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MODEL STATE CONSUMER AND EMPLOYEE JUSTICE ENFORCEMENT ACT

TITLES IX & X

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Introduction

In 2016, NCLC released a Model State Consumer and Employee Justice Enforcement Act, and bills based on that model have been introduced in several states. Since then NCLC has developed model language on two additional topics—the effect in standard form contracts of opt-out provisions and the appropriate remedy where a standard form contract contains illegal or unconscionable terms.

The enclosed addendum to the Model State Consumer and Employee Justice Enforcement Act contains new Titles IX and X responding to those issues. While these two titles are narrow in scope, they would help deter drafters from including unfair and unconscionable terms in standard form contracts.

Consider, for example, a loan contract that contains an arbitration clause with a clearly unconscionable term—like a term requiring the consumer to pay tens of thousands of dollars to bring a case in arbitration—but that also contains a provision allowing consumers to opt out of the arbitration requirement within 5 days of signing it. Seeking to enforce the arbitration requirement notwithstanding the clearly unenforceable term, the lender will likely argue (1) that the arbitration clause cannot be unconscionable because it allows the consumer an opportunity to opt out, and (2) that, at most, the unconscionable term should be severed and the clause enforced in its absence.

These two new titles would give courts the tools to reject those arguments and to deny enforcement of the arbitration clause entirely. This would protect consumers and workers harmed by illegal contractual terms and deter drafters from in the future including such terms in standard form contracts.

The following proposals can be considered as part of a broader legislative package that includes Titles I-VIII. Alternatively, because these two titles address two discrete concerns with simple straightforward legislative language, they can also be considered as stand-alone legislation applied alongside preexisting state common law.

TITLE IX: EFFECT of OPT-OUT PROVISIONS

Section 1. Findings.

Standard form contracts sometimes allow the party of weaker bargaining power the opportunity to opt out of the contract or one of its clauses, creating the illusion of meaningful assent to the contract or the clause containing the opt-out provision. In practice, however, opt-out provisions in standard form contracts do not significantly change the nature of a one-sided or oppressive contract, as the party of weaker bargaining power rarely understands or exercises these opt-out opportunities.

Section 2. Effect of opportunity to opt out.

For any standard form contract drafted by one party and presented to another party of weaker bargaining power, there is a rebuttable presumption that the offeree's right to opt out of the contract or any of its provisions does not bear on whether the contract is procedurally conscionable.

Notes

Section 1—Findings. The findings declare the legislature's determination that an opt-out provision in a standard form contract in most cases does not make that contract more voluntary or less one-sided than it would be without that provision. As described in the analysis below, courts frequently treat standard form contracts with opt-out provisions more favorably than those without them, even enforcing substantively unfair terms that would not be enforceable in contracts that did not allow the offeree an opportunity to opt out. That line of precedent is inconsistent with the experience of consumers, employees, and others. The legislature can correct it.

Section 2—Effect of right to opt out. In analyzing whether a contract provision is unconscionable, courts typically examine both how a contract (or clause within a contract) was negotiated (procedural unconscionability) and the fairness of its substantive terms (substantive unconscionability).

Section 2 does not alter pre-existing state law concerning the relationship between procedural and substantive unconscionability. It addresses only how an opt-out provision bears on the procedural unconscionability analysis. This provision states that the opportunity to opt out of any clause in a contract of adhesion is presumptively irrelevant to the court's determination of whether the contract is procedurally unconscionable. The offeror may overcome this presumption in special circumstances, but standard opt-out provisions—like those giving the consumer or employee a certain amount of time to opt out of the contract—should not overcome the presumption.

Analysis of Title IX: Effect of Opt-Out Provisions

Clarifying Procedural Unconscionability Law

Standard form contracts frequently include terms that allow the party of weaker bargaining power the opportunity to opt out of the contract or one of its clauses. The Consumer Financial Protection Bureau's recent study of forced arbitration agreements concluded that a significant percentage of arbitration clauses in consumer financial product contracts include such "opt out" provisions, which allow the consumer to opt out of the arbitration requirement, generally within a specified period.[1] And a significant percentage of employment contracts also include arbitration clauses with opt-out provisions.[2]

Giving a consumer or worker the right to opt out of an arbitration requirement may seem to provide a fair opportunity to reject the requirement voluntarily. But, in practice, few consumers and employees read or understand fine-print opt-out opportunities. The CFPB's study found that 27.3% of credit card arbitration agreements include opt-out provisions, but when the Bureau interviewed 1,007 consumers about their credit card contracts, only three stated that they were given an opportunity to opt out of their arbitration agreements. None of those three had done so.[3]

While opt-out opportunities in practice do not provide meaningful choice to individuals presented with one-sided clauses, the presence of an opportunity to opt out of the contract—even when buried in the fine print—often carries outsized legal significance. Most states require a showing of both procedural and substantive unconscionability to declare a contract unenforceable.[4] This means that before even getting to the question of whether the terms of an agreement are unfair or oppressive (substantive unconscionability), many courts will ask whether the clause was presented in an unfair way, without the offeree having a sufficient opportunity to accept or reject its terms (procedural unconscionability).[5]

Standard form contracts, prepared by one party, to be signed by another party in a weaker position, are contracts of adhesion,[6] and that alone makes them procedurally unconscionable to at least some degree—whether or not they have an

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[1] Consumer Fin. Protection Bureau, Arbitration Study: Report to Congress, pursuant to Dodd-Frank Wall Street Reform and Consumer Protection Act § 1028(a) at 2.5.1 ("CFPB Study"), *available at* http://files.consumerfinance.gov/f/201503_cfpb_arbitration-study-report-to-congress-2015.pdf.

[2] *See, e.g.*, *Johnmohammadi v. Bloomingdale's, Inc.*, 755 F.3d 1072, 1075 (9th Cir. 2014).

[3] CFPB Study at 3.4.3.

[4] National Consumer Law Center, Consumer Arbitration Agreements § 6.5 (7th ed. 2015).

[5] *Id.*

[6] Contract, Black's Law Dictionary (10th ed. 2014).

opt-out term.[7] Yet a number of courts have concluded that the presence of an opt-out term is relevant to the procedural unconscionability analysis, and even that in some circumstances the presence of an opt-out provision necessarily renders an agreement procedurally conscionable.[8]

Drafters of standard form contracts thus often include opt-out terms not to provide consumers or employees with any meaningful choice about whether to enter into the agreements, but rather to insulate the agreements from substantive scrutiny. Tellingly, the CFPB found that the consumer financial product contracts whose arbitration agreements were most likely to include opt-out opportunities were products that often target low income consumers for abuse—storefront payday loans (83.7% of arbitration agreements included opt-outs) and private student loans (83.3% of arbitration agreements included opt-outs).[9] It is likely that the companies selling these products are more concerned with insulating themselves from liability with arbitration clauses and class waivers than they are concerned with offering their customers meaningful choice in contract negotiation.

Too often there is a fundamental misconception that opt-out opportunities make standard form agreements meaningfully voluntary.[10] State legislatures should enact Title IX to correct that misconception and to ensure that the common law is grounded in a more accurate understanding of the actual experiences of consumers and employees.

FAA Preemption

The Federal Arbitration Act (FAA) does not preempt Title IX for largely the same reasons that it does not preempt Titles III and IV. The rules set out here are merely the codification of common law principles applying across contracts of adhesion. And as commentators and courts have observed, it is entirely within the

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[7] *Circuit City Stores, Inc. v. Adams*, 279 F.3d 889, 893 (9th Cir. 2002); *Davis v. Gazillion, Inc.*, 2010 WL 2740002 (N.D. Cal. July 12, 2010) (any adhesive contract is procedurally unconscionable under California law); *Delmore v. Ricoh Americas Corp.*, 667 F. Supp. 2d 1129, 1136 (N.D. Cal. 2009) ("A contract or clause is procedurally unconscionable if it is a contract of adhesion.").

[8] *Mohamed v. Uber Techs., Inc.*, --- F.3d ----, 2016 WL 4651409, at *5 (9th Cir. Sept. 7, 2016); *Circuit City Stores, Inc. v. Ahmed*, 283 F.3d 1198, 1199 (9th Cir. 2002) (holding that an arbitration provision was not procedurally unconscionable based on a thirty-day opt out clause); *Nesbitt v. FCNH, Inc.*, 74 F. Supp. 3d 1366, 1372 (D. Colo. 2014); *Clerk v. ACE Cash Express, Inc.*, 2010 WL 364450, at *8-10 (E.D. Pa. Jan. 29, 2010*); Fluke v. Cashcall, Inc.*, 2009 WL 1437593, at *8 (E.D. Pa. May 21, 2009) (holding that an arbitration provision containing a sixty-day opt out clause was not unconscionable); *Guadagno v. E*Trade Bank*, 592 F. Supp. 2d 1263, 1270 (C.D. Cal. 2008) (same).

[9] CFPB Study at 2.5.1.

[10] *James v. Comcast Corp.*, 2016 WL 4269898, at *3 (N.D. Cal. Aug. 15, 2016).

bounds of the FAA—and arguably even complimentary to the FAA—for states to regulate contracts of adhesion generally.[11]

[11] *See Reed Elsevier, Inc. ex rel. LexisNexis Div. v. Crocket*t, 734 F.3d 594, 600 (6th Cir. 2013); Richard Frankel, *Concepcion and Mis-Concepcion: Why Unconscionability Survives the Supreme Court's Arbitration Jurisprudence*, 17 J. Disp. Resol. 225, 242–250 (2014) ("[A]dhesion contracts, in which one party lacks meaningful choice over arbitration terms, are anathema to fundamental principles of arbitration and thus may be freely regulated by states without risking federal preemption.").

TITLE X: REMEDY FOR DRAFTER OVERREACH IN STANDARD FORM CONTRACTS

Section 1. Findings.

The remedies for illegal or unconscionable terms in standard form consumer and employment contracts are frequently insufficient to deter drafter overreach. In some cases, consumers and employees may not challenge enforcement of these terms because they do not understand their rights or because the terms threaten harsh consequences and exert an *in terrorem* effect. Even when a consumer or employee challenges the illegal unconscionable term, the court may decide to sever only that term and enforce the remainder of the agreement in its absence.

Section 2. Remedies for illegal or unconscionable terms in standard form contracts.

If a court finds that a standard form contract contains an illegal or unconscionable term, the court may

(a) refuse to enforce the entire contract or the specific part, clause, or provision containing the term;
(b) enforce the contract including the specific part, clause, or provision containing the term, while severing only the illegal or unconscionable term; or
(c) so limit the application of the illegal or unconscionable term or the clause containing such term as to avoid any illegal or unconscionable result.

Section 3. Factors relevant to determining an appropriate remedy.

In ordering a remedy for illegal or unconscionable terms in standard form contracts, a court shall consider the following factors:

(a) whether severing the term and enforcing the contract in its absence creates an incentive for drafters to include illegal or unconscionable terms in standard form contracts;
(b) whether severing the term and enforcing the contract in its absence removes, in whole or in part, the incentive to draft enforceable standard form contracts that do not include such terms;
(c) whether the inclusion of such an illegal or unconscionable term might exert an *in terrorem* effect by deterring the non-drafting party from asserting his rights under the contract or by deterring the non-drafting party from challenging the enforcement of the illegal or unconscionable term;
(d) whether the drafting party acted in bad faith, for example, by including a term that is illegal or unconscionable under established precedent; and
(e) the parties' actual purposes.

Section 4. Severance provisions.

In deciding whether merely to sever unenforceable terms from a standard form contract, a court shall not consider a term in such contract stating that unenforceable terms shall be severed.

Notes

Section 1—Findings. These legislative findings observe that drafters of contracts of adhesion have an incentive to include illegal or unconscionable terms if the very worst that can happen is that those terms are severed and the rest of the clause or contract enforced in their absence.

Section 2—Remedies for illegal or unconscionable terms in standard form contracts. This section describes the possible outcomes in a case where a court determines that a standard form contract includes an illegal or unconscionable term. The legislative language mirrors the Uniform Commercial Code's unconscionability provision, UCC § 2-302, and does not alter preexisting rules regarding judicial remedies in contract cases. The only addition here is the express instruction that, in cases where severance is inappropriate, courts may strike the clause containing the unconscionable term as opposed to declining to enforce the entire contract. While most courts understand that already, this language should allay concerns that this provision would require courts to deem unenforceable an entire consumer contract, allowing the consumer to keep the benefit of the bargain, where the contract contained an unconscionable term. Instead, based on the factors described in Section 3, the court could strike the clause containing the unconscionable term, while leaving the rest of the contract intact.

Section 3—Factors relevant to determining an appropriate remedy. Section 3 reiterates that the choice of the proper remedy for an illegal or unconscionable term remains committed to the discretion of the trial court. But this section does not askcourts to look to the mutual purposes of the parties, which is not appropriate in cases involving standard form, take-it-or-leave-it contracts. Instead, the court is asked to consider such factors as whether severance would provide the right incentives for the drafter, whether the term might, in some cases, chill the weaker party from asserting his or her rights in court by exerting an *in terrorem* effect, and the extent to which existing precedent suggests that the drafter would likely have known the term was unenforceable. The provision also asks the court to consider the parties' purposes, but only their *actual* purposes. For example, while the parties might have the mutual purposes of effecting a loan transaction, it is unlikely that the consumer would have had any actual purposes respecting an arbitration clause containing an unconscionable term within the loan contract. In that case, the court could decide to

enforce the loan agreement but decline to enforce the entire arbitration clause, and not just the unconscionable term within the arbitration clause.

Section 4—Severance provisions. Consistent with the policy of considering drafter incentives, bad faith, and the parties' actual purposes, Section 4 clarifies that irrelevant to the severance analysis set out in Section 3 are any "severance provisions." Such provisions may be buried in form contracts to protect the drafter from a judicial decision to deny enforcement of the entire agreement or an entire clause within that agreement. One justification for severance provisions is to prevent an entire contract from being defeated by a minor drafting mistake. But Sections 2 and 3 give courts sufficient tools to avoid potentially harmful outcomes. For example, Section 3 asks courts to consider how clearly unenforceable the unconscionable term is. If the term was included as an honest mistake, the court simply can sever it.

Analysis of Title X: Remedy for Drafter Overreach in Standard Form Contracts

A. Background

Even when the law is clear that a particular contract term is unenforceable, many drafters continue to include that term in standard form contracts. For example, frequently arbitration clauses include terms that are unenforceable and clearly unprotected by the Federal Arbitration Act, such as clauses that limit the plaintiff's ability to bring claims or seek remedies allowed by law,[12] or the availability of attorney's fees as provided by law;[13] clauses allowing either party to obtain a fee award

[12] *See, e.g.*, *Roberts v. Blue World Pools, Inc.*, 2015 WL 5315213, at *4 (W.D. Ky. Sept. 11, 2015) (concluding that term in arbitration agreement with pool installation and financing company that prohibits arbitrator from awarding any damages besides pool repair is unconscionable); *Gorman v. S/W Tax Loans*, No. 14-civ-00089, ECF Doc. No. 55 (D.N.M. March 17, 2015) (in suit against tax refund anticipation lender, concluding that plaintiff could not "effectively vindicate" her rights under the Truth in Lending Act because the arbitration clause prevented her from recovering statutory damages and attorney's fees provided under TILA); *Willis v. Nationwide Debt Settlement Group*, 878 F. Supp. 2d 1208 (D. Or. 2012) (concluding that term that bans punitive damages is unenforceable, violates public policy); *Newton v. Am. Debt Services, Inc.*, 854 F. Supp. 2d 712 (N.D. Cal. 2012) (concluding that limitation of liability provision stripping plaintiffs of statutory rights under Credit Repair Organizations Act was substantively unconscionable).

[13] *See, e.g.*, *Nino v. Jewelry Exch., Inc.*, 609 F.3d 191, 203 (3d Cir. 2010) ("Provisions in arbitration clauses requiring parties to bear their own attorney's fees, costs, and expenses work to the disadvantage of an employee needing to obtain legal assistance . . . [and] also undermine the legislative intent behind fee-shifting statutes like Title VII."); *Sanchez v. CleanNet USA, Inc.,* 78 F. Supp. 3d 747, 757 (N.D. Ill. 2015).

if it prevails ("loser pays" provisions);[14] clauses that impose excessive fees or costs;[15] and even clauses that require the consumer or employee to arbitrate in a far off venue.[16]

These terms continue to appear in consumer and employment contracts because even where a particularly unfair term is certain to be struck down, drafters have little incentive not to include it—or, put another way, they have little incentive to draft the agreement to be enforceable in all aspects. In many cases, the presence of an unenforceable term will exert a powerful chilling effect that may prevent the individual from pursuing her legal rights. After all, would a low-wage worker or low-income consumer, already skeptical that the law provides an avenue for the vindication of her rights, decide to pursue a claim after her attorney explains to her that her contract purports to waive those rights or includes term that requires her to pay the other side's fees and costs if she loses? Even if the attorney explains that such a term is almost certainly unenforceable, the consumer or employee will frequently be chilled from taking the risk of challenging it.[17] Drafters thus may include the terms *in terrorem*—for the purpose of frightening the offeree without intending ever to seek enforcement of the unenforceable term.

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[14] *See, e.g.*, *Coronado v. D.N. W. Houston, Inc.*, 2015 WL 5781375, at *10 (S.D. Tex. Sept. 30, 2015); *Saravia v. Dynamex, Inc.*, 310 F.R.D. 412, 422 (N.D. Cal. 2015); *Valle v. ATM Nat.*, LLC, 2015 WL 413449, at *6 (S.D.N.Y. Jan. 30, 2015) (involving arbitration clause stating that "[t]he losing party must pay the expense of the prevailing party's attorneys, experts and witnesses"); *Brinkley v. Monterey Fin. Servs., Inc.,* 242 Cal. App. 4th 314, 323 (2015); *DeVito v. Autos Direct Online, Inc.*, 37 N.E.3d 194, 202 (Ohio Ct. App. 2015) (in case against auto dealer, stating that "the undisclosed, unlisted costs of the process under the loser-pays provision would result in prohibitive assessed costs for almost all vehicle buyers"); *Hedeen v. Autos Direct Online, Inc.*, 19 N.E.3d 957, 969 (Ohio Ct. App. 2014) ("[T]he loser-pay provision chills consumers from pursuing their statutory claims through arbitration.").

[15] *See, e.g., Nesbitt v. FCNH, Inc.,* 811 F.3d 371 (10th Cir. 2016); *Chavarria v. Ralphs Grocery Co.*, 733 F.3d 916 (9th Cir. 2013); *Brownlee v. Lithia Motors, Inc.*, 49 F. Supp. 3d 875, 881 (D. Colo. 2014); *Mance v. Mercedes-Benz USA*, 901 F. Supp. 2d 1147, 1165 (N.D. Cal. 2012); *Simmons v. Morgan Stanley Smith Barney, L.L.C.*, 872 F. Supp. 2d 1002 (S.D. Cal. 2012); *James v. Conceptus, Inc.*, 851 F. Supp. 2d 1020 (S.D. Tex. 2012); *Antonelli v. Finish Line, Inc.*, 2012 WL 525538 (N.D. Cal. Feb. 16, 2012); *Wolf v. Nissan Motor Acceptance Corp.,* 2011 WL 2490939 (D.N.J. June 22, 2011).

[16] *See, e.g.*, *Duran v. J. Hass Group, L.L.C.*, 531 Fed. App'x 146 (2d Cir. 2013) (summary order); *Sanchez v. Nitro Lift Techs., L.L.C.*, 91 F. Supp. 3d 1218, 1223 (E.D. Okla. 2015); *Whataburger Restaurants LLC v. Cardwell*, 446 S.W.3d 897, 911 (Tex. App. 2014).

[17] Charles A. Sullivan, *The Puzzling Persistence of Unenforceable Contract Terms*, 70 OHIO ST. L.J. 1127, 1175 (2009) ("[I]t seems likely that the low level of risk in insisting on invalid terms results in many thousands of contracts containing such terms, contracts that will have adverse real world effects on their signatories because of information asymmetries.").

Even when the individual does challenge the enforceability of the term, a business may not face any serious consequences for including it. Particularly if the clause includes a "severance" provision, instructing the court to sever illegal terms and enforce the agreement as a whole in their absence, unenforceable terms are often merely struck from the agreement.[18] In this way, drafters can have their cake and eat it too—they can purposefully overreach in including unenforceable terms, knowing that those terms will chill most claims but confident that even if the terms are challenged, the very worst that can happen is that the arbitration agreement is enforced without them.

B. An Alternative Approach to Severance

Generally, the common law instructs courts to give effect to the intention of the parties when deciding whether to sever unenforceable terms from a contract. In line with this principle, courts frequently conclude that illegal terms should merely be severed from an agreement. For example, courts may sever an unconscionable provision from an arbitration clause while still enforcing the clause without the provision by concluding that the clause's primary purpose appears to be bilateral arbitration, particularly where the agreement includes a severance clause providing that unenforceable terms should be severed.[19]

That approach may make some sense when considering contracts negotiated between two sophisticated parties, but it makes little sense in the context of contracts of adhesion—particularly consumer and employment contracts—where the consumer or employee is unlikely to have even read the complete agreement, let alone to have entered into it with an intention to be bound by all of its provisions. Rather, in these contexts, when deciding whether to sever illegal terms, this legislation instructs courts to consider (1) whether severing would provide the drafter with an incentive to include such terms or remove the incentive *not* to include such terms, (2) whether the inclusion of these terms might exert an *in terrorem* effect on the offeree, and (3) whether the drafter has acted in bad faith.

This analysis is critical for at least two reasons. First, because of their own limitations, it is impossible for courts to police the legality of *all* contracts on a *post hoc* basis. Therefore, to protect against the purposeful subversion of contract-enforceability doctrines, the law must sufficiently deter the inclusion of illegal terms

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[18] *See, e.g.*, *Booker v. Robert Half Int'l, Inc.*, 413 F.3d 77, 79 (D.C. Cir. 2005); *Bynum v. Maplebear Inc.,* 160 F. Supp. 3d 527, 537 (E.D.N.Y. 2016); *McLaurin v. Russell Sigler, Inc.*, 155 F. Supp. 3d 1042, 1044 (C.D. Cal. 2016); *Pollard v. ETS PC, Inc.,* 2016 WL 2983530, at *9 (D. Colo. May 12, 2016); *Coronado v. D.N. W. Houston, Inc.*, 2015 WL 5781375, at *11 (S.D. Tex. Sept. 30, 2015).

[19] *Gannon v. Circuit City Stores, Inc.*, 262 F.3d 677, 680 (8th Cir. 2001).

at the drafting stage.[20] Second, contract law must protect against the *in terrorem* effects of clearly unenforceable contract terms. As courts have recognized in a number of contexts—including when examining landlord-tenant agreements and covenants not to compete—courts should refuse to sever illegal terms where the inclusion of those terms may prevent parties from asserting their legal rights or, perversely, from challenging the enforcement of the same illegal terms.[21]

C. FAA Preemption

Title X applies to all contracts and not just to arbitration agreements, but an issue sure to be raised is whether the Federal Arbitration Act (FAA) preempts Title X as it relates to arbitration agreements. Severance doctrine has received increased attention over the past year because of the possibility (now mooted) that the Supreme Court would consider that issue in *MHN Gov't Servs, Inc. v. Zaborowski*,[22] a case where the lower court refused to merely sever multiple illegal terms found in an arbitration clause in an employment contract.[23] Instead the court refused to enforce the arbitration requirement. The defendant who drafted the contract argued that the court had applied a California rule of decision that (contrary to generally applicable contract law) disfavored severance in cases involving arbitration clauses.[24] The case settled before the Court could resolve the appeal.

The defendant in *Zaborowski* might be right that *if* California had a different rule for severance in arbitration agreements than in other form contracts, the

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[20] *See generally*, Russell Korobkin, *Bounded Rationality, Standard Form Contracts, and Unconscionability*, 70 U. CHI. L. REV. 1203, 1288 (2003) ("[I]t is important for courts to provide sellers with the maximum incentive not only to attempt to draft efficient non-salient form terms, but also to invest time and resources in doing so.").

[21] *Summers v. Crestview Apartments*, 236 P.3d 586, 593 (Mont. 2010); *Baierl v. McTaggart*, 629 N.W.2d 277, 285 (Wis. 2001); Harlan M. Blake, *Employee Agreements Not to Compete*, 73 HARV. L. REV. 625, 682 (1960) ("For every covenant [not to compete] that finds its way to court, there are thousands which exercise an in terrorem effect on employees who respect their contractual obligations and on competitors who fear legal complications if they employ a covenantor, or who are anxious to maintain gentlemanly relations with their competitors.").

[22] *MHN Gov't Servs., Inc. v. Zaborowski*, 136 S. Ct. 27 (2015).

[23] *MHN Gov't Servs., Inc. v. Zaborowski*, 136 S. Ct. 1539 (2016).

[24] Br. for Petitioners, *MHN v. Gov't Servs., Inc. v. Zaborwoski*, 14-1458 (U.S. 2015), *available at* http://www.scotusblog.com/wp-content/uploads/2015/12/14-1458ts.pdf (framing question presented as: "The Federal Arbitration Act (FAA) provides that an arbitration agreement shall be enforced 'save upon such grounds as exist at law or in equity for the revocation of any contract,' 9 U.S.C. § 2. California law applies one rule of contract severability to contracts in general, and a separate rule of contract severability to agreements to arbitrate. The arbitration-only rule disfavors arbitration and applies even when the agreement contains an express severability clause. Its application in this case conflicts with binding precedent of this Court and with opinions of four other courts of appeals").

arbitration-specific rule would be preempted. But, as long as the doctrine is not arbitration-specific—in other words, as long as it applies to other contracts in the same setting that do not involve arbitration—then it should not be preempted by the FAA.

To avoid FAA preemption, however, it is not enough for this legislation to merely fail to mention arbitration by name. Even state rules that do not mention arbitration are preempted if they are designed to target arbitration agreements as opposed to other types of contracts.[25]

For example, the California doctrine that the Court was prepared to address in *Zaborowski* did not expressly mention arbitration, but critics (and, it seems, at least four members of the Supreme Court) were skeptical that it was a generally applicable rule. One problem, it seems, was that many lower courts expressed the doctrine as involving the mere counting of unconscionable terms—if an arbitration agreement included "multiple" illegal terms, the court would deny enforcement of the entire arbitration agreement.[26] That mechanical analysis might strike some as conflicting with the traditional approach to severance that encourages courts to "engage in [an] equitable and fact specific analysis [of the purpose of the parties] with a liberal preference for severability."[27] And because that analysis seems to diverge from general contract doctrine in this way, courts might be skeptical that it is actually a generally applicable rule.

To craft an effective severance rule that would survive preemption, states should strive to ground their severance doctrine in long-standing principles of contract law that apply outside of the arbitration context. Even before arbitration clauses became prevalent in consumer and employment contracts, scholars and judges grappled with whether a severance doctrine that examined the purposes of the parties made much sense when it came to adhesive contracts. They developed a set of principles specific to those contacts. The incentive-oriented analysis outlined here is rooted in such principles.

While commentators and courts have long discussed a preference for severance, they have frequently also acknowledged concern for drafter overreach—or the drafter having his cake and eating it too. As the notes to the Restatement (Second) of Contracts provide, "a court will not aid a party who has taken advantage of his dominant bargaining power to extract from the other party a promise that is clearly so broad as to offend public policy by redrafting the agreement so as to make a part

[25] Mortensen v. Bresnan Commc'ns, LLC, 722 F.3d 1151, 1159 (9th Cir. 2013).
[26] *See Armendariz v. Found. Health Psychcare Servs., Inc.,* 6 P.3d 669, 695 (Cal. 2000).
[27] Br. of Chamber of Commerce of the U.S.A. as *Amicus Curiae* in Support of Petitioners, *MHN*, No. 14-1458 (Dec. 2014).

of the promise enforceable."[28] Indeed, since the beginning of the proliferation of contracts of adhesion there has been a concern that severing unenforceable terms in these contracts may create an incentive for drafters to include as many unfair terms as possible, without fear that the inclusion of these terms will prevent enforcement of the agreement as a whole.[29]

Outside of the arbitration context, courts have considered drafter incentives and bad faith in deciding not to merely sever unconscionable terms. The issue has been particularly likely to arise in cases where drafters might have an incentive to overreach or chill the lawful behavior of the offeree, for example in landlord-tenant cases and in employment agreements containing covenants not to compete.[30]

This approach, therefore, avoids the critique that it is arbitration focused. For all contracts of adhesion, it allows courts to continue to engage in the kind of equitable and fact-specific analysis that is commonly applied to the question whether to sever illegal terms. But unlike the severance analysis normally applied to negotiated contracts, it recognizes that parties to adhesive contracts will rarely have a mutual purpose that the court should attempt to preserve in crafting a remedy for unconscionable terms. Instead, for these contracts, courts should look to the drafter's aims and incentives and, to the extent they exist, the parties' *actual* understanding of the contract's purpose.

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[28] Restatement (Second) of Contracts § 184, cmt. (b) (1981).

[29] *See, e.g.*, Harlan M. Blake, *Employee Agreements Not to Compete*, 73 HARV. L. REV. 625, 683 (1960) ("If severance is generally applied, employers can fashion truly ominous covenants with confidence that they will be pared down and enforced when the facts of a particular case are not unreasonable. This smacks of having one's employee's cake, and eating it too.").

[30] *Summers v. Crestview Apartments*, 236 P.3d 586, 593 (Mont. 2010); *Baierl v. McTaggart*, 629 N.W.2d 277, 285 (Wis. 2001); Harlan M. Blake, *Employee Agreements Not to Compete*, 73 HARV. L. REV. 625, 682 (1960) ("For every covenant [not to compete] that finds its way to court, there are thousands which exercise an *in terrorem* effect on employees who respect their contractual obligations and on competitors who fear legal complications if they employ a covenantor, or who are anxious to maintain gentlemanly relations with their competitors.").