Kilpatrick

AUGUST 29, 2024

California Supreme Court outlines severance standards for unconscionable contract provisions in arbitration case

by Michele Floyd

Issues surrounding unconscionability and severance are commonplace in motions to compel arbitration, especially in California. Under California Civil Code section 1670.5, a court has three options when presented with an unconscionable contract provision: it can refuse to enforce the contract; it can sever the unconscionable provision and enforce the remainder of the contract; or it can limit the application of the contract provision to avoid unconscionable results. While the statute gives courts broad discretion to choose among the three options, case law instructs that invalidating the contract should be reserved for situations where the contract is "permeated" with unconscionability.

Before the California Supreme Court's recent decision in *Ramirez v. Charter Communications, Inc.,* 551 P.3d 520 (Cal. 2024), case law provided little guidance on when a contract was "permeated" with unconscionability. Many courts made the analysis a quantitative one, often finding that a single unconscionable provision was enough to invalidate the contract. But *Ramirez* confirms that the proper analysis is qualitative, not quantitative, and that one unconscionable provision is not necessarily enough to invalidate a contract as a whole.

The *Ramirez* case involved a motion to compel arbitration pursuant to an employment contract. Plaintiff argued that four aspects of the arbitration agreement were unconscionable: it lacked mutuality in the claims subject to arbitration; it shortened the statute of limitations; it limited discovery; and it impermissibly permitted attorneys' fees for a successful motion to compel. The trial court agreed. Rather than severing the offending provisions, it invalidated the agreement entirely and denied the motion to compel. The intermediate appellate court affirmed. *Id.* at 528.

The Supreme Court reversed and remanded. While the high court agreed that three of the four provisions in the arbitration provision were unconscionable, it found that both the trial court and the appellate court relied on an incorrect standard in deciding to invalidate the contract rather than sever the unconscionable provisions. *Id.* at 544-48.

The Supreme Court outlined the correct analysis to be applied on remand. First, it confirmed that the analysis is qualitative and not quantitative: "[n]o bright line rule *requires* a court to refuse enforcement if a contract has more than one unconscionable term. Likewise, a court is not *required* to sever or restrict an unconscionable term if an agreement has only a single such term." *Id.* at 546 (emphasis in original). Noting that the "strong legislative and judicial preference" is to sever and enforce (*id.* at 544), the Court found severance appropriate where "the illegality is collateral to the contract's main purpose; it is possible to cure the illegality by means of severance; *and* enforcing the balance of the contract would be in the interests of justice." *Id.* at 547 (emphasis in original).