Can Unconscionable Arb Provisions Be Waived and Severed?

Judge Abraham J. Gafni (Ret.)
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The Federal Arbitration Act (FAA) and state law favor arbitration agreements, and, as the FAA reflects, such agreements are "valid, enforceable and irrevocable, save upon such grounds as exist at law or in equity for the revocation of any contract."

In considering the validity and enforceability of an arbitration agreement, "generally applicable contract defenses such as fraud, duress or unconscionability may be applied to invalidate arbitration agreements without contravening Section 2," according to *Doctor's Associates v. Casarotto*, 517 U.S. 681,687 (1996).

But what if the party benefiting from an unconscionable provision is prepared to waive it? Would a court sever or modify it and require that the arbitration agreement be enforced, as the unfair advantage had been eliminated?

A recent case in the federal district court in the Northern District of California, *Capili v. The Finish Line*, 15-cv-01158-HSG (July 22, 2015), reflects how courts are likely to rule when confronted with this issue.

Ritarose Capili, an employee of The Finish Line Inc., had agreed in her employment agreement to abide by Finish Line's employee dispute resolution plan. Moreover, she would not have been employed had she not so consented. Subsequently, she alleged that she had been terminated for improper reasons relating to pregnancy and other health conditions, according to the opinion. Arbitration of this dispute would clearly be mandated under the plan.

Nonetheless, Capili contended that she should not be required to submit to arbitration, as the plan was a contract of adhesion that was both procedurally and substantively unconscionable.

It is generally understood that both forms of unconscionability must be present to render the obligation to arbitrate invalid, although they "need not be present in the same degree."

Procedural Unconscionability

Procedural unconscionability typically looks to circumstances under which one of the parties has been subjected to a contract of adhesion by reason of unequal bargaining power that imposed acceptance on a take-it-or-leave-it basis.

Here, Finish Line agreed that Capili had no option other than to accept the plan as a condition of employment. On this basis, the court found that the method of presentation of the agreement to Capili did demonstrate some level of procedural unconscionability.

Substantive Unconscionability

Substantive unconscionability presents different considerations, i.e., whether the terms create "an overly harsh or one-sided result." The court discussed three provisions in the Finish Line plan deemed sufficient collectively to render the entire agreement invalid.

• **Forum selection.**

While forum selection clauses are enforceable, they must be reasonable and not impose unduly oppressive restrictions. Here, the agreement required that the arbitration, including any issues relating to enforceability, be conducted in Indiana, thousands of miles away from Capili's employment in California.

The court agreed that this forum selection clause was unconscionable in that it would place a substantial barrier to Capili's vindication of her claims.

Finish Line did not dispute that the forum selection provisions were unconscionable, but contended that they were moot, and should be severed, because it had agreed that the arbitration might be conducted in California.

• **Exemption of certain claims.**

An agreement under which the claims of the weaker party must be arbitrated but which allows the stronger party a choice of forum may also be deemed unconscionable.

Here, the agreement required both parties to arbitrate claims for wages, compensation and some benefits, as well as state and federal statutory claims, contract and tort claims and claims of discrimination.

Exempted from the agreement, however, were any "claims by [Finish Line] for injunctive and/or other equitable relief for unfair competition and/or the use and/or unauthorized disclosure of trade secrets or confidential information." In short, the agreement allowed only Finish Line but not Capili to pursue judicial remedies concerning these causes of action.

The court found that these exemption provisions were unconscionable in that they required arbitration only for those claims that the employee, Capili, was likely to bring. The exemptions, in contrast, related to claims that only Finish Line was likely to bring. In short, Capili would be required to arbitrate her claims, but Finish Line would have the right to proceed with a court proceeding with respect to its claims.

- **Cost sharing.**

Unconscionability may also be found if mandatory arbitration as a condition of employment requires the employee to bear any type of expense that she would not be required to bear were she free to bring this action in court.

Here the arbitration agreement provided that the employee must pay half the costs and fees of the arbitration, limited to the greater of $10,000 or 10 percent of the amount in controversy. This action, however, was brought under California's Fair Employment and Housing Act that obligates the employer to pay all costs and expenses of the arbitration. Thus, the cost-sharing provision was unenforceable.

Again, Finish Line agreed this provision was unconscionable, but contended that it was moot because Finish Line was prepared to pay all of Capili's arbitration fees, and, accordingly, this provision should be severed and the remainder of the agreement enforced.

The Court's Perspective

At this stage, one might have expected that because the admittedly unconscionable provisions in the plan had either been waived or did not relate to the issues to be arbitrated, the court would have severed them and directed that the arbitration proceed.

The court, however, did not agree to enter such an order, although it did acknowledge that an arbitration agreement would not necessarily be invalidated in its entirety by reason of a single unconscionable provision.

It emphasized, however, that while a court may sever an unconscionable provision, it would generally do so only if the provision is merely collateral to the main purpose of the

arbitration agreement, and, in fact, some courts have severed unconscionable forum selection provisions.

But this has not occurred in circumstances where there is a multiplicity of unconscionable provisions. Here, the provisions relating to forum selection, claim exemption and cost sharing were found to be "too numerous and too important to be severed from the whole."

The court, citing precedent, concluded that "multiple defects indicate a systematic effort to impose arbitration on an employee not simply as an alternative to litigation, but as an inferior forum that works to the employer's advantage." To allow the court to reform an agreement so "permeated by unconscionability would require this court to assume the role of contract author rather than interpreter."

Moreover, the court was not swayed by Finish Line's offer to waive the unconscionable provisions. It noted that the agreement was contrary to public policy, defective and never properly accepted. A party's subsequent "newfound willingness" to waive these provisions will not succeed in resuscitating it.

Most critical was the court's conclusion that a late waiver will not overcome the initial chilling of an employee's initiation of a claim resulting from the overhanging threat of such unconscionable provisions.

As the court recognized, such late waivers would "provide a perverse incentive for Finish Line and other employers." They would be employed as a "tactic" that would encourage employers to pack their agreements with unconscionable provisions that would discourage claims by employees; employers would "simply agree to waive those provisions in the rare event they are challenged in court."

In short, where one party has the power to require that a weaker party sign an agreement to arbitrate, (such that the agreement itself may be viewed as procedurally unconscionable) extra care must be taken to assure that its provisions are not substantively unconscionable. If a party wishes to compel arbitration, "it must draft an agreement that is not permeated with unenforceable provisions," as courts will not generally allow the stronger party to later waive and sever significant unconscionable provisions after a challenge has been raised.

Abraham J. Gafni *is a retired judge and mediator/arbitrator with ADR Options and a professor at Villanova University School of Law.* •