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# California Court of Appeals Examines Unconscionability in Arbitration Agreements

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In yet another chapter of the saga involving California and its treatment of employment arbitration agreements, a Court of Appeals recently issued two decisions examining the state's legal standard for determining unconscionable arbitration clauses.

*Fuentes v. Empire Nissan, Inc*., — Cal. Rptr. 3d. —, No. B314490, April 21, 2023, 2023 WL 3029968 (Apr. 21, 2023) and *Basith v. Lithia Motors, Inc*., — Cal. Rptr. 3d —, No. B316098, 2023 WL 3032099 (Apr. 21, 2023), involved employees of unrelated Nissan dealerships in southern California, who signed similar form arbitration clauses when hired (Fuentes signed a paper agreement; Basith signed a digital version). Both employees were terminated from their employment, and sued the dealerships for alleged violations of the California Labor Code. Both dealerships filed motions to compel arbitration of the disputes, and the respective trial courts denied the motions to compel, ruling the arbitration agreements were substantively unconscionable. Both dealerships filed appeals in the Second Appellate District, and the Court of Appeals reversed both decisions because the agreements were not substantively unconscionable.

Citing *OTO, LLC v. Kho*, 8 Cal. 5th 111 (2019), *Fuentes* and *Basith* reiterated that to invalidate an arbitration agreement, an employee must show **both** procedural and substantive unconscionability.

Substantive unconscionability relates solely to the terms of the contract, and asks whether those terms are unreasonably favorable to the "stronger" party. Procedural unconscionability, by contrast, relates to the circumstances by which the "weaker" party consented to those terms – in other words, to the "process" by which the apparent consent was obtained. Questions about whether the weaker party truly understood what they signed, or about whether they had any "meaningful choice" in the matter are questions about procedural rather than substantive unconscionability. In fact, *Fuentes* points out that nearly every form employment contract can be perceived as having some procedural unfairness, because employees generally lack any power to bargain. Sometimes employers insist, "sign it or no job." *Fuentes* then astutely explains when the law automatically attributes some procedural unfairness to every form employment contract, then "the real fight boils down to whether the substance of the final terms are fair" and courts "must enforce [such] contracts if the substance is even-handed."

The *Fuentes* opinion examined the operative differences between substantive and procedural unconscionability, and illustrated how arguments regarding font size and readability are pertinent only to procedural unconscionability. The Court explained that even if the words of a contract were reduced to a font "so minute as to be completely unreadable without a strong magnifying glass … [t]he fairness of the contract's substance . . . remains unchanged." Similarly, *Basith* held that whether a contract used convoluted language or "legalese" to explain its terms goes to procedural unconscionability, because they have no bearing on whether the final terms of the deal were "fair." Again, the words of a contract make up its substance.

Notably, *Fuentes* instructed that a single feature cannot "count twice" as both procedurally ***and*** substantively unconscionable. Not only is such a determination illogical, but moreover, would change the law and make the unconscionability doctrine a one-element defense where the sole issue would be whether there is procedural unconscionability – something that arguably always exists in employment form contracts. The Court of Appeals was rightfully cautious not to "dilute or trivialize [the substantive unconscionability element] by smuggling in procedural objections masked as substantive points," because it could result in the same "doctrinal revision as eliminating the substantive element altogether" and also make new rules that apply only to arbitration contracts (and arbitration-specific rules are preempted).

*Fuentes* and *Basith* collectively addressed common practices used by employers in both drafting and presenting arbitration agreements to their employees and therefore can provide a better understanding of what courts will and won't be skeptical of when examining employment arbitration agreements. These cases also highlight the importance of understanding not only what is going into arbitration agreements (the substance), but also how they are being rolled out to employees (the procedure).

In the end, the Court of Appeals found the agreements fair because even though the agreements were deemed to have procedural unconscionability (they were presented on a take-it-or-leave-it basis in connection with their employment) the overall substance of the agreements was fair and thus no substantive unconscionability existed to render the agreements invalid.

Unconscionability is often used to attack arbitration agreements, and therefore both *Fuentes* and *Basith* are notable because they re-establish the dividing line between procedural and substantive unconscionability. However, employers should note these decisions were issued from a single California Court of Appeals and other such courts may place greater emphasis on procedural unconscionability. Accordingly, employers remain well advised to avoid using minute fonts and obscure language.



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