



MANDATORY ARBITRATION AGREEMENT HELD UNENFORCEABLE UNDER CALIFORNIA LAW

By Michael L. Wachtell and Robert A. Willner

In a published decision filed April 20, 2010, the Ninth Circuit Court of Appeals affirmed a district court decision holding that a mandatory Arbitration Agreement was both procedurally and substantively unconscionable and therefore unenforceable under California law.¹

This decision is potentially troubling to many companies doing business in California. Most banks and other commercial lenders based in California, for example, routinely require their borrowers to sign mandatory arbitration agreements, particularly since 2005 when the California Supreme Court held in the *Grafton* decision that pre-dispute jury trial waivers are unenforceable under California law. Once the certainty of knowing that any dispute would be resolved by a bench trial was taken away, banks and other commercial lenders determined that arbitration was the better alternative to a jury trial.

The Court of Appeals rendered its decision in connection with a class action brought by certain individuals against Quixtar, Inc., successor-in-interest to Amway Corporation. The plaintiffs were all distributors of the defendant, known as Individual Business Owners (“IBOs”). In order to become an IBO, the defendant required the plaintiffs to sign the defendant’s “Agreement to Arbitrate.”

Before addressing the merits of the plaintiff’s arguments of unconscionability, the Court needed to determine whether California law applied. The Court rejected the defendant’s argument that Michigan law should apply on the basis of a choice-of-law provision in the Arbitration Agreement stating that “the law of Michigan shall apply in all arbitrations under these rules.” The Court held that the district court properly rejected that argument because the question of whether the Quixtar Arbitration Agreements are unconscionable does not fall within the scope of the choice-of-law clause. In holding that California law applied, the Court held that the district court properly applied the “governmental interest analysis” used by California courts when there is no controlling choice-of-law agreement.

Then, turning to the Quixtar Arbitration Agreement itself, the Court of Appeals noted that an arbitration agreement, like any contract, is unenforceable under California law if it is both procedurally and substantively unconscionable.

The Court found that the Quixtar Arbitration Agreement was procedurally unconscionable in that it was drafted by the party with the superior bargaining power and was non-negotiable.

The Court found that the Quixtar Arbitration Agreement was substantively unconscionable in that it was not mutual in numerous respects. For example, only the IBOs were required to arbitrate; Quixtar was free to sue the IBOs in federal or state court. Also, the IBOs were subject to a two year statute of limitations to bring a claim. Quixtar, on the other hand, was free to bring a claim after two years. Furthermore, the Arbitration Agreement had a confidentially provision that unfairly advantaged Quixtar. Finally, the Quixtar Arbitration Agreement contained a fee shifting provision whereby the loser of the arbitration was obligated to pay the winner’s legal fees. The Court found that this “loser pays” provision unfairly exposed the IBOs to a greater financial risk in arbitrating claims than they would face if they were to litigate those same claims in federal court.

The lessons of the Quixtar case are straightforward. First and foremost, the terms of any arbitration agreement must be mutual. Second, the arbitration agreement should not be presented as a “take it or leave it” provision, particularly if it is drafted by the party with the superior bargaining power. Third, do not assume that a choice-of-law provision electing the law of a state other than California will exempt the agreement from California law analysis.

The enforceability of your company’s arbitration agreement should now be reviewed by experienced counsel in light of the analysis in the Quixtar decision.

¹ *Pokorny vs. Quixtar*, --- F.3d ---, 2010 WL 1542508, 10 Cal. Daily Op. Serv. 4839, 2010 Daily Journal D.A.R. 5810.



Michael Wachtell is a Shareholder in Buchalter Nemer’s Litigation Practice Group in the Los Angeles Office. He can be reached at (213) 891-5460; email: mwachtell@buchalter.com.



Robert Willner is a Shareholder in Buchalter Nemer’s Bank and Finance Practice Group in the Los Angeles Office. He can be reached at (213) 891-5107; email: rwillner@buchalter.com.

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