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Drafting Arbitration Agreements: A Practitioner's Guide for Consumer Credit Contracts

INTRODUCTION

IN RECENT YEARS, CREDITORS SEEKING SOME RELIEF from costly consumer class action lawsuits have turned to arbitration agreements for protection. A well-drafted mandatory pre-dispute arbitration clause that prohibits class action relief is likely to withstand consumer challenges to the clause's enforceability and provide the creditor the protection it seeks.¹ In the standard arbitration agreement, the creditor and the consumer agree to arbitrate disputes arising under the related contract.² The consumer also waives the right to proceed as a class representative in arbitration.³ Working together, a mandatory arbitration agreement and a class action waiver result in a prohibition against the consumer's participation in a class action before a court.⁴ The consumer must instead proceed as an individual in an arbitration proceeding.⁵

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1. See *Coneff v. AT&T Corp.*, 673 F.3d 1155, 1161 (9th Cir. 2012) (determining that the Federal Arbitration Act preempts a Washington state law that invalidates class-action waivers); *Johnson v. West Suburban Bank*, 225 F.3d 366, 370 (3d Cir. 2000) (citing *Gilmer v. Interstate/Johnson Lane Corp.*, 500 U.S. 20, 26 (1991)) (noting that contracts may provide for statutory claims to be handled through arbitration); *AutoNation USA Corp. v. Leroy*, 105 S.W.3d 190, 200 (Tex. App. 2003) (holding that while an arbitration provision prohibiting class treatment may be unfair, plaintiff must demonstrate such unfairness); Richard M. Alderman, *Pre-Dispute Mandatory Arbitration in Consumer Contracts: A Call for Reform*, 38 HOUS. L. REV. 1237, 1245 (2001) (stating that "[a]rbitration agreements must be enforced, even if the result would be inefficiency").

2. Thomas J. Stipanowich, *The Third Arbitration Trilogy: Stolt-Nielsen, Rent-A-Center, Concepcion and the Future of American Arbitration*, 22 AM. REV. INT'L ARB. 323, 365 (2011); see also *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*, 473 U.S. 614, 626 (1985) (signaling that courts asked to compel arbitration must first determine whether the parties have agreed to handle disputes through arbitration).

3. See *AT&T Mobility LLC v. Concepcion*, 131 S. Ct. 1740, 1748 (2011) (reasoning that classwide arbitration would interfere with the fundamental purpose of arbitration and the FAA).

4. J. Maria Glover, Note, *Beyond Unconscionability: Class Action Waivers and Mandatory Arbitration Agreements*, 59 VAND. L. REV. 1735, 1748 (2006) (recognizing a recent trend by employers of incorporating class action waivers into arbitration clauses to shield themselves from potential class action lawsuits); see also 9 U.S.C. § 3 (2006) ("If any suit or proceeding be brought in any of the courts of the United States upon any issue referable to arbitration, the court in which such suit is pending, upon being satisfied that the issue involved in

Although arbitration provisions are undoubtedly the most effective defense a creditor has against consumer class actions, enforcement of those provisions is not guaranteed in all situations or in all jurisdictions.⁶ Consumers challenge arbitration agreements and class action waivers under various legal theories, but chief among them is the state common law defense of unconscionability.⁷ In addition, consumers claim that arbitration agreements implicitly prohibit consumers from spreading the costs of litigation among litigants with common claims, which has the effect of precluding an individual from being able to vindicate his or her federal statutory rights.⁸

In order to meet these challenges and ensure that an arbitration agreement will be enforced, an arbitration agreement must be crafted carefully. This Article will review the aspects of arbitration clauses that have rendered them unenforceable and suggest drafting techniques to counter those challenges.⁹ The Article begins by providing some background on federal arbitration law¹⁰ and then surveys the current landscape of the case law while focusing on the recent Supreme Court decision in *AT&T v. Concepcion* and its progeny.¹¹ It then analyzes the main legal doctrine, unconscionability, used by opponents of arbitration in motions to strike

such suit or proceeding is referable to arbitration under such an agreement, shall on application of one of the parties stay the trial of the action until such arbitration has been had in accordance with the terms of the agreement, providing the applicant for the stay is not in default in proceeding with such arbitration.”); 9 U.S.C. § 4 (2006) (“The court shall hear the parties, and upon being satisfied that the making of the agreement for arbitration or the failure to comply therewith is not in issue, the court shall make an order directing the parties to proceed to arbitration in accordance with the terms of the agreement.”).

5. *Harris v. Shearson Hayden Stone, Inc.*, 441 N.Y.S.2d 70, 79 (N.Y. App. Div. 1981) (Bloom, J., dissenting) (stating that “if the matter is to proceed in arbitration it must proceed as an individual claim”).

6. *E.g.*, *Ting v. AT&T*, 319 F.3d 1126, 1152 (9th Cir. 2003) (reversing the district court’s ruling, which voided class action bans, because it failed to find a two-year limitation period unconscionable); *Luna v. Household Fin. Corp.*, III, 236 F. Supp. 2d 1166, 1178–79 (W.D. Wash. 2002) (addressing the need for courts to balance the value of class actions with strong public policy that favors enforcement of arbitration agreements); *Vasquez-Lopez v. Beneficial Or., Inc.*, 152 P.3d 940, 951 (Or. 2007) (stating that class action bans are unconscionable and would give businesses opportunities to commit fraud); *Muhammad v. County Bank of Rehoboth Beach*, 912 A.2d 88, 99–100 (N.J. 2006) (establishing that, in New Jersey, class arbitration waivers are not exculpatory clauses and the presence of one in an arbitration agreement is unconscionable).

7. *See, e.g.*, *Scott v. Cingular Wireless*, 161 P.3d 1000, 1004 (Wash. 2007) (noting Plaintiffs’ argument that Cingular’s class action waiver was “substantively and procedurally unconscionable”); BLACK’S LAW DICTIONARY 1663–64 (9th ed. 2009) (defining unconscionability as “[t]he principle that a court may refuse to enforce a contract that is unfair or oppressive because of procedural abuses during contract formation or because of overreaching contractual terms . . .”).

8. *See Myriam Gilles & Gary Friedman, After Class: Aggregate Litigation in the Wake of AT&T Mobility v. Concepcion*, 79 U. CHI. L. REV. 623, 633–36 (2012) (asserting that challenges to class action waivers were made under two arguments: (1) unconscionability and (2) prohibition against spreading costs of litigation precludes individuals from vindicating federal statutory rights); *see also Green Tree Financial Corp.-Ala. v. Randolph*, 531 U.S. 79, 90 (2000) (determining that “[i]t may well be that the existence of large arbitration costs could preclude a litigant such as Randolph from effectively vindicating her federal statutory rights in the arbitral forum”).

9. *See infra* Part III.

10. *See infra* Part I.

11. *See infra* Part II.A (discussing *AT&T Mobility LLC v. Concepcion*, 131 S. Ct. 1740 (2011)).

the clauses from consumer contracts.¹² To respond to and ideally defeat these arguments, we provide a drafter's guide addressing this main threat to enforceability.¹³ Finally, we take a quick look at the road ahead for arbitration.¹⁴

I. BACKGROUND

Consumer challenges to arbitration agreements take various forms, but to understand why arbitration agreements have become the battleground of consumer protection advocates, one need only identify those arguing vehemently on behalf of consumers against class action waivers in mandatory arbitration agreements: the plaintiffs' bar.¹⁵ All other issues aside, plaintiffs' attorneys have the most to lose from an effective class action waiver provision in an arbitration agreement.¹⁶ To the extent such clauses reduce class action lawsuits (and concomitantly, class action settlements), plaintiffs' attorneys stand to lose a large amount of business because they cannot collect the significant class action fees in arbitration proceedings where class claims are prohibited.¹⁷

The standard argument against class action waivers is that it is uneconomical for consumers to pursue small claims individually, either through the courts or in arbitration.¹⁸ It is not clear that this is the case, but what is clear is that it is uneconomical for a plaintiff's attorney to represent consumers with small claims on an individual basis.¹⁹ Thus, regardless of the benefit that arbitration actually provides to consumers (and there are benefits),²⁰ plaintiffs' attorneys will continue to vigorously challenge the enforceability of arbitration agreements to preserve the flow of revenue that streams from large class action settlements. It is largely because

12. See *infra* Part II.B.

13. See *infra* Parts III.A–C.

14. See *infra* Part III.D.

15. See Jonathan R. Macey & Geoffrey P. Miller, *The Plaintiffs' Attorney's Role in Class Action and Derivative Litigation: Economic Analysis and Recommendations for Reform*, 58 U. CHI. L. REV. 1, 44–45 (1991) (arguing that plaintiffs' attorneys have the most to gain financially in class action proceedings).

16. See Jean R. Sternlight, *As Mandatory Binding Arbitration Meets the Class Action, Will the Class Action Survive?*, 42 WM. & MARY L. REV. 1, 34–35 (2000) (criticizing class actions as serving plaintiffs' attorneys more than plaintiffs and creating conflicts of interest between class attorneys and their clients).

17. See Robert Alexander Schwartz, Note, *Can Arbitration Do More For Consumers? The TILA Class Action Reconsidered*, 78 N.Y.U. L. REV. 809, 825 (2003) (noting the significant fees plaintiffs' attorneys stand to receive in such actions).

18. See Bryon Allyn Rice, Comment, *Enforceable or Not? Class Action Waivers in Mandatory Arbitration Clauses and the Need for a Judicial Standard*, 45 HOUS. L. REV. 215, 247 (2008) (stating that class action waivers essentially eliminate the opportunity for plaintiffs to pursue individual claims because the costs of individual suits are exorbitantly high); see also, e.g., *Fiser v. Dell Computer Corp.*, 188 P.3d 1215, 1219 (N.M. 2008) (arguing that the opportunity to seek class relief is critical because it “allows claimants with individually small claims the opportunity for relief that would otherwise be economically infeasible”).

19. Alan S. Kaplinsky & Mark J. Levin, *The Gold Rush of 2002: California Courts Lure Plaintiffs Lawyers (but Undermine Federal Arbitration Act) by Refusing to Enforce “No-Class Action” Clauses in Consumer Arbitration Agreements*, 58 BUS. LAW. 1289, 1297 (2003).

20. *Id.* at 1297–99.

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of this threat to their livelihoods that arbitration agreements have been so strenuously challenged.²¹

A. *The Federal Arbitration Act*

Enacted in 1925 to promote arbitration as an alternative dispute resolution process to litigation, the Federal Arbitration Act²² (FAA) provides that a written arbitration agreement involving interstate commerce “shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract.”²³ The explicit goal of the FAA is to encourage arbitration by requiring courts to honor arbitration agreements in accordance with the contracting parties’ expectations.²⁴ The federal law accomplishes this by partially preempting state law.²⁵ However, Section 2 of the FAA provides that arbitration clauses can still be invalidated by general state law contract defenses such as fraud, duress, and unconscionability.²⁶ This so-called “savings clause” notably excludes state-law defenses that apply exclusively to arbitration or defenses that derive their meaning from the fact that an arbitration clause is at issue.²⁷

Of the state-law defenses, unconscionability is the most often used and most effective legal justification for invalidating arbitration agreements.²⁸ Because California has served as the leading battleground state for disputing arbitration

21. Hal Davis, *Banks Follow Brokerages: Arbitrate Yes, Litigate No: Plaintiffs’ Attorneys Say Forcing Consumers to Arbitrate Disputes Will Eliminate Class Actions and Is Unfair*, NAT’L L.J., Sept. 12, 1994, at 4.

22. 9 U.S.C. §§ 1–16, 201–208, 301–307 (2006).

23. 9 U.S.C. § 2 (2006).

24. “The ‘principal purpose’ of the FAA is to ‘ensur[e] that private arbitration agreements are enforced according to their terms.’” AT&T Mobility LLC v. Concepcion, 131 S. Ct. 1740, 1748 (2011) (quoting Volt Info. Scis. v. Bd. of Trs. of Leland Stanford Junior Univ., 489 U.S. 468, 478 (1989)).

25. Southland Corp. v. Keating, 465 U.S. 1, 10 (1984) (determining that “the California Franchise Investment Law directly conflicts with § 2 of the Federal Arbitration Act and violates the Supremacy Clause”; see also U.S. CONST. art. VI, cl. 2 (Supremacy Clause)).

26. 9 U.S.C. § 2 (2006) (providing for the validity and enforceability of arbitration clauses “save upon such grounds as exist at law or in equity for the revocation of any contract”); see also Great Earth Cos. v. Simons, 288 F.3d 878, 889 (6th Cir. 2002) (finding that “state law governs ‘generally applicable contract defenses [to an arbitration clause], such as fraud, duress, or unconscionability’” (quoting Doctor’s Assocs. v. Casarotto, 517 U.S. 681, 687 (1996))).

27. Stephen A. Broome, *An Unconscionable Application of the Unconscionability Doctrine: How the California Courts Are Circumventing the Federal Arbitration Act*, 3 HASTINGS BUS. L.J. 39, 48 (2006); see also Casarotto, 517 U.S. at 687 (holding that “[c]ourts may not, however, invalidate arbitration agreements under state laws applicable *only* to arbitration provisions”); Perry v. Thomas, 482 U.S. 483, 492–93 n.9 (1987) (recognizing that state laws are applicable when they were established to handle issues surrounding the validity, revocability, and enforceability of contracts).

28. See, e.g., Coneff v. AT&T Corp., 673 F.3d 1155, 1157–62 (9th Cir. 2012) (analyzing the substantive and procedural unconscionability under the FAA); Stienen v. Apple Computer, Inc., 556 F. Supp. 2d 1016, 1022 (N.D. Cal. 2008) (holding a class arbitration waiver unconscionable); Sonic-Calabasas A, Inc. v. Moreno, 247 P.3d 130, 139–46 (Cal. 2011) (discussing whether a waiver is unconscionable).

agreements,²⁹ this Article will focus on California state law in exploring the doctrine of unconscionability. It is to this legal doctrine that we now turn.

B. State Law Doctrine of Unconscionability

Unconscionability is the main defense used to invalidate arbitration clauses.³⁰ As a creature of state common law, its specific application may vary from state-to-state; however, the elements of unconscionability are common to all states and can effectively be discussed in general.³¹ The doctrine consists of two elements — procedural and substantive unconscionability.³² For a court to find a contract term unconscionable and thus unenforceable, a party must show that both elements are present in the transaction.³³ This is a question of law for the judge.³⁴ The procedural element addresses how the contract was negotiated and focuses on “oppression” and “surprise” in the negotiating process with regard to the suspect provision.³⁵ The substantive element focuses on the actual terms of the agreement, emphasizing terms that are overly harsh or one-sided.³⁶

In determining whether a particular contract provision or the entire contract is unconscionable, the two elements need not be found in the provision or contract to a specific degree.³⁷ Rather, they are weighed in a balancing test: “[T]he 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.”³⁸

29. Frank Blechschmidt, Comment, *All Alone in Arbitration: AT&T Mobility v. Concepcion and the Substantive Impact of Class Action Waivers*, 160 U. PA. L. REV. 541, 556 (“California pioneered the use of unconscionability to protect individuals from class action waivers.”).

30. Aaron-Andrew P. Bruhl, *The Unconscionability Game: Strategic Judging and the Evolution of Federal Arbitration Law*, 83 N.Y.U. L. REV. 1420, 1422 (2008); see also Susan Randal, *Judicial Attitudes Toward Arbitration and the Resurgence of Unconscionability*, 52 BUFF. L. REV. 185, 194–96 (2004) (noting the statistical rise of unconscionability arguments and the relative success of such arguments in the arbitration context).

31. See Yongdan Li, *Applying the Doctrine of Unconscionability to Employment Arbitration Agreements, With Emphasis on Class Action/Arbitration Waivers*, 31 WHITTIER L. REV. 665, 670–96 (2010) (comparing and noting commonalities among five states’ application of the doctrine of unconscionability in the arbitration context).

32. Broome, *supra* note 27, at 48 (citing *Armendariz v. Foundation Health Psychcare Servs.*, 6 P.3d 669, 690 (Cal. 2000)).

33. *Id.* (citing *Armendariz*, 6 P.3d at 690).

34. *Sanchez v. Valencia Holding Co.*, 135 Cal. Rptr. 3d 19, 28 (Cal. Ct. App. 2011), *petition for review granted*, 272 P.3d 976 (Cal. 2012).

35. *Nagrampa v. Mailcoups, Inc.*, 469 F.3d 1257, 1280 (9th Cir. 2006); see also Melissa T. Lonegrass, *Finding Room for Fairness in Formalism—The Sliding Scale Approach to Unconscionability*, 44 LOY. U. CHI. L.J. 1, 9 (2012) (indicating that this language was originally borrowed from comments to the Uniform Commercial Code).

36. Broome, *supra* note 27, at 49 (quoting *Armendariz*, 6 P.3d at 690).

37. *Id.* at 48–49 (citing *Armendariz*, 6 P.3d at 690).

38. *Pinnacle Museum Tower Assn. v. Pinnacle Market Dev. (US), LLC*, 282 P.3d 1217, 1232 (Cal. 2012) (quoting *Armendariz*, 6 P.3d at 690).

1. Procedural Unconscionability

To determine whether an arbitration clause is procedurally unconscionable, courts consider two factors: oppression and surprise.³⁹ These are alternative prongs, either of which alone can satisfy the procedural element.⁴⁰ Courts find oppression where there is inequality of bargaining power resulting in no real negotiation between the parties and no meaningful choice for the consumer.⁴¹ The surprise factor concerns the extent to which the terms of the contract are hidden or are not easily readable to the consumer.⁴²

When discussing the procedural element, courts will often discuss whether the contract is a contract of adhesion. A contract of adhesion is a standardized contract drafted by a party of superior bargaining strength (i.e., the creditor) and imposed on the party contracting with the drafter.⁴³ The other party can only either adhere to all of the contract's terms or reject the entire contract completely. The Supreme Court of the United States recently recognized that all consumer contracts are contracts of adhesion.⁴⁴ However, that a contract is one of adhesion does not render it presumptively unconscionable.⁴⁵ In fact, outside of the arbitration context, adhesion contracts are routinely found enforceable.⁴⁶ Yet when a contract has an arbitration provision, the conclusion that a contract is a contract of adhesion will almost certainly render it procedurally unconscionable in California.⁴⁷

39. *Armendariz*, 6 P.3d at 690 (quoting *A & M Produce Co. v. FMC Corp.*, 186 Cal. Rptr. 114, 121–22 (Cal. Ct. App. 1982)).

40. Broome, *supra* note 27, at 58.

41. *Id.*

42. *Id.* at 58–59.

43. *Armendariz*, 6 P.3d at 689 (quoting *Neal v. State Farm Ins. Cos.*, 10 Cal. Rptr 781, 784 (Cal. Ct. App. 1961)).

44. *AT&T Mobility LLC v. Concepcion*, 131 S. Ct. 1740, 1750 (2011) (“[T]he times in which consumer contracts were anything other than adhesive are long past.”).

45. See Steven J. Burton, *The New Judicial Hostility to Arbitration: Federal Preemption, Contract Unconscionability, and Agreements to Arbitrate*, 2006 J. DISP. RESOL. 469, 479 (2006) (noting that adhesion contracts are frequently enforced and used in the overwhelming majority of contracts); Andrew A. Schwartz, *Consumer Contract Exchanges and the Problem of Adhesion*, 28 YALE J. ON REG. 313, 354–55 (2011) (stating that “courts have never adopted a flat rule against enforcing” contracts of adhesion and thus conduct judicial reviews of such contracts); cf. Sierra David Sterkin, *Challenging Adhesion Contracts in California: A Consumer’s Guide*, 34 GOLDEN GATE U. L. REV. 285, 298 (2004) (noting that contracts of adhesion are considered procedurally unconscionable under California law).

46. See, e.g., Burton, *supra* note 45, at 479 (stating that “[a]dhesion contracts are ubiquitous” and “generally are enforced”).

47. Broome, *supra* note 27, at 59–61; see also Todd D. Rakoff, *Contracts of Adhesion: An Essay in Reconstruction*, 96 HARV. L. REV. 1173, 1265–66 (1983) (noting a “substantial body of case law” in which courts have determined arbitration agreements within contracts of adhesion to be unenforceable).

2. Substantive Unconscionability

To determine whether the arbitration clause is substantively unconscionable, courts look for overly-harsh and one-sided terms in the arbitration clause. If the arbitration clause lacks a “modicum of bilaterality,” courts are likely to find substantive unconscionability and refuse to enforce the arbitration clause.⁴⁸ Generally, courts will sever unconscionable terms from an agreement and enforce the rest of the agreement.⁴⁹ This might be possible, for example, if the only unconscionable term was one that required the plaintiff to advance the costs of arbitration.⁵⁰ A court might strike this provision and otherwise compel arbitration subject to the remaining terms of the agreement.

However, a court will not always sever a particular unconscionable term and enforce the other conscionable provisions of an agreement. If a court finds that the arbitration clause contains many terms deemed unconscionable such that the agreement is “permeated by unconscionability,” the court will not sever the offending terms and will refuse to compel arbitration.⁵¹

II. CASELAW

Having outlined the background of the FAA and generalized the state law doctrine of unconscionability, this Article will now review the United States Supreme Court’s most recent decision on the FAA and the California courts’ responses to that decision. An evaluation of these decisions serves as a guide for developing effective drafting techniques, which we distill into a drafting guide in the penultimate section.

A. AT&T Mobility LLC v. Concepcion

In April 2011, the Supreme Court decided its most recent FAA case in *AT&T Mobility LLC v. Concepcion*.⁵² At issue in *Concepcion* was whether the FAA prohibited a state from conditioning the enforceability of certain arbitration

48. Broome, *supra* note 27, at 48–50 (quoting *Stirlen v. Supercuts, Inc.*, 60 Cal. Rptr. 2d 138, 151 (Cal. Ct. App. 1997)) (describing elements considered in establishing substantive unconscionability).

49. *Id.* at 44–45.

50. *See, e.g., Gentry v. Super. Ct.*, 165 P.3d 556, 570 (Cal. 2007) (stating that the preference to sever unconscionable aspects of arbitration agreements is “particularly appropriate in the case of class arbitration waivers”); *Ajamian v. CantorCO2e, L.P.*, 137 Cal. Rptr. 3d 773, 799 (Cal. Ct. App. 2012) (“[T]he strong preference is to sever [unconscionable clauses] unless the agreement is ‘permeated’ by unconscionability.” (citing and quoting *Dotson v. Amgen, Inc.*, 104 Cal. Rptr. 3d 341, 350–51 (Cal. Ct. App. 2010))).

51. *Ajamian*, 137 Cal. Rptr. 3d at 799; *see also Ferguson v. Countrywide Credit Indus., Inc.*, 298 F.3d 778, 788 (9th Cir. 2002) (holding an entire contract invalid after several clauses were found unconscionable); *Ting v. AT&T*, 182 F. Supp. 2d 902, 936 (N.D. Cal. 2002) (refusing to enforce all terms of contract where terms were “permeated with unconscionability and illegality”), *aff’d in part, rev’d in part sub nom.* 319 F.3d 1126 (9th Cir. 2003).

52. 131 S. Ct. 1740 (2011).

agreements on the availability of class-wide arbitration procedures.⁵³ More specifically, *Concepcion* considered whether California's *Discover Bank* rule — which stated that in a contract of adhesion, class action waivers were void as against public policy — unconstitutionally interfered with the FAA.⁵⁴ The Plaintiffs, who were arguing that the class action waiver was unconscionable, had each signed a cellular service agreement with AT&T that included a new free cellular phone.⁵⁵ The Plaintiffs received the phone at no charge, but were still required to pay sales tax on the retail value of the phones.⁵⁶ The agreement contained an arbitration clause requiring any dispute to be submitted to arbitration and also included a class action waiver clause, requiring any dispute between the parties to be brought in an individual capacity.⁵⁷ The Plaintiffs filed a putative class action lawsuit against AT&T, alleging that the practice of charging sales tax on a phone advertised as free was fraudulent, and AT&T moved to compel arbitration.⁵⁸

The Ninth Circuit affirmed the district court's decision that the arbitration agreement was unenforceable because it was unconscionable under the rationale of *Discover Bank*.⁵⁹ When the case finally made it to the Supreme Court, the Court invalidated the *Discover Bank* rule, holding that the FAA preempted California law.⁶⁰ The Court noted that while the FAA's saving clause preserves generally applicable contract defenses, "nothing in it suggests an intent to preserve state-law rules that stand as an obstacle to the accomplishment of the FAA's objectives."⁶¹

Before *Concepcion*, the Supreme Court had said that "a court [may not] rely on the uniqueness of an agreement to arbitrate as a basis for a state-law holding that enforcement would be unconscionable, for this would enable the court to effect what . . . the state legislature cannot."⁶² The Supreme Court stated that California courts were impermissibly interfering with the fundamental attributes of arbitration in contravention of the arbitration scheme prescribed by the FAA.⁶³ The Court observed that the FAA cannot be held to destroy itself by permitting the application

53. *Id.* at 1745–46.

54. *Id.* at 1746.

55. *Id.* at 1744–45.

56. *Id.* at 1744.

57. *Id.*

58. *Id.*

59. *Laster v. AT&T Mobility LLC*, 584 F.3d 849, 853–54 (9th Cir. 2009), *rev'd sub nom. Concepcion*, 131 S. Ct. at 1740.

60. *Concepcion*, 131 S. Ct. at 1753.

61. *Id.* at 1748.

62. *Perry v. Thomas*, 482 U.S. 483, 492 n.9 (1987).

63. *Discover Bank v. Super. Ct.*, 113 P.3d 1100, 1103 (Cal. 2005), *abrogated by Concepcion*, 131 S. Ct. 1740 (2011).

of a common law doctrine (here unconscionability) that is absolutely inconsistent with the provisions of the FAA.⁶⁴

Under California's *Discover Bank* rule, class-wide arbitration is not required;⁶⁵ however, the rule effectively allows a consumer to demand class-wide arbitration for conflicts arising out of a consumer contract.⁶⁶ This rule in California, deriving from the doctrine of unconscionability, was limited in application by the state courts to adhesion contracts. The *Discover Bank* rule states that:

*[W]hen [a class action] waiver is found in a consumer contract of adhesion in a setting in which disputes between the contracting parties predictably involve small amounts of damages, and when it is alleged that the party with the superior bargaining power has carried out a scheme to deliberately cheat large numbers of consumers out of individually small sums of money, then the waiver becomes in practice the exemption of the party from responsibility for its own fraud, or willful injury to the person or property of another.*⁶⁷

It is unclear why this rule would even apply to AT&T's situation in the first instance because AT&T was not "cheating" consumers out of small sums of money; as with any other merchant, AT&T was merely acting as California's tax collector and remitting the proper amount of sales tax to the state.⁶⁸ Regardless, today's reality is that every consumer contract is a contract of adhesion.⁶⁹

The *Concepcion* Court, looking at the *Discover Bank* rule, concluded that "class arbitration, to the extent it is manufactured by *Discover Bank* rather than consensual, is inconsistent with the FAA."⁷⁰ This is because of the nature of class arbitration. The principal advantage of arbitration — its informality and relative lower expense — is sacrificed by class arbitration.⁷¹ In a similar vein, the informality of arbitration is inadequate for the settlement of class disputes.⁷² To bind all class

64. *Concepcion*, 131 S. Ct. at 1748 (citing *Am. Tel. & Tel. Co. v. Cent. Office Tel., Inc.*, 524 U.S. 214, 227–28 (1998)).

65. See *Discover Bank*, 113 P.3d at 1109–10 (establishing the rule for California courts which generally classified mandatory collective arbitration agreements in consumer contracts as unconscionable); see also *Concepcion*, 131 S. Ct. at 1750 ("California's *Discover Bank* rule . . . does not require classwide arbitration . . .").

66. *Discover Bank*, 113 P.3d at 1110.

67. *Id.* (internal citations and quotations omitted).

68. See *Concepcion*, 131 S. Ct. at 1744 (explaining that the fees at issue in the case were collected to pay mandatory state taxes).

69. *Id.* at 1750.

70. *Id.* at 1750–51.

71. *Id.* at 1751 (noting that "class arbitration requires procedural formality" and "makes the process slower, more costly, and more likely to generate procedural morass than final judgment").

72. See *id.* at 1752 (discussing errors generated by inadequate review resulting from informal procedures as well as the compounding cost of these errors in class action proceedings); see also Judith Resnik, *Fairness in Numbers: A Comment on AT&T v. Concepcion, Wal-Mart v. Dukes, and Turner v. Rogers*, 125 HARV. L. REV.

representatives to a class decision, procedural formality is required.⁷³ The *Concepcion* Court surmised that, considering the high stakes of class disputes, and the nature of arbitration, arbitration is ill suited as a manner of deciding class disputes.⁷⁴

In *Concepcion*, the majority did not dispute that the *Discover Bank* rule is a valid ground for the revocation of any contract under California law and thus nominally falls within the FAA savings clause permitting state law challenges to arbitration agreements.⁷⁵ However, the majority found that, although the savings clause preserves such state law contract defenses, nothing in Section 2 suggests an intent to preserve state law that stands as an obstacle to the FAA's objective of promoting the enforceability of arbitration agreements.⁷⁶ The majority held that because it allows consumer claimants to force class-wide arbitration in any case, which the Court found to be antithetical to arbitration, the *Discover Bank* rule is an obstacle to the FAA's objectives.⁷⁷ Based on this logic, the Court reversed the Ninth Circuit's decision.⁷⁸

Despite the *Concepcion* decision affirming the FAA's liberal policy favoring arbitration, courts — and the Ninth Circuit in particular — continue to scrutinize arbitration agreements for evidence of procedural and substantive unconscionability.⁷⁹ Recent cases in California demonstrate that the current state of

78, 117 (2011) (“Arbitration’s attributed utilities — speed, low cost, and informality — became more important as the Court lost interest in power imbalances and in the idea that enforcement required negotiation and actual consent.”); S.I. Strong, *Does Class Arbitration “Change the Nature” of Arbitration?* Stolt-Nielsen, AT&T, and a Return to First Principles, 17 HARV. NEGOT. L. REV. 201, 270–71 (2012) (discussing representative relief, a major issue in class arbitration which requires increased judicial involvement in response to due process concerns related to judgment without the possibility of review).

73. See *Concepcion*, 131 S. Ct. at 1751 (“If procedures are too informal, absent class members would not be bound by the arbitration.”); see also Jacob Spencer, *Arbitration, Class Waivers, and Statutory Rights*, 35 HARV. J.L. & PUB. POL’Y 991, 1010 (2012) (noting that after *Concepcion*, courts required this procedural formality for all class-action suits in order to avoid the risk of defendants being bound to determinations without the possibility of judicial review).

74. *Concepcion*, 131 S. Ct. at 1752.

75. See *id.* at 1746–47.

76. *Id.* at 1748.

77. *Id.* at 1753 (quoting *Hines v. Davidowitz*, 312 U.S. 52, 67 (1941)).

78. *Id.*

79. See *Buzenes v. Nuvel Fin. Services*, No. B221870, 2012 WL 208051, at *5 (Cal. Ct. App. Jan. 25, 2012) (unpublished decision) (refusing to acknowledge that the *Concepcion* holding abrogated California’s rule against class action arbitration agreements), *review granted*, (May 9, 2012); *Sanchez v. Valencia Holding Co., LLC*, 135 Cal. Rptr. 3d 19, 28–29 (Ct. App. 2011) (limiting the *Concepcion* ruling to apply to class action waivers that conflict with arbitration provisions of the Federal Arbitration Act), *petition for review granted*, 272 P.3d 976 (Cal. 2012); *Lau v. Mercedes-Benz USA, LLC*, No. CV 11-1940 MEJ, 2012 WL 370557, at *7 (N.D. Cal. Jan. 31, 2012) (asserting the California court’s right to review a contract containing an arbitration agreement is based on California law under which such agreement is void if it is both procedurally and substantively unconscionable); *Plows v. Rockwell Collins, Inc.*, 812 F. Supp. 2d 1063, 1069 (C.D. Cal. 2011) (concluding that the California Court of Appeals was correct for not applying *Concepcion* to employee arbitration dispute).

arbitration in California generally favors challenges to arbitration clauses,⁸⁰ but there is still the possibility that a properly drafted and negotiated arbitration agreement will be enforced. While California is clearly a leader in consumer-friendly law, it is unclear to what extent other states will follow California's aggressive stance against compelling arbitration. Still, important lessons can be learned from California's cases as to how to draft arbitration clauses that may withstand attack, even in California.

B. California Courts Find Arbitration Unconscionable Post-Concepcion

California state courts and the Ninth Circuit have been the most fertile ground for challenges to arbitration agreements based on unconscionability.⁸¹ It is because of the volume of cases there that this Article now looks primarily at California case law. Certainly different jurisdictions are less aggressive in finding arbitration agreements unenforceable,⁸² but to work towards drafting an agreement that a drafter can rely upon to be enforced in the majority of circumstances, it is best to study the extremes.

California courts have identified various factors that when considered together can render an arbitration agreement procedurally unconscionable.⁸³ The courts

80. See, e.g., *Ontiveros v. DHL Express (USA), Inc.*, 79 Cal. Rptr. 3d 471, 486–89 (Ct. App. 2008) (affirming the trial court's determination that an arbitration agreement is substantively unconscionable without a showing of substantial need); *Newton v. Am. Debt Servs., Inc.*, 854 F. Supp. 2d 712, 728, 733 (N.D. Cal. 2012) (stating that the FAA does not preempt state law challenges for arbitration agreements and held that the arbitration clause "as a whole [was] unconscionable and therefore unenforceable"); *Doubt v. NCR Corp.*, No. C 09–05917 SBA, 2010 WL 3619854, at *6–7 (N.D. Cal. Sept. 13, 2010) (finding arbitration agreement that limited discovery of a weaker party to be unconscionable noting the unfairness of an agreement that "compels arbitration of [only] the types of claims more likely to be brought by the weaker party") (citing *Fitz v. NCR Corp.*, 13 Cal. Rptr. 3d 88, 104 (2004)). *Contra Lucas v. Hertz Corp.*, 875 F. Supp. 2d 991, 1009 (N.D. Cal. 2012) (upholding an arbitration agreement in a consumer contract on the grounds that "in this post-*Concepcion* landscape, the arbitration agreement is not substantively unconscionable"), *reconsideration denied*, No. C 11–01581 LB, 2012 WL 3638568 (N.D. Cal. Aug. 22, 2012).

81. See Myriam Gilles, *Opting Out of Liability: The Forthcoming, Near-Total Demise of the Modern Class Action*, 104 MICH. L. REV. 373, 400–02 n.139–50 (2005) (arguing that the multitude of cases from California in which arbitration agreements are deemed unconscionable defies the norm in other jurisdictions). While California was one of the first states to accept challenges to arbitration agreements on grounds of unconscionability, by 2011, when *Concepcion* was decided, at least 14 states had held that class action waivers in arbitration agreements were unenforceable. Myriam Gilles & Gary Friedman, *After Class: Aggregate Litigation in the Wake of AT&T v. Concepcion*, 79 U. CHI. L. REV. 623, 633 (2012).

82. See, e.g., *Quilloin v. Tenet HealthSystem Phila., Inc.*, 673 F.3d 221, 236–37 (3d Cir. 2012) (upholding an arbitration agreement in an employee contract that the employee did not read); *In re Checking Account Overdraft Litig.*, MDL No. 2036, 672 F.3d 1224, 1229–30 (11th Cir. 2012) (ruling that an the arbitration clause in a bank's deposit agreement was not procedurally unconscionable under Georgia law), *cert. denied sub nom. Hough v. Regions Fin. Corp.*, 133 S. Ct. 430 (2012); *Soto v. State Indus. Prods., Inc.*, 642 F.3d 67, 76 (1st Cir. 2011) (concluding that an mandatory arbitrary agreement is not unconscionable under Puerto Rican law).

83. See *Lau*, 2012 WL 370557, at *8–9 (finding an arbitration agreement "procedurally unconscionable because the agreement was oppressive and created unfair surprise"); *Buzenes*, 2012 WL 208051, at *6 (applying the unconscionability factors in finding arbitration agreement unconscionable); *Sanchez*, 135 Cal. Rptr. 3d at

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have found procedural unconscionability where the actual arbitration clause is inconspicuously located in the agreement (e.g., on the back of the last page).⁸⁴ Courts also analyze the style and size of fonts to determine whether the buyer could adequately identify the clause.⁸⁵

Most important to courts is the consumer's opportunity to negotiate terms of the contract, although the agreements are almost always boilerplate.⁸⁶ Still, California courts are looking for some evidence of a meaningful opportunity for negotiation and absent that they are likely to find a clause procedurally unconscionable.⁸⁷ Specifically, courts noted the creditor's failure to give a consumer adequate time to read the contract, the failure to mention the arbitration clause to the consumer and state its importance, and the failure to require that the consumer initial pages and certain provisions.⁸⁸

California courts have also identified various factors which render an arbitration agreement substantively unconscionable.⁸⁹ The focus is on the effect of the agreement's terms, not whether they appear fair on their face.⁹⁰ Courts viewed a term which allowed the creditor to retain its right to self-help repossession as one-sided because the consumer was still subject to arbitration for any conceivable claim

30–31 (identifying the two factors considered for procedural unconscionability by the California Courts and providing numerous examples).

84. See, e.g., *Flores v. W. Covina Auto Grp.*, 212 Cal. App. 4th 895, 921–22 (Cal. Ct. App. 2013) (“The general rule that a party cannot avoid the terms of a contract because the party failed to read it before signing it applies even to adhesion contracts, when the provisions are conspicuous and clear and do not defeat the reasonable expectations of the parties.”); *Powers v. Dickson, Carlson & Campillo*, 63 Cal. Rptr. 2d 261, 265 (Ct. App. 1997) (“[C]ourts will not enforce provisions in adhesion contracts which limit the duties or liability of the stronger party unless such provisions are ‘conspicuous, plain and clear’ . . .” (citing *Madden v. Kaiser Found. Hosps.*, 552 P.2d 1178, 1185 (Cal. 1976) (en banc))); *Windsor Mills, Inc. v. Collins & Aikman Corp.*, 101 Cal. Rptr. 347, 353 (Cal. Ct. App. 1972) (holding an arbitration agreement inconspicuously written on the back page of a contract unconscionable).

85. See *Lucas*, 875 F. Supp. 2d at 1004–05 (finding that the small font and style made arbitration agreement “nearly illegible” and thus unconscionable). But see *Sanchez*, 135 Cal. Rptr. 3d at 30–31 (asserting that typeface in an agreement is an item taken into consideration for procedural unconscionability, but that the location of the agreement on the back of the contract controls unconscionability).

86. See *Gutierrez v. Autowest, Inc.*, 7 Cal. Rptr. 3d 267, 276 (Ct. App. 2003) (finding an arbitration clause unconscionable because it was presented on a take it or leave it basis and because there was no opportunity to negotiate any of the preprinted terms).

87. See *Bruni v. Didion*, 73 Cal. Rptr. 3d 395, 409 (Ct. App. 2008) (“‘Oppression’ arises from an inequality of bargaining power which results in no real negotiation . . . ‘Surprise’ involves . . . supposedly agreed-upon terms of the bargain [being] hidden in a prolix printed form drafted by the party seeking to enforce the disputed terms.” (internal citations omitted)).

88. See *Gutierrez*, 7 Cal. Rptr. 3d at 276 (arbitration clause unconscionable because the buyer was not made aware of its presence in the lease or required to initial the clause).

89. See *id.* at 275–76 (“Substantive unconscionability focuses on whether the provision is overly harsh or one-sided and is shown if the disputed provision of the contract falls outside the ‘reasonable expectations’ of the nondrafting party or is ‘unduly oppressive.’” (internal citations omitted)).

90. See *Saika v. Gold*, 56 Cal. Rptr. 2d 922, 923 (Ct. App. 1996) (noting that, despite a clause within an arbitration agreement purporting to allow parties to disregard the results of arbitration and litigate under certain circumstances, “the practical effect of the clause is to tilt the playing field . . .”).

the consumer might have.⁹¹ Thus, the clause lacked “bilateralism.”⁹² Also substantively unconscionable were terms that put the burden of high arbitration costs on the consumer⁹³ and procedures for appeal which provided the consumer with no meaningful opportunity to appeal and thus unjustly favored the creditor.⁹⁴

Considering the facts of these cases, one wonders what arbitration clause would be enforceable in California. Even one creditor’s attempt to argue that an arbitration clause was not procedurally unconscionable because the consumer could have bought the consumer product from another merchant under a contract which did not contain an arbitration term was rebuffed by a California state court.⁹⁵ The court stated that it was not obligated to enforce procedurally unconscionable agreements just because there is a market affording a consumer choice, especially since no evidence was presented that arbitration clauses were not universal contract terms in that market.⁹⁶ The California courts have been clear that the procedural element focuses specifically on the negotiation of the sales contract in the dealer’s office and courts seem unlikely to consider other realities in the process of a consumer buying a product.⁹⁷

Still, two recent California cases offer some hope for compelling arbitration. In a case recently decided in federal district court in California, the court compelled arbitration where the agreement contained a delegation provision by which the parties had agreed to have the arbitrator decide the issue of arbitrability.⁹⁸ Although the arbitration clause in this case had the same terms as those declared unconscionable in the cases discussed above, the court did not find that it was

91. *Flores v. Transamerica*, 113 Cal. Rptr. 2d 376, 383 (Ct. App. 2001) (finding that a lender attempted to advantage itself by avoiding arbitration on its own claims by reserving the ability to foreclose on a borrower while restricting borrowers to arbitration on their claims).

92. *Id.* at 382.

93. *See Gutierrez*, 7 Cal. Rptr. 3d at 277 (discussing the unconscionability of an arbitration clause that builds prohibitively expensive fees into the process for which the consumer is responsible); *Lau v. Mercedes-Benz USA, LLC*, No. CV 11-1940 MEJ, 2012 WL 370557, at *27 (N.D. Cal. Jan. 31, 2012) (finding an arbitration clause substantially unconscionable because it would require a buyer to advance between \$10,000 and \$15,000 to arbitrate his claim).

94. *See Sanchez v. Valencia Holding Co.*, 135 Cal. Rptr. 3d 19, 33, 35 (Ct. App. 2011), *petition for review granted*, 272 P.3d 976 (Cal. 2012) (finding that an arbitration clause which stipulates that either party may appeal an initial decision only if the award exceeds \$100,000 or is in the form of injunctive relief has the effect of benefitting the party with superior bargaining power and is thus unconscionable).

95. *See id.* at 31 (“[C]ourts are not obligated to enforce highly unfair provisions that undermine important public policies simply because there is some degree of consumer choice in the market.” (quoting *Gatton v. T-Mobile USA, Inc.*, 61 Cal. Rptr. 3d 344, 356 (Ct. App. 2007))).

96. *Id.* at 31–32.

97. *See Ann Tracey & Shelly McGill, Seeking a Rational Lawyer for Consumer Claims After the Supreme Court Disconnects Consumers in AT&T Mobility LLC v. Concepcion*, 45 LOY. L.A. L. REV. 435, 462 (2012) (arguing that by focusing on the ability to negotiate terms of an arbitration clause, courts are obfuscating the reality that such clauses are presented on a take it or leave it basis, such that consumers have no alternative but to agree to such clauses).

98. Order Granting Motion to Compel Arbitration at 8–9, *Hamby v. Power Toyota Irvine*, 798 F. Supp. 2d 1163 (S.D. Cal. 2011) (No. 3:11-cv-00544-BTM-BGS).

permeated with unconscionability and therefore certain unconscionable provisions could not be severed.⁹⁹ Importantly, however, the court noted that the buyer had acknowledged reading, understanding, and agreeing to the terms of the contract.¹⁰⁰ Thus, there was no clear procedural unconscionability to the arbitration agreement. Had the court found more evidence of procedural unconscionability, it might not have been as quick to compel arbitration, but the importance of counsel's reliance on the delegation provision cannot be ignored.

In a recent California state court of appeals case, the court similarly compelled arbitration.¹⁰¹ The court found that because the arbitration agreement in the motor vehicle retail installment sale contract at issue was imposed on the buyer without the opportunity for negotiation, it was an adhesion contract and therefore the transaction was procedurally unconscionable.¹⁰² However, while the degree of procedural unconscionability was enough to trigger the court's examination of the terms of the contract,¹⁰³ the court did not find significant substantive unconscionability in the contract sufficient to void the arbitration agreement.¹⁰⁴ Significantly, the arbitration agreement at issue contained many of the provisions described in the Drafter's Guide section below.¹⁰⁵ The court found that the one suggestion of substantive unconscionability in the arbitration agreement — a lack of bilaterality caused by a clause which failed to permit an "appeal" arbitration in the event a buyer sought and was denied injunctive relief — was mitigated by a provision permitting a second arbitration if the buyer were denied a monetary recovery.¹⁰⁶ With regard to substantive unconscionability in general, the court stated: "[O]ne-sidedness, standing alone, is not sufficient to qualify an arbitration clause as substantively unconscionable. . . . It is the attempt to make the arbitration proceeding something other than a fair forum that 'shocks the conscience.'"¹⁰⁷

III. A DRAFTER'S GUIDE

Even after *Concepcion*, arbitration agreements must be designed to convey to consumers the implications of entering into an arbitration agreement and must also strive to ensure that consumers will be able to vindicate their rights. Practically, what this requires is that an arbitration clause be prominent and substantively even-handed. A well-written arbitration agreement will not only protect the drafting party (and its assigns) from class action, but a well-written arbitration agreement

99. *Id.* at 13–14.

100. *Id.* at 16.

101. *Vasquez v. Greene Motors, Inc.*, 214 Cal. App. 4th 1172, 1179 (Ct. App. 2013).

102. *Id.*

103. *Id.* at 1186.

104. *Id.* at 1199–1200.

105. *See infra* Part III.

106. *Vasquez*, 214 Cal. App. 4th at 1199–1200.

107. *Id.* at 1193.

will also allow consumers to adequately assert their rights. Such an agreement will be enforceable under *Concepcion* and also should withstand attacks based upon the state contract law doctrine of unconscionability.¹⁰⁸

So how do we draft such an agreement? The most effective strategy is to deconstruct the consumer arguments about procedural and substantive unconscionability, and then draft clauses designed to neutralize or minimize those arguments. Thus, the arbitration cases surveyed above are instructive as to how to draft clauses that will be conspicuous in the contract and that will be considered fair, which as a concept has unfortunately proven to be a moving target for practitioners.¹⁰⁹

The recommendations that follow are not all necessarily required to ensure an enforceable arbitration agreement. By the same token, an arbitration agreement that precisely traces this outline cannot be guaranteed to withstand every challenge. There is no perfect contract as state law is constantly evolving; one can only draft a clause that attempts to incorporate the lessons that available law provides. We also note that the authors' expertise lies in the auto finance industry and thus these recommendations are derived chiefly from that perspective.

A. Drafting to Avoid Claims of Procedural Unconscionability

The first, and perhaps easiest, drafting advice is to design the form of the contract to draw attention to the arbitration clause. Thus, the arbitration clause should be contained in the related contract, or attached to and incorporated by specific reference to the related contract. An arbitration agreement should be conspicuous. It should not be placed in a "bill stuffer"¹¹⁰ included in a mailing to the buyer after the deal has been formally executed or approved. If the arbitration clause is not contained on the first or front page of the contract, the contract should include a provision in a prominent location indicating where the arbitration clause is located, and encouraging the buyer to read the entire contract, including the arbitration clause. A conservative practitioner may also want to include in the reference provision an agreement that the consumer has read the arbitration clause and agrees to its terms. Placing signature or initial lines in the arbitration reference provision for the consumer to sign further evidences the consumer's knowledge of and agreement to the terms contained in the arbitration clause.

108. See *AT&T Mobility LLC v. Concepcion*, 131 S. Ct. 1740, 1748 (2011) (stating that although the savings clause in Section 2 of the FAA preserves state-law rules such as contract defenses, the section will not prevent the accomplishment of the FAA's objectives which are to streamline the arbitration process and ensure that arbitration agreements are enforced according to their terms).

109. See *supra* Part II.B.

110. *Kortum-Managhan v. Herbergers NBGL*, 204 P.3d 693, 700 (Mont. 2009) (finding that a "bill stuffer" — a provision within a billing statement sent along with other junk mail — that sought to "lull [a consumer] into agreeing to waive her constitutional rights" was "sneaky and unfair").

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In addition, the title of the credit contract should indicate in some manner that the credit contract contains an arbitration provision. Any acknowledgement provision affirming the consumer's review and receipt of a completed agreement should also contain a reference to the arbitration provision contained in the contract, and acknowledgment of review of such provision.

The arbitration provision itself should be conspicuous. There is no special formula for making the clause conspicuous; what makes it conspicuous will depend on the layout and appearance of the contract. To make the arbitration provision conspicuous, a drafter may adjust the font, type size, type color, location, and bordering of the provision.

Still, even when all pages are initialed by the consumer, courts have found procedural unconscionability.¹¹¹ Because preprinted contracts are provided to consumers on a "take it or leave it" basis and consumers typically have no meaningful opportunity to negotiate the terms of the contract, these contracts of adhesion can be deemed procedurally unconscionable.¹¹² However, considering the general acceptance of a preprinted contract in *Concepcion*,¹¹³ the focus shifts to a consumer's ability to understand the contract provisions. Thus, it is important to actually direct the consumer to take time to read the contract and it may also be necessary to explicitly tell the consumer that any disputes are subject to mandatory arbitration.

Besides the physical appearance of the contract, the manner in which the contract is presented and described by the creditor to the consumer is also important in a court's determination of procedural unconscionability. Although this is not advice as to how to actually draft the agreement, it is still germane to the issue of procedural unconscionability. To this end, the creditor should specifically identify for the consumer the fact that the contract contains an arbitration provision. A creditor should also explain in common parlance what the result of agreeing to the arbitration provision is (i.e., that both parties will have to arbitrate certain disputes and will not be able to sue in court). It would be best to have these explanations scripted and approved by competent counsel. The script should conclude with an admonition to the consumer to read the entire clause with care and to also consult his own lawyer if the buyer has any questions.

Another approach to addressing procedural unconscionability, and countering the typical consumer-advocate argument that a consumer did not have adequate time to consider the contract's terms, is to actually provide a meaningful opportunity for the consumer to opt out of the arbitration clause. This could take

111. See, e.g., *Lau v. Mercedes-Benz USA, LLC*, No. CV 11-1940 MEJ, 2012 WL 370557, at *21 (N.D. Cal. Jan. 31, 2012) (arbitration clause was deemed procedurally unconscionable even though purchaser acknowledged by signature that he read the entire purchase agreement).

112. See *Gutierrez v. Autowest, Inc.*, 7 Cal. Rptr. 3d 267, 276 (Ct. App. 2003).

113. See *Concepcion*, 131 S. Ct. at 1744 (contract provided for arbitration of all disputes to be brought in the parties' individual capacity and authorized AT&T to unilaterally amend provisions).

the form of a provision in the arbitration clause that would provide that within thirty days of signing the contract the consumer could unconditionally choose to opt out of the agreement to arbitrate by informing the creditor in writing of his intent to do so. A creditor offering an opt-out must establish a system to track consumers who exercise that option.

B. Drafting to Avoid Claims of Substantive Unconscionability

While unconscionability contains two elements that must be satisfied,¹¹⁴ drafting to avoid claims of substantive unconscionability is the drafter's most important goal. It is more important than drafting around procedural unconscionability because, as has been noted, nearly all consumer contracts are boilerplate contracts that a court could easily deem an adhesion contract.¹¹⁵ Thus, because both procedural and substantive unconscionability must be found for a contract provision to be declared unconscionable, and a court can often easily make a finding of procedural unconscionability, substantive issues come to the fore when drafting an enforceable arbitration provision.

Creditors gain a significant benefit from arbitration in class action avoidance, and so when it comes to crafting an enforceable arbitration agreement, substantive unconscionability requires that the agreement provide incentives to consumers to arbitrate and a fair and adequate process where a consumer may vindicate his claims. A drafter should consider the following suggestions when addressing substantive unconscionability. Consistent with the approach to avoid claims of procedural unconscionability, there is no particular manner of drafting an unassailable arbitration provision in terms of substantive unconscionability. Thus, inclusion of all of these recommended suggestions provides no guarantee that a provision will be enforced and, in a similar vein, not all these provisions need to be incorporated to ensure that a court will compel arbitration.

There are things the creditor can do to make an arbitration agreement fairer to the consumer. The creditor can agree to advance on behalf of the buyer the costs of arbitration and the costs of any appeal. The advancement of funds can be conditioned in ways that will reduce the creditor's exposure, but obviously the less consumer friendly the provision is, the more likely a court will be to view the provision as oppressive and thus substantively unconscionable. For example, the creditor could agree to advance funds subject to reimbursement of costs to the extent the claim is found by the arbitrator to be frivolous. An example of a less consumer-friendly option would be to allow for reimbursement of costs at the discretion of the arbitrator, or to only advance funds if the consumer is able to show an inability to pay or that the arbitration would be cost-prohibitive.

114. Broome, *supra* note 27, at 48.

115. See *Gutierrez*, 7 Cal. Rptr. 3d at 276; see also *supra* text accompanying note 84.

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Also relating to the financial burdens of arbitration on a consumer, the arbitration clause could provide for shifting fees to the successful claimant, including attorney's fees and expert costs. To remove the stench of oppression, the creditor can also waive its right to seek attorney's fees or allow the consumer the option to file actions in small claims court. This last provision attempts to overcome the consumer advocate argument that a consumer is unable to vindicate small claims through normal channels.

In an effort to ensure the "bilateralism" of the contract, if the creditor is permitted under the arbitration clause to exercise a right under the law, such as self-help repossession without waiving the right to arbitrate, the clause should also explicitly provide a consumer a comparable right under the law, such as filing an action in court for individual injunctive relief.

Courts have considered provisions limiting rights to appeal if an award in arbitration exceeds a certain sum of money as benefitting only the creditor and thus unconscionable.¹¹⁶ Therefore, any right to appeal granted in an arbitration clause should be limited to the circumstances permitted by the FAA. In that instance, both the creditor and consumer share the same limited right, which may be amended from time to time under the FAA and is not dependent on the award in any particular transaction. The arbitration clause should also provide for a venue that is convenient to the consumer, and indicate that the arbitration will take place in the county, state, or federal district of the consumer's residence, or some other similar place that is convenient to the consumer. Such a provision would of course be subject to any relevant state limitations on venue. For example, the Wisconsin Consumer Act, applicable to consumer credit transactions with an amount financed of \$25,000 or less, contains venue limitations.¹¹⁷ A wise practitioner should not overlook state laws entirely when drafting an arbitration provision governed by the FAA.

The clause should also provide that the arbitrator may award the types of individual relief available in a court proceeding, including injunctions and punitive damages. This ensures that in agreeing to arbitrate, the consumer has not forgone any possible judicial remedies he may have had and thus reduces the theoretical oppressiveness of the contract.

Like AT&T's arbitration agreement that was at issue in *Concepcion*, another provision a drafter may employ is a so-called "bump up" provision.¹¹⁸ Such a provision provides that if the arbitrator issues an award to the consumer that is greater than the creditor's last written settlement offer, the creditor will pay an

116. See, e.g., *Little v. Auto Stiegler, Inc.*, 63 P.3d 979, 984-85 (Cal. 2003) (finding unconscionable a provision allowing either party to appeal an initial award only if it exceeded \$50,000).

117. WIS. STAT. ANN. § 421.401 (West 1988).

118. Alan S. Kaplinsky & Mark J. Levin, *The Impact of Concepcion on Consumer Financial Services Arbitration Agreements and the Future of Consumer Litigation*, CONSUMER FIN. SERVICES L. REP., May 25, 2011, at 3-4.

additional dollar amount over the arbitrator's award.¹¹⁹ For example, AT&T's arbitration agreement provided for a \$7,500 "bump up," plus double the amount of the attorney's fees.¹²⁰ This directly addresses the consumer advocate argument that mandatory arbitration agreements disadvantage consumers and deny them a greater remedy that could only be achieved through class action litigation. In fact, the California district court in *Concepcion* noted that the Plaintiffs were actually better off *under the arbitration agreement* with AT&T than pursuing their claims through class action litigation because with this provision they had a much better opportunity at securing meaningful damages when compared to class litigation.¹²¹ The *Concepcion* Court noted that in class litigation, the Plaintiffs would have been in class litigation for years (instead of months with arbitration) and that once a settlement or verdict was reached, only then would they have an opportunity to submit their claims for a small percentage of the dollar award.¹²²

C. Standard Required General Language

There are also certain other important provisions that every well-drafted arbitration agreement must include. Although they do not necessarily bear on whether the clause would stand up to an attack based on the theory of unconscionability, these drafting recommendations are nonetheless important and therefore included in this Article.

The class action waiver is the focal point of any arbitration clause. Without a class action waiver, one need not engage in arbitration. In addition to a class action waiver, every arbitration clause should expressly adopt the FAA as the governing law for its provisions.¹²³ Thus, where the language of the clause leaves gaps that must be filled or explained, those gaps will be filled or explained by the FAA, which is generally more favorable to creditors. Like a venue clause, the agreement should name one or more of the various arbitration organizations as the arbitrator (e.g., the American Arbitration Association or JAMS), and should also give the consumer the option of selecting another arbitration organization to arbitrate the dispute, subject to the creditor's approval. By giving additional, more open-ended choices, the creditor will be protected should one or more of the organizations cease conducting consumer arbitrations and will gain some insulation from claims that a particular arbitration organization is biased as to the creditor because the creditor is a repeat customer.

119. Kaplinsky & Levin, *supra* note 111, at 4.

120. AT&T Mobility LLC v. Concepcion, 131 S. Ct. 1740, 1744 (2011); see Kaplinsky & Levin, *supra* note 111, at 4.

121. *Concepcion*, 131 S. Ct. at 1753.

122. *Id.*

123. See, e.g., VERIZON WIRELESS CUSTOMER AGREEMENT ARBITRATION CLAUSE, available at <http://www.proandcontracts.com/wp-content/uploads/2011/09/2011.09.08-Verizon-Wireless-Arbitration-Clause.pdf>.

Along these lines, the agreement should explicitly allow for either party to the contract to request arbitration, but it should not require arbitration of every possible dispute. This allows a creditor or consumer to proceed with a non-judicial process or in court, and also to opt into arbitration as necessary, for example, if a dispute leads to a class action. At the same time, the definition of “dispute” or “claim” for which either party may demand arbitration should be broadly defined to encompass disputes that occur in the application, origination, servicing, and collection stages of a credit transaction. The agreement should indicate that the arbitration will take place in the county, state, or federal district of the consumer’s residence, or some other place convenient to the consumer. This is obviously a consumer-friendly provision that goes to defending against attacks that the agreement is substantively unconscionable.

Similar to a delegation clause in any standard contract, the arbitration agreement should stipulate that the arbitrator will decide issues of arbitrability and enforceability of the clause. The arbitration agreement should also provide for the (hopefully) unlikely event that the class action waiver or other provision of an arbitration clause is deemed unenforceable. If the class action waiver provision is deemed unenforceable, a “poison pill” in the arbitration clause should void the entire arbitration clause.¹²⁴ As stated in *Concepcion*,¹²⁵ arbitration and class actions are incompatible, and therefore the arbitration clause should fail in the event the class action waiver is deemed unenforceable. If any other provision is deemed unenforceable, the arbitration clause should remain valid.

D. The Road Ahead

The Dodd-Frank Wall Street Reform and Consumer Protection Act (the Dodd-Frank Act) requires the Bureau of Consumer Financial Protection (the “CFPB” or the “Bureau”) to conduct a study concerning the use of mandatory pre-dispute arbitration agreements by banks and other covered entities under the CFPB’s supervision.¹²⁶ Based on the conclusions of the study, the CFPB may impose conditions or limitations on the use of such arbitration agreements and is even permitted by the Dodd-Frank Act to prohibit their use altogether “if the Bureau finds that such a prohibition or imposition of conditions or limitations is in the public interest and for the protection of consumers.”¹²⁷ Of course, such a prohibition would apply only to those entities over which the CFPB has direct

124. *Sanchez v. Valencia Holding Co.*, 135 Cal. Rptr. 3d 19, 26 (Ct. App. 2011), *petition for review granted*, 272 P.3d 976 (Cal. 2012).

125. *Concepcion*, 131 S. Ct. at 1748.

126. Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111–203, 124 Stat. 1367, § 1028(a) (codified as amended in scattered sections of U.S.C. titles 7, 12, 15, and 31).

127. *Id.* at § 1028(b).

authority, but depending on the structure of a given consumer transaction, this could cover a potentially wide swath of creditors.

The CFPB is currently conducting the study and because by law it is not permitted to issue regulations until concluding the study, any potential regulations would likely not be effective until 2014 or beyond.¹²⁸ Still, the nature of the study and its conclusions will provide an indication of what type of regulations the CFPB might eventually promulgate, or whether the CFPB will prohibit arbitration agreements altogether. Any drafter should remain aware of the Bureau's study and watch out for the regulations, which almost inevitably will be promulgated.

CONCLUSION

While the future of arbitration is uncertain, for the next couple of years arbitration will remain a useful tool to quickly and efficiently handle individual consumer disputes. By using arbitration clauses with the requisite class action waiver, creditors avoid the time and expense involved in defending a class action.¹²⁹ At the same time, consumer complaints can be adjudicated by an arbitrator just as quickly and easily (if not more) as in a judicial setting.¹³⁰ Although arbitration clauses continue to be a viable consumer contract option, as this Article has explained,¹³¹ such clauses must be carefully drafted by competent counsel with consumer fairness in mind to withstand enforceability challenges.¹³²

128. *Id.* at § 1028(d) (providing that any regulation will apply only to contracts entered into 180 days after the effective date of such regulation).

129. *See supra* Part III.

130. *See supra* Part I.A.

131. *See supra* Part II.A.

132. *See supra* Parts III.A–C.