# Unconscionability—Should We Revisit This Backdoor Challenge to Arbitration?

By Laura A. Kaster

Consumer and employee arbitration has received overt challenges by commentators and a good deal of covert challenge as well in state court rulings dealing with the topic of unconscionability. Despite a well-established federal policy favoring arbitration and enforcing pre-dispute arbitration clauses, the belief that consumers are ill served by arbitration persists.[1] Should we reexamine that assumption?

The Federal Arbitration Act was enacted to eliminate a unique hostility to pre-dispute arbitration agreements that made them revocable and unenforceable, unlike all other contracts. The rationale for the change was to allow the parties to agree to a process that would reduce the cost of dispute resolution, reduce delay, and preserve relationships. The Act by its terms makes arbitration contracts equal to all other contracts. Under the Act, an agreement to arbitrate is "valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract."[2] Over time, that simple rule requiring equal legal treatment of these agreements morphed into a national policy favoring arbitration and resolving doubt in favor of arbitration.[3] As applied to business parties, that policy has been well received and is not generally challenged. That is not the case when it comes to contracts between businesses and consumers or employers and employees, where the state courts have evinced continuing hostility to arbitration by analyzing whether the clauses are "unconscionable."[4]

On the federal level, similar hostility to arbitration of consumer and employee disputes has led Senator Feingold and Representative Johnson to introduce the Arbitration Fairness Act, which is directed against pre-dispute arbitration clauses or what the sponsors have called "mandatory arbitration" in consumer and employment agreements.

The ability of the states to undercut a federal Act derives from the peculiar fact that despite the broad reach of the Federal Arbitration Act to all contractual relations that can be governed by the commerce clause, covering the vast majority of transactions between businesses and nationwide consumers, the Act provides no basis for federal jurisdiction. Therefore, when there is no independent basis for federal jurisdiction, the Act must be construed by state courts. Moreover, the Supreme Court has indicated that state law has a role in determining the validity of arbitration agreements—precisely in the way—and presumably applying the same rules—that state courts would apply to determine the validity of all contracts:

> In any event, § 2 gives States a method for protecting consumers against unfair pressure to agree to a contract with an unwanted arbitration provision. States may regulate contracts, including arbitration clauses, under general contract law principles and they may invalidate an arbitration clause "upon such grounds as exist at law or in equity for revocation of *any* contract." 9 U.S.C. § 2 (emphasis added). What States may not do is to decide that a contract is fair enough to enforce all of its basic terms (price, service, credit), but not fair enough to enforce its arbitration clause. The Act makes any such state policy unlawful, for that kind of policy would place arbitration clauses on an unequal "footing," directly contrary to the Act's language and Congress' intent.[5]

But the analytical framework for determining whether an arbitration agreement is unconscionable is often unique to an arbitration clause. Under the rubric of unconscionability, state courts examine these agreements for procedural and substantive unconscionability. Once it is determined that there is "procedural" unfairness—which some state courts treat as satisfied if there is a contract of adhesion—the courts look behind the arbitration agreement to establish its "substantive" fairness, e.g., whether the clause is unfair to one party, imposing costs or inconvenience, or impairing the ability to obtain an unbiased result. This is a kind of analysis rarely applied to the run-of-the-mill agreement. Singling out an arbitration clause for this heightened scrutiny ignores the dictates of the Federal Arbitration Act because the price and warrantee terms, the limitation of economic damages, and all provisions that have a very substantial impact on the consumer are not typically examined even in contracts of adhesion. Certainly gross impositions—such as requiring a consumer to arbitrate only in a single location far from the purchase, or requiring payment of fees substantially in excess of court fees, and extremely lopsided obligations to arbitrate—should raise concerns.[6] However, the Act precludes treating an arbitration clause as especially suspect.[7]

As neutrals and practitioners interested in dispute resolution processes, we should explore this hostility. In fact, lowered cost, reduced delay, informality, and improved relationships should be prized by the consumer

and employee as well as the businesses with which they deal. Often, reducing the cost of dispute resolution for the business also reduces the cost of goods and services to the benefit of consumers.[8] Arbitration that is fairly, appropriately, and flexibly conducted may be an ideal dispute-resolution mechanism for consumer disputes. The American Arbitration Association has Supplementary Procedures for Consumer-Related Disputes (effective Sept. 15, 2005),[9] which preserve the right of consumers to proceed to small claims court and limit the cost of a consumer dispute involving a claim of less than $10,000 to $125. These procedures permit submission in writing or a telephonic hearing. The World Intellectual Property Organization's domain name dispute arbitrations are all resolved online and have enjoyed a very positive reception. Moreover, there is no evidence that consumers have better outcomes or are more satisfied with the process when they proceed in court. The information that is available indicates that consumers and employees may on average fare better in arbitration.[10]

Is there a way to foster the actual fairness of the process and the satisfaction of consumers? Can the large providers, such as the American Arbitration Association, the Financial Industry Regulatory Authority (FINRA), and the Better Business Bureau develop a process of assessing and then promoting satisfaction? Should we not evaluate court processes for satisfaction and fairness on the same basis we are examining arbitration? The political forces involving an ideological dispute between plaintiff's class counsel and businesses desiring to control costs has had more to do with the discourse than the actual experiences of participants in the process and an analysis of whether the typical cases are even susceptible to class treatment.[11] Some neutrals are concerned that negative feelings about consumer arbitration may taint arbitration in general. But it may work the other way around. The satisfactory encounters that consumers may have—if they are actually heard and have disputes promptly and fairly resolved—may improve the reputation of arbitration in general and also provide an opportunity for developing innovative processes.

## Endnotes

1. *See, e.g.*, Adam Klein and Nantiya Ruan, "Mandatory Arbitration of Employment Class Action Disputes: from the Perspective of Plaintiff's Counsel," 776 PLI/Lit 255 (PLI 2008); Mark E. Budnitz, "The High Cost of mandatory Consumer Arbitration," 67 Law & Contemp. Probs. 133 (2004); Paul D. Carrington, "Unconscionable Lawyers," 19 Ga. St. U. L. Rev. 361 (2003); Jean R. Sternlight, "Mandatory Binding Arbitration and the Demise of the Seventh Amendment Right to a Jury Trial," 16 Ohio St. J. On Disp. Resoll. 669 (2001).
2. 9 U.S.C. § 2.
3. *Moses H. Cone Memorial Hospital v. Mercury Const. Corp.*, 460 U.S. 1, 24–25 (1983).
4. *See, e.g., Tillman v. Commercial Credit Loans, Inc*, 655 S.E. 2d 362, 372–73 ( N.C. 2008) (holding unconscionable, invalid and unenforceable arbitration clause in loan agreements that precluded class arbitration had loser paying provision and a *de novo* appeal provision and excluded certain claims); *Ontiveros v. DHL Exp. (USA), Inc.*, 08 Cal. Daily Op. serv. 8379 (Cal. App. 1st. Dist, 2008) (arbitration agreement in employment agreement was unconscionable because it was a contract of adhesion and was substantively unconscionable because it limited discovery and the employer would be a "repeat player," giving the arbitrator an interest in deciding the dispute was arbitrable); *Wigginton v. Dell, Inc.*, 2008 WL 2267173 (Ill. App. 5th Dist. 2008) (arbitration provision that barred class claims was unconscionable because cost of arbitration would likely exceed recovery).
5. *Allied Bruce v. Terminix*, 513 U.S. 265, 281 (1995).
6. *See Green Tree Fin. Corp.—Ala. v. Randolph*, 531 U.S. 79, 92 (2000) (discussing measures for determining adequacy of access in the context of redress of statutory rights and requiring individualized proof); *see also Bradford v. Rockwell Semiconductor Systems, Inc.*, 238 F.3d 549, 556 (4th Cir. 2001) (noting that forum fees should be considered in the context of the total cost of arbitration versus litigation.)
7. *Doctor's Associates, Inc. v. Casarotto*, 517 U.S. 681, 686–87 (1996).
8. *See* Stephen J. Ware, "The Case for Enforcing Adhesive Arbitration Agreements—With Particular Consideration of Class Actions and Arbitration Fees," 5 J. A. Arb. 251, 255 (2006).
9. *See* http://www.adr.org/sp.asp?id=22014.
10. *See* Ware, 5 J. Am. Arb. at 26 and n.19 (noting that recoveries may be more likely but may be smaller); Eric J. Mogilnicki and Kirk D. Jensen, "Arbitration and Unconscionability," 19 Ga. St. U. L. Rev. 761, 763–764 (2003) (citing an AAA study finding that employees won 73% of the cases they filed, a related study stating that 63% of employees won in arbitration while only 15% won in litigation, an NAF study showing that plaintiffs win 71% of claims brought against corporate entities before NAF and another survey revealing that 93% of parties believed that NASD arbitrators handled their cases "fairly and without bias").
11. *See* Twentieth Annual Corporate Law Symposium: Twenty Years after *Shearson/American Express v. McMahon*: Assessing Investors' Remedies, 76 U. Cin. L. Rev. 375 (2008).

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