

CA Court of Appeal Finds Three-Arbitrator Panel Contract Provision Unenforceable

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In Parada v. Superior Court, 2009 DJDAR 12745 (August 27, 2009), the Fourth District Court of Appeal held an arbitration clause in contracts between an investment company and its customers requiring a three-arbitrator panel was unconscionable and therefore unenforceable where the company failed to justify it.

On August 27, 2009, the Fourth District Court of Appeal issued *Parada v. Superior Court*, 2009 DJDAR 12745, in which the Court refused to enforce a contractual arbitration provision between an investment company and its investors requiring arbitration by a three-arbitrator panel. In finding the provision unconscionable, the Court relied on evidence that the investors would have difficulty paying the \$20,000 or more in likely arbitrators' fees and costs to arbitrate their individual claims. It also noted that the investment company failed to explain the need for three arbitrators. It concluded that the company included the provision "deliberately for the improper purpose of discouraging or preventing its customers from vindicating their rights."

Parada suggests that to avoid a finding of unconscionability, a party requiring in its standard arbitration provisions a three-arbitrator panel may need to: 1) articulate why it is requiring three arbitrators rather than one; 2) consider pointing out the provision to the other party prior to execution of the contract; and 3) consider the other party's ability to pay the costs associated with the arbitration.

The *Parada* Decision

In *Parada*, school teachers, a school custodian, and a Federal Express driver invested with Monex Deposit Company and Monex Credit Corporation (collectively, "Monex"). The amount of their investments ranged from \$43,000 to \$140,000 and their incomes ranged from \$55,000 to \$70,000 per household. These investors filed suit against Monex for the purported loss of their investments and alleged fraud, breach of fiduciary duty and unfair competition, among other claims. Monex moved to compel arbitration under the contracts. The trial court granted Monex's motion and the investors filed a writ of mandate with the appellate court.

The issue before the Court of Appeal was whether two provisions in the contracts were unconscionable. The first required the arbitrations to be conducted by a three-arbitrator panel. The second prevented parties from joining their claims in a single proceeding. The contracts also required the parties to share equally in arbitration costs subject to the arbitrators' discretion to allocate them to one party.

In reaching its decision, the Court looked for both "procedural" and "substantive" unconscionability. Procedural unconscionability concerns the manner in which the contracts at issue were negotiated and the circumstances of the parties at the time with a focus on the presence of oppression and surprise. Substantive unconscionability, on the other hand, involves one-sided contract provisions that impose harsh or oppressive terms that "shock the conscience."

With respect to procedural unconscionability, the Court concluded that the contracts were "contracts of adhesion," meaning that they were standardized, drafted by the party of superior bargaining strength and left the other parties merely the ability to accept or reject them. It also concluded that the element of surprise existed since the investors would not have reasonably expected either that a panel of three arbitrators would be required or that they could not join their claims in a single proceeding. Where a contractual provision would defeat the reasonable expectation of the "weaker" party, the Court indicated that Monex may be required to call attention to the unexpected contract provision.

With respect to substantive unconscionability, the Court focused on the arbitration costs, and the ability of the investors to pay them. Under the contracts, the investors would each have to initiate their own arbitration and foot half of the total bill. With the three-arbitrator requirement, the Court estimated that each arbitration would cost the investors at least \$20,800—a cost it found to be "prohibitive" given the investors' monthly incomes and expenses and the damages they sought. The Court further found that Monex offered no justification or explanation for needing three arbitrators or for prohibiting the joinder of claims into a single action. That Monex agreed after-the-fact to decrease the number of arbitrators from three to one was to no avail since it did "not change the fact that the arbitration agreement as written is unconscionable and contrary to public policy."

In weighing both procedural and substantive unconscionability, the Court found the arbitration provision in the contracts to be unconscionable and, as a result, unenforceable. It consequently ordered the trial court to deny Monex's motion to compel arbitration.

If you have any questions about the content of this alert, please contact the Pillsbury attorney with whom you regularly work, or the authors of this alert.

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