California's Court of Appeal Provides Guidance on the Application of Arbitration Clauses

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May 20, 2020

In April the California Court of Appeal, Second District, addressed the interpretation and applicability of arbitration terms in consumer agreements in *Dennison v. Rosland Capital LLC* (Case No. B295350). Practitioners should take note of the Court's decision as guidance in both drafting and interpreting arbitration clauses.

Specifically, the Court upheld the trial court's order denying Defendant's motion to compel arbitration. In reaching its decision, the Court evaluated whether a term in a purchase agreement properly gave an arbitrator the authority to decide whether disputes arising from the contract were subject to arbitration.

Plaintiff/Respondent in this case was an 82-year old widower and retired Naval aviator. After seeing Defendants' television advertisements promoting investment in precious metals, Plaintiff contacted Rosland Capital and purchased nearly $50,000 of gold and silver coins. Thereafter, Rosland Capital's agent allegedly contacted Plaintiff repeatedly, with Plaintiff eventually placing approximately $200,000 in total orders. Plaintiff filed suit against Defendants in California Superior Court, alleging the price he paid for the coins was significantly higher than their actual value. The seller moved to compel arbitration based on the Customer Agreement signed by Plaintiff when he placed his first order. The trial court denied the motion to compel; Defendants appealed that decision.

The Customer Agreement was described by the Court of Appeals as a standard form agreement: "two pages long, in two compressed side by side columns, printed in extremely small font. It is impossible to read without a magnifying glass." The Agreement itself contained an arbitration clause providing that the "Customer agrees to arbitrate all controversies between Customer and Rosland . . . arising out of or relating in any way to the products or this agreement, including the determination of the scope or applicability of this agreement to arbitrate . . ." Plaintiff argued the Agreement was procedurally and substantively unconscionable, making the arbitration clause unenforceable. Defendants argued that the Agreement delegated the authority to determine the unconscionability of the Agreement to the arbitrator, not the Court.

The Court noted that, under California Law, a presumption exists that the trial court will determine arbitrability in the absence of clear and unmistakable evidence that the parties

intended the arbitrator to decide arbitrability.[i] The Agreement contained language purporting to grant to the arbitrator the authority to determine the scope or applicability of the arbitration agreement. However, the Agreement also contained a severability clause providing that "[i]f any provision of this agreement is held by a court of competent jurisdiction to be void, invalid, or unenforceable," such term was severable.

Where a contract includes a severability clause stating that a court of competent jurisdiction may excise an unconscionable provision, there is no clear and unmistakable delegation to the arbitrator to decide if the arbitration agreement is enforceable, and therefore the issue of scope of arbitration remains with the court.[ii] Given the severability clause in the Agreement, the Court reasoned, there was no clear and unmistakable delegation of authority to the arbitrator to determine if the provision as to arbitration of the scope of the Agreement itself is unconscionable.

Having determined that the trial court, and not an arbitrator, was the proper authority to determine arbitrability of the action, the Appellate Court evaluated the trial court's determination that the Agreement was unconscionable *de novo*. The Appellate Court found ample evidence that the Agreement was unconscionable. The Court disagreed with Defendants' assertion that Plaintiff could not show procedural unconscionability because his lifetime of experience, including his military service, should have allowed him to negotiate the terms of the Agreement: "An 82-year-old consumer who calls a telephone number displayed in a television ad to make his first-ever investment in the highly volatile precious metals market, no matter how sophisticated he may be in other matters, cannot reasonably be expected to consider negotiating the terms of a form contract in such tiny print it cannot be read without a magnifying glass." The Court further noted that in the context of consumer contracts, the Supreme Court has never required a party to show that it attempted to negotiate standardized contract provisions as a prerequisite to establishing unconscionability.[iii]

Moreover, the Appellate Court found the contract lacked mutuality in the application of the arbitration clause, limited Defendants' liability, and limited the statute of limitations for claims against Defendants. Due to the pervasive nature of the Agreement's unconscionable clauses, the Court of Appeals determined it could not serve the interests of justice by severing any single provision of the contract. An agreement to arbitrate is permeated by unconscionability where it contains more than one unconscionable provision, indicating a systemic effort to impose arbitration on the non-drafting party where it would work to the drafting party's advantage. As in this case, where a court cannot reform the contract by striking a single clause, but instead would have to augment it with additional terms, the court must void the entire agreement.[iv] In so finding, the Court of Appeals upheld the trial court's denial of the motion to compel arbitration, and awarded costs to Plaintiff.

For practitioners, the key takeaways from this decision are twofold. First, to carefully draft or evaluate clients' arbitration clauses to determine the applicability of clauses purporting to grant to an arbitrator the decision of arbitrability, because that may be defeated when used

in connection with severability clauses. Second, as always, attorneys must be careful to not overreach when drafting arbitration clauses, as an agreement "permeated by unconscionability" will be voided by the court.

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[i] *Aanderud v. Superior Court*, (2017) 13 Cal.App.5th 880, 891-892.
[ii] *Baker v. Osborne Development Corp.*, (2008) 159 Cal.App.4th 884, 891-894.
[iii] *Sanchez v. Valencia Holding Co., LLC*, (2015) 61 Cal.4th 899, 914.
[iv] *Magno v. The College Network, Inc.*, (2016) 1 Cal.App.5th 277, 292.