MEMORANDUM

To: RUAA Drafting Committee Members, Liaisons, and Academic Advisors
From: Dean Tim Heinsz, Reporter
Subject: Contracts of Adhesion and Unconscionability
Date: September 29, 1998

At the March 20, 1998 meeting, the Drafting Committee members, academic advisors and observers thoroughly and vigorously discussed the issues of arbitration agreements, contracts of adhesion and unconscionability. The Reporter presented four options: (1) add specific statutory language in every section of the RUAA that might touch on adhesion situations; (2) have the RUAA cover only commercial agreements and propose that the National Conference of Commissioners on Uniform State Laws have separate Acts for situations involving unequal bargaining power, such as consumer, employment, franchises, etc.; (3) discuss the special problems of adhesion contracts in the arbitration setting in the Official Comments but leave to developing state (and federal) substantive law the applicable doctrines for contracts of adhesion and unconscionability; and (4) discuss the use of industry protocols similar to the DUE PROCESS PROTOCOL FOR MEDIATION AND ARBITRATION OF STATUTORY DISPUTES ARISING OUT OF THE EMPLOYMENT RELATIONSHIP. The Drafting Committee voted unanimously to leave the issue of adhesion contracts and unconscionability to developing law but to discuss these issues in the Official Comments and to also point out the development of industry protocols.

The Reporter would suggest the following as an official comment to Section 2, Validity of Arbitration Agreement because unconscionability and adhesion issues arise most often in regard to arbitrability. I am forwarding you this draft now for any comments prior to our October meeting.

Official Comment: Unequal bargaining power often occurs in arbitration provisions involving employers and employees, sellers and consumers, health maintenance organizations and patients, franchisors and franchisees, and others.

Despite some recent developments to the contrary, courts do not often find contracts unenforceable for unconscionability. To determine whether to void a contract on this ground, courts examine a number of factors. These factors include: unequal bargaining power, whether the weaker party may opt out of arbitration, the arbitration clause's clarity and conspicuousness,

whether an unfair advantage is obtained, whether the arbitration clause is negotiable, whether the arbitration provision is boilerplate, whether the aggrieved party had a meaningful choice or was compelled to accept, whether the arbitration agreement is within the reasonable expectations of the weaker party, and whether the stronger party used deceptive tactics. *See, e.g.,* Broemmer v. Abortion Serv. of Phoenix, Ltd., 173 Ariz. 148, 840 P.2d 1013 (1992); Chor v. Piper, Jaffray & Hopwood, Inc., 261 Mont. 143, 862 P.2d 26 (1993); Buraczynski v. Eyring, 919 S.W.2d 314 (Tenn. 1996); Sosa v. Paulos, 924 P.2d 357 (Utah 1996); Powers v. Dickson, Carlson & Campillo, 54 Cal.App. 4th 1102, 63 Cal.Rptr.2d 261 (1997); Beldon Roofing & Remodeling Co. v. Tanner, 1997 W.L. 280482 (Tex.Ct.App.).

Despite these many factors, courts have been reluctant to find arbitration agreements unconscionable. II MACNEIL TREATISE § 19.3; 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); Steven J. Ware, *Arbitration and Unconscionability After Doctor's Associates, Inc. v. Cassarotto,* 31 Wake Forest L. Rev. 1001 (1996). However, in the last few years, some cases have gone the other way and courts have begun to scrutinize more closely the enforceability of arbitration agreements. Paladino v. Avnet Computer Tech., Inc., 134 F.3d 1054 (11th Cir. 1998) (employee not required to arbitrate Title VII claim where the contract limits damages below that allowed by the statute); Hooters of America, Inc. v. Phillips, 1998 U.S. Dist. LEXIS 3962 (D. S.C.) (one-sided arbitration agreement that takes away numerous substantive rights and remedies of employee under Title VII unenforceable as unconscionable and void on public policy grounds); Rosenberg v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 995 F. Supp. (D. Mass.) (NYSE Arbitration Program inadequate to vindicate broker's ADEA claim against former employer); Broemmer v. Abortion Serv. of Phoenix, Ltd., *supra* (arbitration agreement unenforceable as contract of adhesion because it required a patient to arbitrate a malpractice claim and to waive the right to jury trial and was beyond the patient's reasonable expectations where drafter inserted potentially advantageous term requiring arbitrator of malpractice claims to be a licensed medical doctor); Engalla v. Permanente Med. Grp., 15 Cal. 4th 951, 64 Cal. Rptr. 2d 843 (1997) (health maintenance organization may not compel arbitration where it fraudulently induced participant to agree to the arbitration of disputes, fraudulently misrepresented speed of arbitration selection process and forced delays so as to waive the right of arbitration); Stirlen v. Supercuts, Inc., 51 Cal. App. 4th 1519, 60 Cal. Rptr. 2d 138 (1997) (one-sided compulsory arbitration clause which reserved litigation rights to the employer only and denied employees rights to exemplary damages, equitable relief, attorney fees, costs, and a shorter statute of limitations unconscionable); Alamo Rent A Car, Inc. v. Galarza, 306 N.J. Super. 384, 703 A.2d 961 (1997) (arbitration clause that does not clearly and unmistakably include claims of employment discrimination fails to waive employee's statutory rights and remedies).

As a result of concerns over fairness in arbitration involving those with unequal bargaining power, organizations and individuals involved in employment, consumer and health-care arbitration have determined common standards for arbitration in these fields. In 1995, a broad-based coalition representing interests of employers, employees, arbitrators and arbitration

institutions agreed upon a DUE PROCESS PROTOCOL FOR MEDIATION AND ARBITRATION OF STATUTORY DISPUTES ARISING OUT OF THE EMPLOYMENT RELATIONSHIP; *see also* National Academy of Arbitrators, GUIDELINES ON ARBITRATION OF STATUTORY CLAIMS UNDER EMPLOYER-PROMULGATED SYSTEMS (May 21, 1997) . In May of 1998, a similar group, the National Consumer Disputes Advisory Committee, under the auspices of the American Arbitration Association, adopted a DUE PROCESS PROTOCOL FOR MEDIATION AND ARBITRATION OF CONSUMER DISPUTES. In July of 1998 the Commission on Health Care Dispute Resolution, comprised of representatives from the American Arbitration Association, the American Bar Association and the American Medical Association endorsed a DUE PROCESS PROTOCOL FOR MEDIATION AND ARBITRATION OF HEALTH CARE DISPUTES. The purpose of these protocols is to ensure both procedural and substantive fairness in arbitrations involving employees, consumers and patients. The arbitration of employment, consumer and health-care disputes in accordance with these standards will be a legitimate and meaningful alternative to litigation. *See, e.g.*, Cole v. Burns Int'l Security Serv., 105 F.3d 1465 (D.C. Cir. 1997) (referring specifically to the due process protocol in the employment relationship in a case involving the arbitration of an employee's rights under Title VII).

The Drafting Committee determined to leave the issue of adhesion contracts and unconscionability to developing law (1) because the issue of unconscionability reflects so much the substantive law of the states and not just arbitration, (2) because the case law, statutes and arbitration standards are rapidly changing, and (3) because treating arbitration clauses differently than other contract provisions would raise significant preemption issues under the Federal Arbitration Act.

However, because an arbitration agreement in many instances effectively waives a party's right to a jury trial, courts should ensure that the parties have knowingly and voluntarily assented to an arbitration procedure. This scrutiny is particularly important in instances involving statutory rights which provide claimants with important remedies. Courts should determine that an arbitration process is fair and adequate to protect these important rights. Without these safeguards, arbitration loses credibility as an appropriate option to litigation.