability of contracts generally.” (citation omitted) . . . Thus, generally applicable contract defenses, such as fraud, duress, or unconscionability, may be applied to invalidate arbitration agreements without contravening § 2. (citations omitted).<sup>53</sup>

Thus, while it can be argued that state regulatory power to protect consumers from unintentionally waiving access to the courts was severely curtailed in *Casarotto*<sup>54</sup> and that the number of standard form arbitration agreements would grow,<sup>55</sup> this

---

<sup>51</sup> *Casarotto*, 517 U.S. at 683 (citing MONT. CODE ANN. § 27-5-114(4) (1995)).

<sup>52</sup> *See id.* at 687.

<sup>53</sup> *Id.* at 686-87.

<sup>54</sup> David Ling, *Preserving Fairness in Arbitration Agreements: States’ Options after Casarotto*, 2 HARV. NEGOT. L. REV. 193, 205 (1997) (“The Supreme Court’s decision in *Casarotto*, then, does have a largely eviscerating effect on state attempts to regulate arbitration, even those that are geared towards leveling the playing field between individuals with relatively little bargaining power and larger, more powerful corporations, employers, and franchisers.”).

<sup>55</sup> *See* Stephen J. Ware, *Arbitration and Unconscionability After Doctor’s Associates, Inc. v. Casarotto*, 31 WAKE FOREST L. REV. 1001, 1001, note 3 (1996) (referencing growth of standard form arbitration agreements signed by consumers, employees, and others).

article looks at how courts have applied the “generally applicable” contract defense of unconscionability in the wake of *Casarotto*.

The FAA “preclude[s] States from singling out arbitration provisions for suspect status, requiring instead that such provisions be placed ‘upon the same footing as other contracts.’”<sup>56</sup> In the wake of *Casarotto*, state courts were on notice that even seemingly benign regulatory laws would not be tolerated unless the laws applied to all contracts. Commentators pronounced the demise of state regulatory action aimed at protecting citizens from unfair adhesion clauses compelling arbitration.<sup>57</sup> Concurrently, employers as well as retail sellers of goods continued their “stampede”<sup>58</sup> in fashioning pre-dispute binding arbitration agreements drafted to cover every imaginable cause of action arising out of employment or arising under consumer law. Many courts have replied by resurrecting the equitable doctrine of unconscionability in response to the proliferation of aggressively drafted standard form pre-dispute arbitration clauses. This article looks at this judicial response. Perhaps, the strong endorsement of the contract approach to arbitration law in *Casarotto* is at least partly responsible for “unconscionability found” in state and federal decisional law in the decade immediately following the Supreme Court’s decision.

#### V. UNCONSCIONABILITY FOUND UNDER STATE LAW

While *Casarotto* on one hand may have significantly reduced states’ power to regulate arbitration through legislation, it also stands expressly for the proposition that an arbitration provision may be struck down if it is unconscionable.<sup>59</sup> “Because unconscionability is a defense to contracts generally and does not single out arbitration agreements for special scrutiny, it is also a valid reason not to enforce an arbitration agreement under the FAA.”<sup>60</sup> Upon a finding of unconscionability, state

---

<sup>56</sup> *Casarotto*, 517 U.S. at 687 (quoting *Scherk v. Alberto-Culver Co.*, 417 U.S. 506, 511 (1974)).

<sup>57</sup> Ling, *supra* note 54, at 193-94 (“The [*Casarotto*] [c]ourt’s ruling likely will eviscerate existing state legislation aimed at establishing a minimum threshold of fairness in both the formation and the performance of arbitration agreements . . . .”); *see also* Henry C. Strickland, *The Federal Arbitration Act’s Interstate Commerce Requirement: What’s Left for State Arbitration Law?*, 21 HOFSTRA L. REV. 385 (1992). Charles Knapp states:

The United States Supreme Court, followed loyally, and for the most part enthusiastically, by the lower federal courts, has made the strong preference for enforcement of arbitration clauses a matter of federal preemption, so broadly and firmly expressed as to make it nearly impossible for even those state judges or state legislatures who might be so moved to exercise any restraining influence at all. Knapp, *supra* note 3, at 776-77.

<sup>58</sup> Howard, *supra* note 44, at 255.

<sup>59</sup> *See Casarotto*, 517 U.S. at 681; *see also* *Vimar Seguros y Reaseguros, S.A. v. M/V Sky Reefer*, 515 U.S. 528 (1995); *Stirlen v. Supercuts, Inc.*, 60 Cal. Rptr. 2d 138 (Cal. Ct. App. 1997).

<sup>60</sup> *Circuit City Stores, Inc. v. Adams*, 279 F.3d 889, 895 (9th Cir. 2002).

courts often have discretion to deny motions to compel arbitration in whole or in part.<sup>61</sup>

The doctrine of unconscionability post-*Casarotto* is central to assessing the validity of mandatory arbitration clauses when they are challenged under state contract law. The topic of mandatory arbitration clauses was the subject of discussion in June of 2003 when one hundred and twenty judges representing 31 states convened for the Roscoe Pound Institute for State Appellate Court Judges.<sup>62</sup> The increasing role that state courts play in policing arbitration agreements in the wake of the Supreme Court pro-arbitration decisions was discussed. Judge Triewiler, the appellate court judge twice reversed by the U.S. Supreme Court in *Casarotto* noted:

[W]hat we do cling to in Montana are notions of fairness. And we also cling to the notion that if those traditional forms of protection aren't provided by the courts, they are simply not going to be provided. And included in the traditional notions of fairness are access to the courts, the right to trial by jury, and the right to reasonable discovery, so that you can develop your factual record. We consider the rules of evidence important to fairness. We consider the right to appeal, so that one can be sure that the decision was based on the law and the facts, important to principles of fairness. And we believe that public courts, where you don't pay for the judge, are important to the enforcement of the principles of fairness.

We have also taken the Supreme Court at face value. We have taken it to mean what it says when it always points out to us that those grounds that exist at law and equity for the revocation of any contract can be applied to binding, pre-dispute arbitration agreements.

So, recently in *Kloss*, we held, as we have always held, that all contracts of adhesion have to be scrutinized for fairness, and they have to be scrutinized for whether they measure up to the reasonable expectations of the parties who have the least bargaining power. And even if they do, they have to be scrutinized as to whether they are unconscionable. We set forth in *Kloss* what kinds of facts are essential in developing a record of unconscionability. We also said, in the concurring opinion in *Kloss*, that we will consider whether there has been a valid waiver of the constitutional right--the fundamental right in Montana--to trial by jury. .

---

<sup>61</sup> See, e.g., *Armendariz v. Foundation Health Psychcare Servs., Inc.*, 6 P.3d 669, 696-97 (Cal. 2000) (stating that California law grants courts the discretion to sever an unconscionable provision or to refuse to enforce the contract in its entirety, and in exercising this discretion courts look to whether "the central purpose of the contract is tainted with illegality" or "the illegality is collateral to [its] main purpose").

<sup>62</sup> See, e.g., POUND CIVIL JUSTICE INSTITUTE, *THE PRIVATIZATION OF JUSTICE? MANDATORY ARBITRATION, REPORT OF THE 2003 FORUM FOR STATE APPELLATE COURT JUDGES*, 155 (2006), [hereinafter POUND] The report of the 2003 forum for state appellate court judges reports that, "[o]ne standard of assessing the validity of contracts that judges discussed in detail was whether the terms of the contract were unconscionable. Several suggested that was a standard used regularly to overturn mandatory arbitration clauses." *Id.*

. . I think the reason we are able to apply the jury trial waiver standards in Montana is because we have done it in other contexts.<sup>63</sup>

Other generally applicable contract defenses such as fraud, duress, or failure to meet the reasonable expectations of the parties also come into play as part of the unconscionability analysis.<sup>64</sup> This article explores how contractual defenses are applied by courts refusing to enforce pre-dispute arbitration clauses in the last decade. Courts have not found that arbitration clauses are unconscionable in general; such a finding would be plainly contrary to the Federal Arbitration Act; however, a new type of precedent under arbitration jurisprudence is emerging as a viable defense to arbitration contracts today. “If nothing else, the arbitration wars have brought unconscionability back to center stage.”<sup>65</sup>

State contract law is not expressly preempted by the FAA.<sup>66</sup> In significant dicta, the Supreme Court in 1996 explained that “state law, whether of legislative or judicial origin, is applicable [to arbitration agreements] if that law arose to govern issues concerning the validity, revocability, and enforceability of contracts generally.”<sup>67</sup> However, “[o]rdinary principles of unconscionability may manifest themselves in forms peculiar to the arbitration context”<sup>68</sup> and adhesion theory peculiar to arbitration and the FAA is developing.

Most state courts will examine both procedural and substantive unconscionability when an arbitration clause is involved.<sup>69</sup> *Procedural unconscionability* involves inquiry into the contract formation process. This involves consideration of the nature of the negotiation process and the disclosure of arbitration terms focusing on concepts like “oppression” or “surprise” due to “unequal bargaining power.”<sup>70</sup> *Substantive unconscionability* involves an inquiry into the actual terms of the clause.

---

<sup>63</sup> *Id.* at 37-38 (quoting *Kloss v. Edward D. Jones & Co.*, 54 P.3d 1 (Mont. 2002), *cert. denied*, 538 U.S. 956 (2003)).

<sup>64</sup> *See infra* notes 30-37 and accompanying text.

<sup>65</sup> *See Knapp, supra* note 3 at 797 n.120.

<sup>66</sup> 9 U.S.C. § 2 (2000) (providing that the arbitration agreement shall be “valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract”).

<sup>67</sup> *Perry v. Thomas*, 482 U.S. 483, 492 (1987) (reiterating the preemption doctrine created in *Southland Corp. v. Keating*, 465 U.S. 1 (1984), in holding that the FAA preempted California Labor Code § 229).

<sup>68</sup> *Armendariz*, 6 P.3d at 693.

<sup>69</sup> *See, e.g., Harris v. Green Tree Fin. Corp.*, 183 F.3d 173, 181 (3d Cir. 1999) (holding that Pennsylvania law requires both procedural and substantive unconscionability to render a contract term unenforceable); Russell Korobkin, *Bounded Rationality, Standard Form Contracts and Unconscionability*, 70 U. CHI. L. REV. 1203, 1251-78 (2003) (concluding that most courts require both procedural and substantive unconscionability to exist before refusing to enforce an unambiguous contract provision).

<sup>70</sup> *Armendariz*, P.3d at 690 (quoting *A & M Produce Co. v. FMC Corp.*, 135 Cal. App. 3d 473, 486-87 (1982)).

This involves consideration of the fairness evoked by the terms themselves.<sup>71</sup> Courts focus on “overly harsh” or “one sided” results in finding substantive unconscionability.<sup>72</sup> While most courts require a showing of both procedural *and* substantive unconscionability, the two factors are often treated as playing against one another in a sliding scale relationship.<sup>73</sup> For example, the California Supreme Court has stated that “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.”<sup>74</sup> In a number of other jurisdictions, a similar doctrine is set forth in slightly different terms.<sup>75</sup>

The focus is on “fairness” and the defense of unconscionability will only succeed when circumstances surrounding the negotiation of the clause, the terms in the clause, or its contemplated implementation, render it particularly egregious. While the doctrine of unconscionability is a standard contract defense and has been written about extensively elsewhere,<sup>76</sup> factors unique to mandatory pre-dispute arbitration clauses are evolving from decisions involving employment contracts and consumer contracts under the FAA.<sup>77</sup> However, it may be helpful to briefly address the unconscionability analysis forming the basis for current law.

The dictionary definition of “conscience” may be a good place to start. Most dictionaries define the word “conscience” in terms of morality and ethics. A typical definition: “The awareness of a moral or ethical aspect to one’s conduct together with the urge to prefer right over wrong.”<sup>78</sup> When we append the prefix “un”<sup>79</sup> we come up with a “contrary” or “opposite” meaning or the urge to prefer “wrong over right.” One definition of “unconscionability” is “[b]eyond prudence or reason.”<sup>80</sup>

---

<sup>71</sup> See generally, Arthur A. Leff, *Unconscionability and the Code—The Emperor’s New Clause*, 115 U. PA. L. REV. 485, 487 (1967) (“Hereafter, to distinguish the two interests, I shall often refer to bargaining naughtiness as ‘procedural unconscionability,’ and to evils in the resulting contract as ‘substantive unconscionability.’”).

<sup>72</sup> *Armendariz*, 6 P.3d at 690.

<sup>73</sup> See, e.g., *Kinney v. United Healthcare Servs. Inc.*, 83 Cal. Rptr. 2d 348, 352 (Cal. Ct. App. 1999) (discussing a “sliding scale” inquiry where a significant showing of either substantive or procedural unconscionability could render a provision unenforceable); W. DAVID S. LAWSON, *BINDING PROMISES: THE LATE 20<sup>TH</sup> CENTURY REFORMATION OF CONTRACT LAW* 142 (1996) (noting that a sliding scale is utilized by most courts).

<sup>74</sup> *Armendariz*, 6 P3d at 690.

<sup>75</sup> See, e.g., *Eagle v. Fred Martin Motor Co.*, 809 N.E.2d 1161, 1170-72 (Ohio Ct. App. 2004) (applying Ohio law, the court outlines a two prong test for determining unconscionability, explaining “procedural” and “substantive” unconscionability under contract law).

<sup>76</sup> See, e.g., Melvin A. Eisenberg, *The Bargain Principle and Its Limits*, 95 HARV. L. REV. 741, 771-73 (1982); M. P. Ellinghaus, *In Defense of Unconscionability*, 78 YALE L. J. 757, 763-68 (1969).

<sup>77</sup> See *infra* notes 90-158 and accompanying text.

<sup>78</sup> THE AMERICAN HERITAGE DICTIONARY OF THE ENGLISH LANGUAGE 391 (4th ed. 2000).

<sup>79</sup> *Id.* at 1869.

<sup>80</sup> *Id.* at 1873.

How do courts go about fashioning a legal standard for applying this elusive concept on a case-by-case basis?

Common law courts traditionally left evaluation of the fairness of the bargain to the contracting parties. Courts of Equity have historically refused to enforce agreements so unfair as to shock the conscience of the courts.<sup>81</sup> The equitable doctrine of unconscionability applies to contracts generally<sup>82</sup> and to contracts for the sale of goods specifically;<sup>83</sup> however, “the definition of unconscionability remains sketchy and elusive.”<sup>84</sup> How does a judge determine whether a particular agreement “shocks the conscience of the court?” Irving Younger described the two-step analysis as an imprecise process which ultimately “add(s) up merely to the proposition that a judge’s conscience is his only guide.”<sup>85</sup> This two-step analytical process was described early on as an inquiry into “procedural” and “substantive” unconscionability.<sup>86</sup>

Procedural unconscionability or “bargaining naughtiness”<sup>87</sup> traditionally involves the consideration of several factors including: (1) disparity of bargaining between the parties; (2) whether the parties had an opportunity to read and understand the terms; (3) whether the terms were in legalese or fine print; and (4) whether exploitation of a poor or uneducated party took place.<sup>88</sup> Determining substantive unconscionability or the “evils in the resulting contract”<sup>89</sup> involves weighing the disparity of exchange in light of the entire bargain as well as assessing the reasonableness of the individual terms.<sup>90</sup> In light of the overall unconscionability analysis, adhesion contracts often receive scrutiny for fairness because by definition they involve a party with little bargaining power. In this context, courts faced with boilerplate arbitration clauses involving individual employment or consumer contracts are crafting modern adhesion law under the FAA.<sup>91</sup>

---

<sup>81</sup> See generally *Campbell Soup Co. v. Wentz*, 172 F.2d 80, 83 (3d Cir. 1948) (“That equity does not enforce unconscionable bargains is too well established to require citation.”).

<sup>82</sup> RESTATEMENT (SECOND) OF CONTRACTS § 208 (1981).

<sup>83</sup> See U.C.C. § 2-302 (1998) (authorizing refusal to enforce “unconscionable” contracts in whole or part without specifically defining the term).

<sup>84</sup> Susan A. Fitzgibbon, *Teaching Important Contracts Concepts: Teaching Unconscionability through Agreements to Arbitrate Employment Claims*, 44 ST. LOUIS U. L.J. 1401, 1405 (2000).

<sup>85</sup> Irving Younger, *A Judge’s View of Unconscionability*, 13 JUDGES’ J. 32, 33 (1974).

<sup>86</sup> See Leff, *supra* note 71.

<sup>87</sup> *Id.*

<sup>88</sup> RESTATEMENT (SECOND) OF CONTRACTS § 208 cmt. d (1981).

<sup>89</sup> Leff, *supra* note 71, at 487.

<sup>90</sup> *Id.*

<sup>91</sup> See Korobkin, *supra* note 69 (“[A]rbitration jurisprudence is a good source of insight into the unconscionability doctrine.”).

While the judicially created unconscionability analysis generally begins with a determination of whether the clause at hand is one of adhesion,<sup>92</sup> it does not end there. The Supreme Court stated in fairly strong language in *Gilmer* that the “mere inequality in bargaining power” that often exists between employers and employees would not render an agreement to arbitrate unenforceable.<sup>93</sup> Post *Casarotto*, courts began to apply general principles of contract law unconscionability with increasing frequency in the arbitration context. California’s highest court led the way by reaffirming its view that “ordinary principles of unconscionability may manifest themselves in forms peculiar to the arbitration context” and further holding that “[o]ne such form is an agreement requiring arbitration for the claims of the weaker party but a choice of forum for the claims of the stronger party.”<sup>94</sup> In *Armendariz v. Found. Health Psychcare Servs., Inc.*, the court considered the defense of unconscionability as it applies “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.”<sup>95</sup> *Armendariz* involved two employees claiming wrongful termination based on sexual harassment and discrimination. Both had signed pre-dispute arbitration clauses in conjunction with application for employment forms. The arbitration provisions mandated arbitration for employees who file claims against the employer, but the employer was free to sue in court. The clauses signed expressly limited all “remedies for violation of the terms, conditions or covenants of employment . . . to a sum equal to the wages . . . earned from the date of any discharge until the date of the arbitration award.”<sup>96</sup> Reinstatement and even injunctive relief were expressly excluded.<sup>97</sup> The court applied the following unconscionability analysis to the facts of the case.

Step number one in the analysis is to determine (under applicable state law) whether the contract is one of adhesion. *Armendariz*, applied a sliding scale test examining the challenged arbitration provisions for both procedural and substantive unconscionability.<sup>98</sup> The phrase “contract of adhesion” is defined differently from state to state. Under California law, “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.”<sup>99</sup> In California, the court in *Circuit City v. Adams*, on remand from the Supreme Court, held that a finding that the arbitration clause is

---

<sup>92</sup> *Armendariz*, 6 P.3d at 689 (“Unconscionability analysis begins with an inquiry into whether the contract is one of adhesion.”).

<sup>93</sup> *Gilmer*, 500 U. S. at 33.

<sup>94</sup> See *Armendariz*, 6 P.3d at 693 (quoting its prior holding in *Stirlen v. Supercuts, Inc.*, 60 Cal. Rptr. 2d 138 (Cal. Ct. App. 1997)).

<sup>95</sup> *Id.* at 689.

<sup>96</sup> *Id.* at 675.

<sup>97</sup> *Id.*

<sup>98</sup> *Id.* at 689-90.

<sup>99</sup> *Id.* at 689 (citing *Neal v. State Farm Ins. Cos.*, 10 Cal. Repr. 781, 784 (Cal. Ct. App. 1961)).



within a contract of adhesion may be sufficient to render it procedurally unconscionable.<sup>100</sup>

Step number two in the analysis is to “then determine whether ‘other factors are present which, under established legal rules – legislative or judicial – operate to render it [unenforceable].’”<sup>101</sup> The court then went on to delineate two non-exclusive judicial limitations on the enforcement of adhesion contracts, one of which the court, by implication, indicates is peculiar to employment contracts:

“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 expectations of the weaker party or ‘adhering’ party will not be enforced against him. 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.’” Subsequent cases have referred to both the “reasonable expectations” and the “oppressive” limitations as being aspects of unconscionability.<sup>102</sup>

Thus, the unconscionability defense may be predicated upon a variety of factors and is a case sensitive analysis.<sup>103</sup> “It’s so fact-patterned based on circumstances, which means that factors and the criteria shift every time you have a different set of circumstances.”<sup>104</sup> The fact that traits specific to the very nature of the arbitration agreement itself come into play does not detract from the general unconscionability analysis mandated by *Casarotto* and followed by state courts today.<sup>105</sup> A nonexclusive list would include: (1) a finding of an adhesive arbitration clause;<sup>106</sup> (2) a finding of a term violating the “reasonable expectations” of the weaker bargaining party;<sup>107</sup> or (3) a finding of “oppressive” limitations even when the “reasonable

---

<sup>100</sup> See *Adams*, 279 F.3d at 893, *cert. denied*, 535 U.S. 1112 (2002) (revealing that the Ninth Circuit had the last word when finding the arbitration scheme unconscionable under standards of state law).

<sup>101</sup> *Armendariz*, 6 P.3d at 689 (citing *Graham v. Scissor-Tail, Inc.*, 623 P.2d 165 (Cal. 1981)).

<sup>102</sup> *Id.*

<sup>103</sup> *Delta Funding Corp. v. Harris*, No. A-44 September Term 2005, 2006 WL 2277984, at \*4 (N.J. Aug. 9, 2006) (stating “The defense of unconscionability, specifically, calls for a fact-sensitive analysis in each case, even when a contract of adhesion is involved.”).

<sup>104</sup> POUND *supra* note 62, at 115.

<sup>105</sup> *But cf.* Jeffery W. Stempel, *Arbitration, Unconscionability, and Equilibrium: The Return of Unconscionability Analysis as a Counterweight to Arbitration Formalism*, 19 OHIO ST. J. ON DISP. RESOL. 757, 804, 809-10 (2004) (concluding that courts generally police arbitration agreements through a “paint by numbers” analysis citing traits specific to arbitration rather than by applying an “unconscionability norm”).

<sup>106</sup> *Adams*, 279 F.3d at 893.

<sup>107</sup> *Armendariz*, 6 P.3d at 689.

expectations” of the weaker bargaining party are satisfied.<sup>108</sup> In *Armendariz*, the court held that the “unconscionable one-sidedness” of the agreement in the absence of justification rendered the arbitration clause unenforceable.<sup>109</sup>

While the nature of the employee/employer relationship in a particular case plays a major factor in whether courts will compel arbitration, the defense has been successful in cases involving both low<sup>110</sup> and high level employees.<sup>111</sup> An arbitration agreement may also be found unconscionable even in the absence of a finding of a contract of adhesion.<sup>112</sup>

This contractual defense of unconscionability is an extremely fertile ground for consumers as well as employees confronted by one-sided pre-dispute mandatory arbitration clauses. A significant amount of important law relating to unconscionability is found in both the area of both employment and consumer law. In the ten year period since the Supreme Court in *Casarotto* struck the blow to state regulatory efforts to police fairness in the arbitration arena *per se*, many state courts have refused to enforce all or part of arbitration clauses on unconscionability grounds.<sup>113</sup>

Increasingly, consumers encounter pre-dispute arbitration clauses in every day life. Binding arbitration clauses are part of transactions involving sales of consumer goods,<sup>114</sup> consumer services,<sup>115</sup> credit card agreements,<sup>116</sup> brokerage accounts,<sup>117</sup>

---

<sup>108</sup> *Id.*

<sup>109</sup> *Id.* at 694.

<sup>110</sup> *See, e.g.*, *Hooters of Am., Inc. v. Phillips*, 173 F.3d 933 (4th Cir. 1999) (declining to compel bartender to arbitrate Title VII claim on grounds that employer materially breached the agreement to arbitrate by promulgating egregiously one-sided and unfair arbitration rules); *Garrett v. Hooters-Toledo*, 295 F. Supp. 2d 774 (N.D. Ohio 2003) (refusing to compel waitress to arbitrate wrongful discharge upon a finding of procedural and substantive unconscionability); *Alexander v. Anthony Int'l, L.P.*, 341 F.3d 256 (3d Cir. 2003) (declining to compel employee crane operators with limited education to arbitrate wrongful discharge claims upon finding of procedural unconscionability and substantively unconscionable time limitation for filing claim, limitations on relief, and excessive fee arrangements); *Brennan v. Bally Total Fitness*, 198 F. Supp. 2d 377, 383 (S.D.N.Y. 2002) (finding procedural unconscionability when employer used “high pressure tactics,” “gave the employees no more than fifteen minutes to review a sixteen-page single-spaced document,” and employee plaintiff “was an unrepresented, single mother who was then pregnant with twins, and lacked other adequate means of support”).

<sup>111</sup> *Stirlen*, 60 Cal. Rptr. 2d 138 (holding that an experienced executive employee is not estopped from claiming that contract’s arbitration clause was unconscionable).

<sup>112</sup> *See Hooters*, 173 F.3d at 938 (“The judicial inquiry, while highly circumscribed, is not focused only on an examination for contractual formation defects such as a lack of mutual consent and want of consideration.”).

<sup>113</sup> *See infra* notes 114-158 and accompanying text (discussing decisions invalidating arbitration provisions).

<sup>114</sup> *See, e.g.*, *Hill v. Gateway 2000, Inc.*, 105 F.3d 1147 (7th Cir. 1997); *Brower v. Gateway 2000, Inc.*, 676 N.Y.S.2d 569 (N.Y. App. Div. 1998).

<sup>115</sup> *See, e.g.*, *Winig v. Cingular Wireless L.L.C.*, No. C 06 4297 MMC., 2006 WL 2766007 (N.D. Cal. Sept. 27, 2006).

insurance policies,<sup>118</sup> financial services,<sup>119</sup> franchisor agreements,<sup>120</sup> and even professional legal,<sup>121</sup> accounting<sup>122</sup> and health care services.<sup>123</sup> In fact, “the possibilities for the use of arbitration in consumer contracts seem endless.”<sup>124</sup> One study conducted in Los Angeles with respect to a hypothetical “Joe Average” revealed that approximately one-third of consumer transactions in his life were now covered by arbitration clauses.<sup>125</sup> In most states, a finding of both procedural and substantive unconscionability is necessary for the defense to succeed.<sup>126</sup> In just a few states, procedural unconscionability alone will render an arbitration clause unenforceable.<sup>127</sup> However, such cases offer insight to the aggressive drafting and tactics utilized in the consumer field. In one extreme case the court found procedural unconscionability when a surgical patient (dressed in surgical garb) on her way to surgery was asked to sign a standard form agreement without being told about the arbitration provision.<sup>128</sup> The arbitration clause was buried in the form and provided for payment of all costs by the patient in the event she did not win less than one half the amount of the damages sought in arbitration. In the event the doctor was found

---

<sup>116</sup> See, e.g., *Szetela v. Discover Bank*, 118 Cal. Rptr. 2d 862 (Cal. Ct. App. 2002).

<sup>117</sup> See, e.g., *Rodriguez de Quijas*, 490 U.S. at 477.

<sup>118</sup> See, e.g., *State ex rel. Dunlap v. Berger*, 567 S.E.2d 265 (W. Va. 2002).

<sup>119</sup> See, e.g., *Jenkins v. First Am. Cash Advance of Ga.*, 313 F. Supp. 2d 1370 (S.D. Ga. 2003); *Flores v. Transam. Homefirst, Inc.*, 113 Cal. Rptr. 2d 376 (Cal. Ct. App. 2002); *Williams v. Aetna Fin. Co.*, 700 N.E.2d 859 (Ohio 1998).

<sup>120</sup> See, e.g., *Casarotto*, 517 U.S. at 683; *Inv. Partners, L.P., v. Glamour Shots Licensing, Inc.*, 298 F.3d 314 (5th Cir. 2002); *Ticknor v. Choice Hotels Int'l, Inc.*, 265 F.3d 931 (9th Cir. 2001); *We Care Hair Dev., Inc., v. Engen*, 180 F.3d 838 (7th Cir. 1999).

<sup>121</sup> See, e.g., *Lau v. Antonio V. Silva, P.C.*, No. Civ. S-04-2351 WBS PAN (GGH) PS., 2006 WL 2382266 (E.D. Cal. Aug. 17, 2006); *Aguilar v. Lerner*, 88 P.3d 24 (Cal. 2004).

<sup>122</sup> See, e.g., *McNulty v. H&R Block, Inc.*, 843 A.2d 1267 (Pa. 2004).

<sup>123</sup> See, e.g., *Engalla v. Permanente Med. Group, Inc.*, 938 P.2d 903 (Cal. 1997); *Sosa v. Paulos*, 924 P.2d 357 (Utah 1996); *Broemmer v. Abortion Servs. of Phoenix*, 840 P.2d 1013 (Ariz. 1992).

<sup>124</sup> ALLAN S. RAU ET AL., *PROCESSES OF DISPUTE RESOLUTION: THE ROLE OF LAWYERS* 643 (3d ed. 2002).

<sup>125</sup> See Linda J. Demaine & Deborah R. Hensler, “Volunteering” to Arbitrate Through Predispute Arbitration Clauses: The Average Consumer’s Experience, 67 LAW & CONTEMP. PROBS. 55, 62 (2004).

<sup>126</sup> See Korobkin, *supra* note 69, at 1251-78.

<sup>127</sup> See, e.g., *Banc One Acceptance Corp. v. Hill*, 367 F.3d 426, 431-32 (5th Cir. 2004) (applying Mississippi law to strike clause due to procedural unconscionability); *Wilcox v. Valero Ref. Co.*, 256 F. Supp. 2d 687, 691 (S.D. Tex. 2003) (applying Texas law to strike clause due to procedural unconscionability).

<sup>128</sup> See *Sosa*, 924 P.2d at 358.

not to have committed malpractice the patient was required to pay the defendant doctor \$150 per hour for any time spent on the case, plus costs and attorney fees.<sup>129</sup>

In the consumer arena, inquiries into *procedural unconscionability* often focus on whether the contract contained “fine print” or whether the seller used “high-pressured” tactics in making the sale.<sup>130</sup> Whether the party challenging arbitration was “surprised” to find the clause compelling arbitration in the agreement is also a factor courts take into consideration.<sup>131</sup> In some states, the procedural prong of the unconscionability defense is satisfied upon a finding of a contract of adhesion.<sup>132</sup> Other states apply a much heavier burden on consumers. For example, a court applying Michigan law stated that, “[a] contract is an adhesion contract only if the party agrees to the contract because he has no meaningful choice to obtain the desired goods or services elsewhere.”<sup>133</sup> A court applying Tennessee law stated that, “[a] contract is not adhesive merely because it is a standardized form offered on a take-it-or-leave-it basis.”<sup>134</sup> Other courts find that when the arbitration clause is in a boilerplate agreement to which the consumer has no power to negotiate the terms, a careful review of the arbitration agreement is required.<sup>135</sup>

The type of consumer transaction at issue may also influence the approach of a particular court. The Ohio Supreme Court finds that arbitration forms in consumer credit agreements “engender more reservations” than similar agreements in brokerage account agreements or commercial bargaining agreements.<sup>136</sup> Thus, while the nature of the employer/employee relationship is central to the determination of the enforceability of an arbitration agreement in the employment context, the nature of the consumer transaction itself may be central to a particular court’s analysis in

---

<sup>129</sup> *Id.* at 364 (finding the arbitration clause unenforceable on procedural unconscionability alone).

<sup>130</sup> See generally David S. Schwartz, *Enforcing Small Print to Protect Big Business: Employee and Consumer Rights Claims in an Age of Compelled Arbitration*, 1997 WIS. L. REV. 33 (1997).

<sup>131</sup> See, e.g., *Lozada v. Dale Baker Oldsmobile, Inc.*, 91 F. Supp. 2d 1087 (W.D. Mich. 2000) (finding procedural unconscionability in a typical automotive sales practice where dealers rush customers through the paper work process, often failing to provide copies of paperwork at the time of signing).

<sup>132</sup> See, e.g., *Ting v. AT&T*, 319 F.3d 1126, 1148 (9th Cir. 2003) (applying California law when holding that “A contract is procedurally unconscionable if it is a contract of adhesion, *i.e.*, a standardized contract, drafted by the party of superior bargaining strength, that relegates to the subscribing party only the opportunity to adhere to the contract or reject it.”); *Flores*, 113 Cal. Rptr. 2d at 382 (applying California law when stating that “the arbitration agreement . . . imposed upon plaintiffs on a ‘take it or leave it’ basis . . . was a contract of adhesion and thereby procedurally unconscionable”); *McNulty*, 843 A.2d at 1273 (holding that the procedural unconscionability prong is met when “[t]he contract in question is a classic example of an adhesion contract”).

<sup>133</sup> See, e.g., *Veal v. Orkin Exterminating Co.*, No. 1:00-CV-920, 2001 U.S. Dist. LEXIS 4846, at \*7 (W.D. Mich. Apr. 9, 2001).

<sup>134</sup> *Cooper v. MRM Inv. Co.*, 367 F.3d 493, 500 (6th Cir. 2004).

<sup>135</sup> See, e.g., *Williams*, 700 N.E.2d 859.

<sup>136</sup> *Id.* at 866.

the consumer area.<sup>137</sup> One area, however, in which courts have not been very receptive to the defense, is in the “form in a box” sales of computers by Gateway.<sup>138</sup> The use of arbitration clauses in direct sales of computers has been the subject of considerable litigation. After the customer orders the product over the phone, the computer eventually arrives in a box along with a copy of Gateway’s “Standard Terms and Conditions,” which include a pre-dispute arbitration clause that governs unless the customer returns the computer in 30 days. This clause was enforced by the Seventh Circuit in *Hill v. Gateway 2000, Inc.*<sup>139</sup>

The inquiry into *substantive unconscionability* or the “evils in the resulting contract” takes a variety of forms. Substantial precedent is developing from consumer as well as employment cases involving unconscionability on grounds of prohibitive arbitration fees.<sup>140</sup> Although the United States Supreme Court in *Green Tree Fin. Corp.-Ala. v. Randolph* held that the mere risk of excessive arbitration fees is insufficient grounds for unenforceability,<sup>141</sup> a growing number of courts have considered high arbitration fees as a factor in the unconscionability analysis. While the size of the fee is relevant to the determination, whether the cost’s assessed are beyond the consumer’s expectations is also a factor.<sup>142</sup> Courts also consider whether the fees conflict with the purpose of the statute before the court<sup>143</sup> and the public interest affected by the fee provision.<sup>144</sup>

---

<sup>137</sup> *Eagle*, 809 N.E.2d at 1175 (noting the importance of “giving special attention to consumer transactions involving such expensive products as automobiles, which are of critical importance to the consumer-buyer” when finding an arbitration clause in a contract involving the purchase of an automobile unconscionable).

<sup>138</sup> *See, e.g., Hill*, 105 F.3d at 1150.

<sup>139</sup> *Id.* (“By keeping the computer beyond 30 days, the Hills accepted Gateway’s offer, including the arbitration clause.”). *But see Klocek v. Gateway, Inc.*, 104 F. Supp. 2d 1332 (D. Kan. 2000) (denying Gateway’s motion to dismiss consumer’s breach of warranty suit reasoning that Gateway has accepted the offer “either by completing the sales transaction in person or by agreeing to ship and/or shipping the computer to plaintiff,” the court found Gateway’s “additional” arbitration term could only become part of the bargain if plaintiff had “expressly” agreed to the additional term per U.C.C. § 2-207).

<sup>140</sup> *See, e.g., Pinedo v. Premium Tobacco Stores, Inc.*, 102 Cal. Rptr. 2d 435 (Cal. Ct. App. 2000) (finding arbitration clause unconscionable when employee required to pay all fees in the arbitration); *Brower*, 676 N.Y.S.2d at 574 (rejecting procedural unconscionability claim, but holding that excessive filing fee of \$4000, only \$2000 of which would be refunded if consumer prevailed, and location for arbitration rendered clause substantively unconscionable and unenforceable); *Teleserve Sys., Inc. v. MCI Telecomms. Corp.*, 659 N.Y.S.2d 659 (N.Y. App. Div. 1997) (illustrating that, in a commercial case, a filing fee of \$4000 plus one-half of one percent of the amount claimed is unconscionable).

<sup>141</sup> *See Green Tree Fin. Corp.-Ala.*, 531 U.S. at 91; *see also Wilkins v. Weber Motors Fresno, Inc.*, No. F045545, 2005 WL 1941273, at \*11 (Cal. Ct. App. Aug. 15, 2005) (severing cost provision from arbitration agreement on grounds of unconscionability).

<sup>142</sup> *See Myers v. Terminix Int’l Co.*, 697 N.E.2d 277 (Ohio Ct. C.P. 1998) (holding unconscionable requirement that homeowner pay nonrefundable arbitration fee, which could range from \$750 to \$2000, when undisclosed in original arbitration agreement).

<sup>143</sup> *See, e.g., Morrison v. Circuit City Stores, Inc.*, 317 F.3d 646 (6th Cir. 2003) (en banc) (striking cost-splitting provision from employer’s arbitration clause under Ohio law because it

Many courts find “one-way” or “non-mutual” arbitration clauses substantively unconscionable.<sup>145</sup> In *Arnold v. United Cos. Lending Corp.*, the court applying West Virginia law described the “one-way” clause as the sort of deal that might be reached by a rabbit and a fox.<sup>146</sup> In *Arnold*, the clause before the court required the consumer to submit any claims they may have against the lender to arbitration, but permitted the lender to go to court to collect any debts owed.<sup>147</sup> The court concluded that the agreement was unconscionable and unenforceable.<sup>148</sup>

As part of the overall unconscionability analysis courts cite a variety of other factors that may alone or in part constitute substantive unconscionability. For example, bias in the arbitration mechanism or arbitrator;<sup>149</sup> limitations in discovery;<sup>150</sup> waiver of remedies;<sup>151</sup> inconvenient arbitration forum,<sup>152</sup> fraud,<sup>153</sup> and the general contract defense of lack of mutuality.<sup>154</sup>

---

interfered with purpose of Title VII); *Shankle v. B-G Maint. Mgmt. of Colo., Inc.*, 163 F.3d 1230 (10th Cir. 1999) (requiring employee to pay potentially thousands of dollars to participate in arbitration forum renders forum impractical for vindication of statutory rights).

<sup>144</sup> See *Delta Funding Corp.*, 2006 WL 2277984, at \*4-7 (holding that an arbitration agreement ambiguously giving unfettered discretion to shift the entire cost of arbitration may have a “chilling effect” and would violate the right to recover discretionary attorney’s fees and costs under consumer statutory law).

<sup>145</sup> See, e.g., *Adams*, 279 F.3d at 893-94; *Arnold v. United Cos. Lending Corp.*, 511 S.E.2d 854 (W. Va. 1998).

<sup>146</sup> See *Arnold*, 511 S.E.2d at 861. But see *Bess v. Check Express*, 294 F.3d 1298 (11th Cir. 2002) (holding that fact lender may litigate while borrower must arbitrate does not, standing alone, render the arbitration clause unconscionable).

<sup>147</sup> *Arnold*, 511 S.E.2d at 858.

<sup>148</sup> *Id.* at 862.

<sup>149</sup> See, e.g., *Alexander*, 341 F.3d 256 (holding that a 30-day time limit for filing an arbitration claim was substantively unconscionable); *Hooters*, 173 F.3d at 940 (showing that procedural overreaching was held to create a “sham unworthy even of the name arbitration”); *Graham*, 623 P.2d at 177.

<sup>150</sup> *Armendariz*, 6 P.3d at 683.

<sup>151</sup> See, e.g., *Wining*, 2006 WL 2766007, at \*5 (holding under California law that class action/arbitration waivers are unconscionable); *Kinkel v. Cingular Wireless, L.L.C.*, 828 N.E.2d 812 (Ill. App. Ct. 2005) (applying Illinois law struck down a provision waiving class actions hidden in the middle of a long technical paragraph); *Muhammad v. Rehoboth Beach*, No. A-39 September Term 2005, 2006 WL 2273448 (N.J. Aug. 9, 2006) (finding that a class action arbitration bar acts as a waiver of remedies effectively preventing a borrower from pursuing consumer protection rights under New Jersey law); *Berger*, 567 S.E.2d 265 (applying West Virginia law the court held that language in retailer’s purchase and financing agreement that prohibited punitive damages and class action relief was unconscionable and unenforceable); see also Jean R. Sternlight & Elizabeth J. Jensen, *Using Arbitration to Eliminate Consumer Class Actions: Efficient Business Practice or Unconscionable Abuse?*, 67 S.P.G. LAW & CONTEMP. PROBS. 75, 78 n.13 (2004) (cataloging the “numerous courts” holding “that the inclusion of a class action prohibition in an arbitration clause may render that clause unconscionable”). Applying Alabama law one court held that

[a] predispute arbitration clause that forbids an arbitrator from awarding punitive damages is void as contrary to the public policy of this State -- to protect its citizens in certain legislatively prescribed actions from wrongful behavior and to punish the

## VI. CONCLUSION

The Supreme Court's utilization of the FAA over the past few decades as the vehicle for overcoming hostility toward the arbitration process may have generated the back lash taking place in state courts today. The aggressively drafted arbitration clauses employees and consumers encounter daily are part of the "stampede"<sup>155</sup> by employers and others to fashion pre-dispute binding arbitration agreements taking full advantage of the pro-arbitration philosophy articulated by the federal judiciary. In the ten years since the Supreme Court eviscerated state regulatory power to police arbitration clauses *per se* in *Casarotto*<sup>156</sup> a new body of arbitration jurisprudence law has developed around one of the few options left for denying enforceability of these

---

wrongdoer. If parties to an arbitration agreement waive an arbitrator's ability to award punitive damages, the door will open wide to rampant fraudulent conduct with few, if any, legal repercussion.

Cavalier Mfg., Inc. v. Jackson, 823 So. 2d 1237, 1248 (Ala. 2001); *see also Ex parte* Thicklin, 824 So. 2d 723 (Ala. 2002) (holding arbitration clause in mobile dealer's contract unconscionable to the extent it negated possibility of punitive damages and was severed from agreement); Bellsouth Mobility v. Christopher, 819 So. 2d 171 (Fla. Ct. App. 2002) (holding that defendant's arbitration clause was substantively unconscionable because class action suit and punitive damages were prohibited); Iwen v. U.S. West Direct, 977 P.2d 989 (Mont. 1999) (holding, in an opinion carefully worded to avoid the pitfalls of *Casarotto*, that a telephone directory publisher's contract with a customer was a contract of adhesion and substantively unconscionable in that it was one-sided in favor of the drafter and that remedies were unduly limited).

<sup>152</sup> *See Swain v. Auto Servs., Inc.*, 128 S.W.3d 103, 109 (Mo. Ct. App. 2004) (holding that "[i]n sum, the agreement to arbitrate is not unconscionable, but requiring arbitration in Arkansas is"); *Bradley v. Harris Research, Inc.*, 275 F.3d 884 (9th Cir. 2001) (holding that a contract requiring a California franchise to arbitrate in Utah was unconscionable under California law); *Williams*, 700 N.E.2d at 866 (invalidating an arbitration agreement in connection with a consumer loan due to its inconvenient forum and other unconscionable provisions). *But see Doctor's Assocs., Inc. v. Stuart*, 85 F.3d 975, 980 (2d Cir. 1996) (rejecting an unconscionability argument involving a clause requiring arbitration outside of the state where the franchise is located).

<sup>153</sup> *See, e.g., Engalla v. Permanente Med. Group, Inc.*, 938 P.2d 903 (Cal. 1997) (holding an arbitration clause misleading as to speed and other aspects).

<sup>154</sup> *See, e.g., Showmethemoney Check Cashers, Inc. v. Williams*, 27 S.W.3d 361 (Ark. 2000) (refusing to enforce an arbitration provision in a "payday loan" contract that required the borrower to submit her claims to arbitration while allowing the lender to pursue a collection action in court); *Floss v. Ryan's Family Steak Houses, Inc.*, 211 F.3d 306 (6th Cir. 2000) (applying state contract principles of "illusory" promises to invalidate an arbitration agreement requiring an employee to arbitrate his claims before a private arbitration company that specifically reserved the right to modify all rules and procedures without notice or consent to the employee); *Armendariz*, 6 P.3d at 689-99 (holding that it is unconscionable to permit an employer to select litigation or arbitration of disputes while the employee's only option was arbitration); *Samek v. Liberty Mut. Fire Ins. Co.*, 793 N.E.2d 62 (Ill. App. Ct. 2003) (holding that a one-way arbitration clause permitting the insurer to seek a trial de novo, given an award in excess of \$20,000, was unconscionable and in violation of public policy).

<sup>155</sup> Howard, *supra* note 44, at 255.

<sup>156</sup> *Casarotto*, 517 U.S. at 681.

agreements, the contractual defense of unconscionability. The unconscionability doctrine, like the common law itself, is flexible, empowering, and well suited for policing mandatory pre-dispute arbitration contracts for overall fairness. Over the past decade, since the Supreme Court's decision in *Casarotto* the judiciary is "not timid about applying state law" and this state law defense.<sup>157</sup> Whether courts are inappropriately stretching the unconscionability defense,<sup>158</sup> I leave for further study.

---

<sup>157</sup> POUND, *supra* note 62, at 123 ("Judges were not timid about applying state law, and not simply deferring to the U.S. Supreme Court or the FAA.")

<sup>158</sup> GOLDBERG ET AL., *supra* note 11, at 265.