Graham v. Scissor-Tail, Inc.: Unconscionability of Presumptively Biased Arbitration Clauses Within Adhesion Contracts

In *Graham v. Scissor-Tail, Inc.*,[1] the California Supreme Court unanimously held that an arbitration provision in a union form contract was an unenforceable component of a contract of adhesion. The court refused to enforce the provision because it violated the "minimum levels of integrity" under which arbitration procedures must be conducted.[2] The court thus vacated Scissor-Tail's arbitration award but allowed the parties to decide whether they wished to proceed with a "suitable" arbitrator.[3] The case is significant because it extends the protection of adhesion contract theory to a party with sufficient bargaining power to protect his own interests. The court also adopted a rule of substantive unconscionability denying enforcement of the union arbitration clause regardless of whether its adhesive quality rendered it procedurally flawed.

This Note argues that *Graham* was incorrectly decided. The court's adhesion finding is inconsistent with the underlying spirit of adhesion theory. Moreover, the court should not have rendered the arbitration clause unenforceable because it is presumptively unfair but should instead have left open the question whether it is enforceable in freely bargained contracts. Courts should enforce covenants when they are exchanged for valuable consideration. If a particular covenant should be unenforceable as a matter of policy it is the legislature's prerogative to prohibit such terms.

Part I sets forth the *Graham* facts and Part II discusses the court's reasoning. The legal background is examined in Part III. Part IV analyzes the court's holding in light of existing law and concludes that the court should not have found the form contract to be adhesive and that the court's substantive prohibition of the union arbitration clause is unsound public policy.

1. 28 Cal. 3d 807, 623 P.2d 165, 171 Cal. Rptr. 604 (1981) (per curiam).
2. *Id.* at 827, 623 P.2d at 177, 171 Cal. Rptr. at 616.
3. *Id.* at 831, 623 P.2d at 180, 171 Cal. Rptr. at 619.

I
THE CASE

A. The Facts

Bill Graham, an experienced concert promoter, and Scissor-Tail, Inc., a corporation wholly owned by musician Leon Russell, entered into a series of contracts for Russell's musical services in concerts in Ontario, Oakland, Long Island, and Philadelphia. Russell, a member of the American Federation of Musicians (A.F. of M.), a musicians' union, was required to use the union's form contracts. Graham and Scissor-Tail thus used these forms to consummate their agreements. The forms required that disputes arising under the contracts were to be submitted to arbitration before union arbitrators.[4]

The Ontario concert produced a net loss, but the Oakland concert produced a net gain. A dispute then arose over who was to bear the Ontario loss and whether it should be offset against the Oakland concert's profits. The contracts did not address this question.

Graham subsequently filed a breach of contract suit and Scissor-Tail successfully moved to compel arbitration. The A.F. of M., as arbitrator and without hearing, ruled that Graham should bear the unallocated loss. After Graham's protest and Scissor-Tail's consent, the union reopened the case and granted a hearing. The union appointed a former executive officer and longtime union member as arbitrator. This arbitrator, who had heard many previous union matters, ruled against Graham and made an award in conformity with his ruling. The appellate court reversed the Superior Court's confirmation of the award,[5] and Scissor-Tail appealed to the California Supreme Court.

B. The Opinion

The supreme court first considered whether the arbitration provision was a component of a contract of adhesion. Using Justice Tobriner's "serviceable general definition,"[6] the court concluded that in light of the circumstances the contract "may be fairly described as adhe-

4. The form B contract used in *Graham* provided that:

> 9. In accordance with the Constitution, By-laws, Rules and Regulations of the Federation, the parties will submit every claim, dispute, controversy or difference involving the musical services arising out of or connected with this contract and the engagement covered thereby for determination by the International Executive Board of the Federation or a similar board of an appropriate local thereof and such determination shall be conclusive, final and binding upon the parties.

Id. at 813, 623 P.2d at 168, 171 Cal. Rptr. at 607.

5. Graham v. Scissor-Tail, 162 Cal. Rptr. 798 (2d Dist. 1980), *officially depublished pursuant to* CAL. CT. R. 976(d) (West 1982).

6. 28 Cal. 3d at 817, 623 P.2d at 171, 171 Cal. Rptr. at 610; *see infra* note 21 and accompanying text.

sive."[7] The court reasoned that the union's monopoly over all significant performers and its requirement that all members use only union contracts made Graham's adherence to the form contract a business reality.[8] The court rejected Scissor-Tail's arguments that Graham's prominence and the many negotiable provisions prevented a finding of adhesion.[9] The court thus concluded that Graham was subjected to a take-it-or-leave-it contract.

The court then considered whether the arbitration clause in the adhesive agreement was nonetheless enforceable according to its terms. Noting that there are "two judicially imposed limitations on the enforcement of adhesion contracts,"[10] the court found the arbitration clause unenforceable on the ground, applicable to all contracts, that the clause was unconscionable.[11] While arbitrators need not be completely neutral,[12] arbitrations must operate within some minimum levels of integrity.[13] Since the arbitration at issue was conducted by a single arbitrator whose interests were "identical" to Scissor-Tail's, the arbitrator had "an interest in the outcome which, in the view of the law, will render fair and reasoned decision, based on the evidence presented, a virtual impossibility."[14]

The second limitation on the enforcement of adhesion contracts is that they must comport with the reasonable expectations of the adhering party.[15] The reasonable expectations rule, unlike the unconscionability prohibition, is a special rule applicable only to adhesion contracts and is similar but not identical to the rule that a contract is construed against the drafter.[16] Because the union arbitration was not "in any

7. 28 Cal. 3d at 818, 623 P.2d at 171, 171 Cal. Rptr. at 610.

8. *Id.* at 818-19, 623 P.2d at 172, 171 Cal. Rptr. at 611.

9. *Id.* The court thought that negotiable provisions concerning the concert's length, time, and date were of "relatively minor significance in comparison to those imposed by Scissor-Tail, which included not only the provision concerning the manner and rate of compensation but that dictating a union forum for the resolution of any disputes." *Id.*

10. *Id.* at 820, 623 P.2d at 172-73, 171 Cal. Rptr. at 612.

11. *Id.* at 826, 623 P.2d at 177, 171 Cal. Rptr. at 616. The court's unconscionability finding is the first such finding since the enactment of the unconscionability statute. CAL. CIV. CODE § 1670.5 (West 1976).

12. 28 Cal. 3d at 824, 623 P.2d at 175-76, 171 Cal. Rptr. at 615; *see also infra* notes 40-45 and accompanying text.

13. 28 Cal. 3d at 827, 623 P.2d at 177, 171 Cal. Rptr. at 616.

14. *Id.*

15. *Id.* at 820, 623 P.2d at 172-73, 171 Cal. Rptr. at 612. *See also* Gray v. Zurich Ins. Co., 65 Cal. 2d 263, 269-70, 419 P.2d 168, 171-72, 54 Cal. Rptr. 104, 107-09 (1966); Steven v. Fidelity & Casualty Co., 58 Cal. 2d 862, 868-69, 377 P.2d 284, 288-89, 27 Cal. Rptr. 172, 176-77 (1962).

16. *See* Patterson, *The Interpretation and Construction of Contracts*, 64 COLUM. L. REV. 851, 854 (1964). The two rules have a similar impact on ambiguous terms—both protect the party deferring to terms dictated by the drafter. *See, e.g.*, Gray v. Zurich Ins. Co., 65 Cal. 2d at 271, 419 P.2d at 171, 54 Cal. Rptr. at 107 (uncertain terms in adhesion contract construed according to reasonable expectations of adhering party). If a term is unambiguous, however, the rules' applica-

way contrary to the reasonable expectations of plaintiff Graham,"[17] this limitation did not bar enforcement of the arbitration clause.

II
LEGAL BACKGROUND

A. Adhesion Theory in California

In general, parties may contract as they please if they do not violate judicially developed rules of procedure like fraud, duress, and mistake.[18] If standard form contracts are imposed by stronger parties upon those with lesser bargaining power, the weaker parties may be subject to abuse. Weaker or "adhering" parties may have no choice but to accept the harsh terms in a form contract because the subject matter is a necessity or because all other dealers offer similar terms. Moreover, the adhering party may not fully understand the contract's terms.[19]

To ameliorate the harsh consequences resulting from the enforcement of oppressive or unexpected terms, courts have developed a body of contract law known as adhesion theory.[20] California courts first recognized the doctrine in 1961 when a court of appeal defined an adhesion contract as "a standardized contract, which, imposed and drafted by the party of superior bargaining strength, relegates to the subscribing party only the opportunity to adhere to the contract or reject it."[21]

In early decisions, the California Supreme Court found contracts

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tions diverge. Under a general rule of construction, the plain meaning of the provision is given effect. *See* Patterson, *supra*, at 855. On the other hand, the reasonable expectations rule overrides plain, unambiguous terms if they are contrary to the reasonable expectations of the adhering party. For example, a clause may be unambiguous yet inconsistent with reasonable expectations if it is buried in fine print in a lengthy contract. Under the general rule, such a clause would be fully enforceable even if not read by the complaining party. *See, e.g.*, Madden v. Kaiser Found. Hosps., 17 Cal. 3d 699, 710, 552 P.2d 1178, 1185, 131 Cal. Rptr. 882, 889 (1976). The reasonable expectations rule permits the opposite result because even unambiguous terms may not be reasonably expected. *See, e.g.*, Spence v. Omnibus Indus., 44 Cal. App. 3d 970, 974, 119 Cal. Rptr. 171, 173 (4th Dist. 1975). Most courts, however, still equate the two rules where there is no ambiguity by enforcing the contract according to its terms. *See, e.g.*, Yeng Sue Chow v. Levi Strauss & Co., 49 Cal. App. 3d 315, 325, 122 Cal. Rptr. 816, 821-22 (1st Dist. 1975) (adhesion contracts "*are perfectly valid and, in absence of ambiguity, are enforced according to their terms*") (emphasis in original).

17. 28 Cal. 3d at 821, 623 P.2d at 173, 171 Cal. Rptr. at 612.

18. *See* Hurd & Bush, *Unconscionability: A Matter of Conscience for California Consumers*, 25 HASTINGS L.J. 1, 15 (1973); Comment, *Unconscionability in Standard Forms*, 64 CALIF. L. REV. 1151, 1152-53 (1976); *see also* Kessler, *Contracts of Adhesion—Some Thoughts About Freedom of Contract*, 43 COLUM. L. REV. 629, 630, 640 (1943) (freedom of contract was "the inevitable counterpart of a free enterprise system").

19. *See* Kessler, *supra* note 18, at 632.

20. *See* Sybert, *Adhesion Theory in California: A Suggested Redefinition and its Application to Banking*, 11 LOY. L.A.L. REV. 297, 301-05 (1978).

21. Neal v. State Farm Ins. Co., 188 Cal. App. 2d 690, 694, 10 Cal. Rptr. 781, 784 (1st Dist. 1961) (Tobriner, J.).

adhesive if the adhering party had no choice as to the terms of the contract or the transaction itself.[22] More recently, California courts have expanded the adhesion analysis to cases in which there may have been some choice, but no reasonable choice, as to the terms or transaction.[23] The California Supreme Court next expanded the notion of choice by holding that choice can be exercised by an organization on an individual's behalf.

Choice by means of an organization was first recognized in *Madden v. Kaiser Foundation Hospitals*,[24] decided five years before *Graham*. In *Madden*, plaintiff state employee sought to avoid an arbitration provision in the health benefit plan covering state employees on the grounds that the health plan was a contract of adhesion. In rejecting plaintiff's contention, the supreme court identified two characteristics of adhesion contracts. First, the stronger party drafts the contract and the weaker party has no opportunity to negotiate its terms, either personally or through an agent.[25] Second, the weaker party lacks a realistic opportunity to look elsewhere for a more favorable contract and must adhere to the standardized agreement or forego the needed service.[26] Applying these factors, the court found that while plaintiff had

22. For example, in Steven v. Fidelity & Casualty Co., 58 Cal. 2d 862, 377 P.2d 284, 27 Cal. Rptr. 172 (1962), the court, in an opinion authored by Justice Tobriner, held that an airplane life insurance policy was a contract of adhesion because "the insurer had adopted a means of selling policies which makes bargaining totally impossible." *Id.* at 883, 377 P.2d at 297, 27 Cal. Rptr. at 185. One year later, in Tunkl v. Regents of the Univ. of Cal., 60 Cal. 2d 92, 383 P.2d 441, 32 Cal. Rptr. 33 (1963), the supreme court, again led by Justice Tobriner, found an agreement between a hospital and an entering patient to be adhesive: "[the] patient is in no position to reject the proffered agreement, to bargain with the hospital, or in lieu of agreement to find another hospital." *Id.* at 102, 383 P.2d at 447, 32 Cal. Rptr. at 39.

23. For example, in Wheeler v. St. Joseph's Hosp., 63 Cal. App. 3d 345, 133 Cal. Rptr. 775 (4th Dist. 1976), a patient entered a particular hospital at the direction of his doctor to undergo several tests in connection with a coronary problem. Though the patient clearly could have gone to another hospital, the court held that the hospital's standard admission form was a contract of adhesion because a patient normally feels that he has no choice but to seek admission to the hospital designated by his physician. *Id.* at 366, 133 Cal. Rptr. at 789. For a general discussion of the realistic choice standard, see Slawson, *Mass Contracts: Lawful Fraud in California*, 48 S. CAL. L. REV. 1, 47-49 (1974).

24. 17 Cal. 3d 699, 552 P.2d 1178, 131 Cal. Rptr. 882 (1976).

25. *Id.* at 711, 552 P.2d at 1185, 131 Cal. Rptr. at 889.

26. *Id.* In contrast, in Walnut Creek Pipe Distrib., Inc. v. Gates Rubber Co., 228 Cal. App. 2d 810, 39 Cal. Rptr. 767 (1st Dist. 1964), a contract was not adhesive because the alleged adhering party could go elsewhere for more favorable terms. "There was no indication that the plastic pipe and other products were available only from Gates. Rather, the record indicates that other similar products were available and that in fact, after the fall of 1959, respondent acquired its plastic pipe from other manufacturers." *Id.* at 815, 39 Cal. Rptr. at 771. *See also* Sybert, *supra* note 20, at 318 ("One who does not have to enter a given relationship, but who nevertheless does so, can fairly be said to have agreed to the terms even if he or she has no option to vary them.").

The *Madden* court listed a third characteristic of adhesion contracts—they usually contain harsh or oppressive terms limiting the stronger party's liability. 17 Cal. 3d at 711, 552 P.2d at 1186, 131 Cal. Rptr. at 890. This characteristic, however, seems to be an empirical observation

not personally participated in the negotiations, she had been represented by a board of administration that had sufficient bargaining strength to secure more medical protection for employees.[27] *Madden* thus recognizes that individuals may exercise their "choice" through interorganizational bargaining. In addition, the court held that plaintiff had realistic alternatives—she could have selected several negotiated plans that did not contain the arbitration clause, or she could have contracted privately for a medical plan.[28] Thus, that plaintiff signed a standard form agreement and had no personal choice as to its terms did not make the contract adhesive.

In sum, California courts have extended the application of adhesion theory from situations in which parties have no choice except to enter into an agreement to those in which parties have some choice, but not a reasonable one. At the same time, however, the supreme court in *Madden* recognized that freedom to contract still exists in the context of organizational bargaining—individuals can exercise their choice through institutions with sufficient bargaining strength to deal fairly with other powerful entities.

B. Unconscionability

1. Procedural Versus Substantive Unconscionability

Unconscionability is an elusive doctrine invoked by courts to prevent the enforcement of a harsh or oppressive contract or provision[29] that "shocks the conscience"[30] or "affronts the sense of dignity."[31] Scholars have long distinguished between procedural unconscionability, directed at defects in the bargaining process, and substantive unconscionability, directed at the content of a contract.[32] If a contract is procedurally unconscionable, the court renders the contract unenforceable because there is a significant bargaining defect.[33] A contract may be procedurally unconscionable but nonetheless enforceable if the parties, subsequent to initial agreement, dickered over and freely negoti-

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rather than part of the definition of adhesion because adhesion may exist independent of the harshness of contractual terms.

27. 17 Cal. 3d at 711, 552 P.2d at 1185, 131 Cal. Rptr. at 889.

28. *Id.* at 711, 552 P.2d at 1186, 131 Cal. Rptr. at 890.

29. The unconscionability defense is not limited to adhesion cases. It is an independent ground for refusing to enforce a contract. *See generally* J. CALAMARI & J. PERILLO, THE LAW OF CONTRACTS 316-28 (2d ed. 1977) [hereinafter cited as CALAMARI & PERILLO].

30. *See* Jacklich v. Baer, 57 Cal. App. 2d 684, 693, 135 P.2d 179, 183 (3d Dist. 1943).

31. *See* CALAMARI & PERILLO, *supra* note 29, at 325.

32. *See generally* Ellinghaus, *In Defense of Unconscionability*, 78 YALE L.J. 757, 773-808 (1969); Gordley, *Equality in Exchange*, 69 CALIF. L. REV. 1587, 1633-34 (1981); Leff, *Unconscionability and the Code—The Emperor's New Clause*, 115 U. PA. L. REV. 485 (1967); Slawson, *Standard Form Contracts and Democratic Control of Lawmaking Power*, 84 HARV. L. REV. 529, 565 (1971).

33. *See* Leff, *supra* note 32, at 489.

ated the contract even if the latter is identical in content to the former contract. If a contract or provision is substantively unconscionable, however, it is unenforceable whatever the bargaining context because the court's objection to the contract's content would be unchanged even if the contract were freely negotiated.[34] Though courts have yet to implement the commentators' terminology distinguishing between substantive and procedural unconscionability, they do base their unconscionability findings on either the offensiveness of the bargaining process, the offensiveness of the subject matter, or a combination of both. This terminology is thus useful to describe the implications of a court's holding even though it does not appear in judicial opinions.

2. California Cases on Unconscionability

Though unconscionability has deep roots in our legal system, California's unconscionability case law is relatively sparse. Early cases addressing unconscionability typically found price unconscionability—the gross inadequacy of consideration—to be evidence of fraud.[35] In later cases, however, California courts shifted their focus from whether gross inadequacy of consideration was evidence of fraud to whether such inadequacy itself is the harm to be avoided. Thus, in *Jacklich v. Baer*,[36] a contract provided that a payment of five dollars would extend for five years a creditor's right to collect ten percent of the debtor's earning. The court refused to enforce the contract on the grounds that it was unreasonable and unconscionable.[37] The court was concerned with the contract's content rather than the manner of negotiation. The contract's terms were unenforceable under all circumstances and was,

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34. *See* Gordley, *supra* note 32 at 1633 ("If the 'process' were unflawed, but still resulted in objectionable terms, the result would be 'substantive unconscionability' "); Leff, *supra* note 32, at 509.

35. In the first of a series of such cases, the court in State Fin. Co. v. Smith, 44 Cal. App. 2d 688, 112 P.2d 901 (1st Dist. 1941), found the sale of a worthless truck for $300 to be unconscionable and evidence of fraud. Since fraud occurs at the bargaining stage of a contract, the court's holding is closer to procedural than substantive unconscionability and presumably could have been reversed on a finding that fraud did not in fact exist. According to *Smith*, "[w]here the inadequacy is so gross as to shock the conscience and common sense of all men, it may amount both at law and in equity to proof of fraud, oppression and undue influence." *Id.* at 691-92, 112 P.2d at 903 (quoting 17 C.J.S. *Contracts* § 128 (1963)); *see also* Comment, *supra* note 18, at 1159 ("Many cases emphasize that an exorbitant price evidences defects in the formation process of the contract.").

Because the *Smith* court objected to the apparent fraud rather than the imbalance of consideration, it is likely that the court would have rendered a different decision had evidence established that there was in fact no fraud.

36. 57 Cal. App. 2d 684, 135 P.2d 179 (3d Dist. 1943).

37. *But see* Perry v. Bedford, 238 Cal. App. 2d 6, 11, 47 Cal. Rptr. 461, 464 (2d Dist. 1965) (land sale contract was "just and reasonable as to all parties" although buyer's lot did not have practical access to street).

in this Note's terminology, substantively unconscionable.[38] This reading of *Jacklich* is consistent with the Civil Code's unconscionability provision.[39]

C. Potential Bias in Arbitrations

1. The Code of Civil Procedure

Potential bias[40] of arbitrators is implicitly permitted by the California Code of Civil Procedure. The Code defers to privately arranged

38. The distinction between substantive and procedural unconscionability is not clear in price unconscionability cases. *See* Gordley, *supra* note 32, at 1633. Price unconscionability may be viewed as either a substantive defect or indicative of a procedural flaw. That is, a contract not freely negotiated will most likely exhibit gross one-sidedness of consideration, while a grossly disproportionate contract will usually arise if there has been a defect in the bargaining process.

Nevertheless, it is important to read *Jacklich* as a substantive unconscionability case because there may be situations where a clause standing alone is so unfair as to shock the conscience regardless of the bargaining context. Courts may wish to deuy enforcement of such clauses on unconscionability grounds even if the contract is not grossly imbalanced. In such a case, the unconscionability cannot be considered as evidence of fraud. Rather, as in *Jacklich*, the improper content itself must be the basis for the court's refusal to enforce the contract or provision.

39. Substantive unconscionability is authorized by both case law, *see supra* notes 35-39 and accompanying text, and statute. California recently adopted CAL. CIV. CODE § 1670.5 (West Supp. 1982), which is identical to U.C.C. § 2-302. That section reads:

> (a) If the court as a matter of law finds the contract or any clause of the contract to have been unconscionable at the tiune it was made the court may refuse to enforce the contract, or it may enforce the remainder of the contract without the unconscionable clause, or it may so limit the application of any unconscionable clanse as to avoid any unconscionable result.
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> (b) When it is claimed or appears to the court that the contract or any clause thereof may be unconscionable the parties shall be afforded a reasonable opportunity to present evidence as to its commercial setting, purpose, and effect to aid the court in making the determinatiou.

CAL. CIV. CODE § 1670.5 (West Supp. 1982). For a review and discussion of § 1670.5, see *Review of Selected 1979 California Legislation*, 11 PAC. L.J. 391 (1979).

Prior to the enactment of the California statute there was great legislative concern that the rule would give courts the unqualified power to strike out terms, resulting "in the renegotiation of contracts in every case of disagreement with the fairness of provisions the parties accepted." Cal. State Bar Comm. on the Commercial Code, *The Uniform Commercial Code*, 37 CAL. ST. B.J. 117, 136 (1962). Nevertheless, the section was ultimately adopted and has been read by scholars as permitting courts to police contracts for substantive abuses despite the absence of bargaining defects. *See* Ellinghaus, *supra* uote 32 at 774-87 (recognizing that the notion that all clanses of type X, wherever found, are always unconsciouable is at least potentially feasible); Slawson, *supra* note 32, at 565 ("Unconscionability, therefore, slioud be concerned solely with the possible unenforceability of a writing against a party who liad consented to it").

40. At the outset, it is important to define terminology. Courts often refer to the "impression of possible bias" or "appareut bias." *See infra* notes 46-50 and accompanying text. Apparent and poteutial bias are not distinguisliable in the sense that situations wliere there is potential bias are also situations where there is an appearance of bias, and vice versa. Rather, the difference between potential and apparent bias is one of emplıasis. While apparent bias is concerned with the perception of parties that a proceeding is biased, potential bias is concerned with relationships that may lead to actual bias, apart from what parties perceive. Moreover, while an appearance of bias may be raised by any level of potential bias, it takes very little potential for bias to create an appearance of bias. *See infra* notes 114-15 and accompanying text.

The Code of Civil Procedure speaks in terms of nonneutrality. *See infra* uote 41 and accom-

arbitration procedures and admits the possibility that nonneutral arbitrators may be used.[41] The terms nonneutral and potentially biased may be used interchangeably; both allude to the possibility that an arbitrator may be partial to one of the parties to a dispute.[42] Moreover, the Code lists various grounds on which an arbitration award may be vacated,[43] and potential bias or nonneutrality are not among the listed grounds.[44] Courts have rejected challenges for potential bias of the arbitrators on the ground that it is not listed as a basis for vacating an arbitration award and that it is the legislature's prerogative to amend the code to include potential bias.[45]

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panying text. Since nonneutrality and potential bias are directed at the same goal—impartial arbitrators—the terms are synonymous and will be used interchangeably in this Note.

Finally, the *Graham* court spoke in terms of presumptive bias. 28 Cal. 3d at 821, 623 P.2d at 173, 171 Cal. Rptr. at 612. Presumptive bias is a subset of potential bias—that level of potential bias sufficiently great to lead to a presumption of actual bias. *See infra* notes 95-105 and accompanying text. A presumptively biased arbitrator is potentially biased, but a potentially biased arbitrator is not necessarily presumptively biased. Accordingly, these terms will not be used interchangeably in this Note.

41. CAL. CIV. PROC. CODE § 1281.6 (West 1972) reads in part: "If the arbitration agreement provides a method of appointing an arbitrator, such method shall be followed."

In addition to this deference to privately arranged arbitration, *id.* § 1282(d) reads: "If there is no neutral arbitrator, the powers and duties of a neutral arbitrator may be exercised by a majority of the arbitrators."

42. *See infra* note 40.

43. CAL. CIV. PROC. CODE § 1286.2 (West 1972) provides grounds for vacating arbitration awards:

> Subject to Section 1286.4, the court shall vacate the award if the court determines that:
> (a) The award was procured by corruption, fraud or other undue means;
> (b) There was corruption in any of the arbitrators;
> (c) The rights of such party were substantially prejudiced by misconduct of a neutral arbitrator;
> (d) The arbitrators exceeded their powers and the award cannot be corrected without affecting the merits of the decision upon the controversy submitted;
> (e) The rights of such party were substantially prejudiced by the refusal of the arbitrators to postpone the hearing upon sufficient cause being shown therefor or by the refusal of the arbitrators to hear evidence material to the controversy or by other conduct of the arbitrators contrary to the provisions of this title.

44. Actual bias or corruption, however, is a ground for vacating an arbitration award.

45. *See* Federico v. Frick, 3 Cal. App. 3d 872, 876, 84 Cal. Rptr. 74, 76 (2d Dist. 1970) ("potential unfairness resulting from the nonneutral nature of the controlling arbitrator is not a statutory ground for . . . vacation of the award"); Canadian Indem. Co. v. Ohm, 271 Cal. App. 2d 703, 707, 76 Cal. Rptr. 902, 904 (4th Dist. 1969) ("The sole grounds for vacating an arbitration award are those set forth in Code of Civil Procedure, section 1286.2").

However, Johnston v. Security Ins. Co., 6 Cal. App. 3d 839, 86 Cal. Rptr. 133 (2d Dist. 1970), established that the list of statutory gronnds for vacation is incomplete. *Johnston* adopted the rule enunciated in Commonwealth Coatings Corp. v. Continental Casualty Co., 393 U.S. 145 (1968), which held that nondisclosure of possible bias is a ground for vacating an award even though it is not provided for by statute.

Nevertheless, courts have not extended the statute to potential bias, instead requiring actual bias before vacating an award. *See* Arrieta v. Paine, Webber, Jackson & Curtis, Inc., 59 Cal. App. 3d 322, 330, 130 Cal. Rptr. 534, 538 (2d Dist. 1976) (arbitrators were not proven to be "*in fact* biased"); Gear v. Webster, 258 Cal. App. 2d 57, 63, 65 Cal. Rptr. 255, 258 (5th Dist. 1968) ("we are cited no instance of fraud or other equitable ground for setting aside the contract").

2. *Disclosure of Potential Bias*

While the use of potentially biased arbitrators is permitted, courts have limited their use by compelling disclosure of relationships that may create an impression of possible bias.[46] In the leading United States Supreme Court case, *Commonwealth Coatings Corp. v. Continental Casualty Co.*,[47] plaintiff subcontractor sued the sureties on the prime contractor's bond to recover money due for a paint job. The claim went to arbitration and defendants won. Plaintiff challenged the arbitration on the ground that the panel's neutral arbitrator had undisclosed, close business connections with defendant, having sporadically provided engineering services to defendants over a period of four to five years. The Supreme Court vacated the award because arbitrators must disclose any dealings that might create an impression of possible bias.[48] The *Commonwealth* rule has been adopted in California.[49]

Under the *Commonwealth* rule, once the relationships creating the possible bias have been disclosed the parties may then agree to use the arbitrators. Disclosure cases like *Commonwealth* punish the failure to disclose relationships that may create an impression of possible bias, not the existence of possible bias itself. Courts have rejected challenges to arbitration awards if suspect relationships have been fully disclosed.[50]

3. *Unsuccessful Challenges on the Ground of Potential Bias*

Courts have relied on factors other than potential bias to vacate unfair arbitration awards. In *Richards v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*,[51] for example, a customer was required to arbitrate its claim against a stockbrokerage firm under New York Stock Exchange rules providing for arbitration in New York by arbitrators chosen by the Exchange. The court held the arbitration provisions invalid, citing the "basic apparent unfairness" of the requirement that nonmembers

46. *See* Commonwealth Coatings Corp. v. Coutinental Casualty Co., 393 U.S. 145 (1968); Wheeler v. St. Joseph's Hosp., 63 Cal. App. 3d 345, 372, 133 Cal. Rptr. 775, 793 (4th Dist. 1976); Johnston v. Security Ins. Co., 6 Cal. App. 3d 839, 841-42, 86 Cal. Rptr. 133, 134-35 (2d Dist. 1970).

In *Johnston*, plaintiffs made a claim for payment of a fire loss under a policy issued by defendant. A dispute arose as to the amount payable and the parties resorted to arbitration. Each party appointed an appraiser to evaluate the dispute. The umpire was acquainted with the plaintiffs' attorney-appraiser. The umpire's award to plaintiffs was vacated on the ground that the umpire failed to meet his legal duty to disclose any business dealing or relationship that might create an impression of possible bias. *Id.* at 843-44, 86 Cal. Rptr. at 136.

47. 393 U.S. 145 (1968).

48. *Id.* at 149.

49. Johnston v. Security Ins. Co., 6 Cal. App. 3d at 841-44, 86 Cal. Rptr. at 134-36.

50. *See supra* note 45 and accompanying text.

51. 64 Cal. App. 3d 899, 135 Cal. Rptr. 26 (2d Dist. 1976).

submit their claims to exchange arbitrators,[52] but not basing its decision on this apparent unfairness.[53] Rather, the court refused to enforce the arbitration rules on the grounds that the arbitration clause was in "fine print" and was only incorporated into the contract by reference. The court said that "something more than a casual reference by incorporation is called for."[54]

Conversely, courts have enforced arbitration awards arising out of potentially biased arbitration procedures when the parties have notice of the potentially biased procedures and a choice of arbitrators. For example, in *Arrieta v. Paine, Webber, Jackson & Curtis, Inc.*,[55] a customer sued his stockbrokers. The parties stipulated to arbitration under either the rules of the New York Stock Exchange or the American Arbitration Association. The brokers chose the New York Stock Exchange arbitration, and the arbitration board ruled in their favor.

The customer then appealed from the superior court's confirmation of the award on the ground that the panel, with no neutral arbitrators, denied him due process and equal protection. The court rejected this contention because the customer had an opportunity to disqualify biased arbitrators[56] and because potential bias is not a ground for vacating the award.[57]

Arrieta relied on *Federico v. Frick*[58] for the proposition that potential unfairness from a nonneutral arbitrator does not justify vacation of the arbitration award. In *Federico*, plaintiff was hired to play the piano

52. *Id.* at 903, 135 Cal. Rptr. at 28. The agreement also permitted the Exchange to change the arbitration rules.

53. For a discussion of the differences between apparent, potential, and presumptive bias, see *supra* note 40.

54. 64 Cal. App. 3d at 903-04, 135 Cal. Rptr. at 28. Courts in other contexts have relied on procedural flaws to strike oppressive terms. For example, Steven v. Fidelity & Casualty Co., 58 Cal. 2d 862, 377 P.2d 284, 27 Cal. Rptr. 172 (1962) described an exclusionary clause in an insurance contract as tending "toward the harsh and unconscionable," *id.* at 878, 377 P.2d at 294, 27 Cal. Rptr. at 182, yet refused its enforcement, because, inter alia, it was "placed in an inconspicuous position in the document," *id.* at 884, 377 P.2d at 298, 27 Cal. Rptr. at 186. *See also* Gray v. Zurich Ins. Co., 65 Cal. 2d 263, 271, 419 P.2d 168, 171, 54 Cal. Rptr. 104, 107 (1966) (striking exclusionary clause by construing contract according to adhering party's reasonable expectations). This judicial avoidance of rendering judgments on the substance of contracts prompted one commentator to observe that:

> Thus, despite indications of increasing freedom for courts to manipulate contract terms, the concept of unconscionability still directs judicial inquiry to the bargaining behavior of the parties. Courts search for defects in the formation process—the presence of unfair surprise, the absence of bargaining over a particular term, or disparity in bargaining power. A contract exhibiting one of these aspects of procedural unconscionability is suspect, and surprising, unbargained for, or highly oppressive terms may not be enforced.

Comment, *supra* note 18, at 1162.

55. 59 Cal. App. 3d 322, 130 Cal. Rptr. 534 (2d Dist. 1976).

56. *Id.* at 330, 130 Cal. Rptr. at 538-39.

57. *Id.*

58. 3 Cal. App. 3d 872, 84 Cal. Rptr. 74 (2d Dist. 1970).

in a cocktail lounge and restaurant. Discharged from his job, he filed a claim with the A.F. of M. and won an arbitration award. The employer challenged the award on the ground that the arbitration board was neither impartial nor neutral. The court stated in dicta that fairness seems to demand that the arbitration board be neutral.[59] Nonetheless, potential unfairness resulting from the use of a nonneutral arbitrator is not a statutory ground for vacation. The court thus refused to disturb the award, stating that it was the legislature's function to determine whether adhesion contracts are beyond the coverage of the California Arbitration Act.[60]

In the United States Supreme Court's only direct regulation of the fairness of arbitration procedures, the Court in *Hines v. Anchor Motor Freight, Inc.*[61] reviewed an action for wrongful discharge brought by former employees against their employer and their union. Plaintiffs alleged that the union violated its duty of fair representation of the employees before the arbitration committee that sustained the discharges. The Court reasoned that while Congress favors private dispute settlement arrangements in collective agreements, it also anticipated that the contractual machinery would operate within minimum levels of integrity.[62] The Court held that the arbitration award would be tainted and minimum levels of integrity would not be met if plaintiffs could prove that the union breached its statutory duty to defend. The dismissal of plaintiffs' action was thus reversed and they could proceed against the union and the employer.[63]

III
ANALYSIS

A. Adhesion Theory

1. The Spirit of Adhesion Theory

At first glance, *Graham*'s finding that the contract was adhesive is intuitively and perhaps legally appealing, but the court failed to apply correctly the underlying spirit of adhesion theory.

At a superficial level, *Graham*'s adhesion finding seems consistent with adhesion theory's current form. Adhesion theory has been extended to the commercial setting in a few instances,[64] and it has long been recognized that stronger parties may dominate contract negotia-

59. *Id.* at 876, 84 Cal. Rptr. at 76.
60. *Id.*
61. 424 U.S. 554 (1976).
62. *Id.* at 571.
63. *Id.* at 572.
64. *See, e.g.*, Player v. George M. Brewster & Son, Inc., 18 Cal. App. 3d 526, 96 Cal. Rptr. 149 (3d Dist. 1971) (contract between general contractor and subcontractor); *see also* Hurd &

tions.[65] Moreover, the court's fact discussion indicates that the bargaining process was dominated by the union.[66] The court thus concluded that Graham had no realistic choice but to sign the standard contracts—that Graham "was required by the realities of business" to use the union form contract.[67]

The underlying concern of adhesion theory, however, is the protection of parties who otherwise cannot protect themselves.[68] The typical adhesion contract situation involves a consumer who contracts with a powerful entity such as an insurance company[69] or a hospital.[70] The vast majority of adhesion cases involve similar broad discrepancies of bargaining power.[71] The weaker parties lack both the power to exert pressure on the stronger companies and the resources to search for and obtain better terms.[72]

California courts applying adhesion theory have long recognized that the ability to look elsewhere or to change contractual language removes the taint of adhesion.[73] Though the plaintiff in *Madden* per-

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Bush, *supra* note 18, at 35 ("the principles behind the doctrine certainly make sense when applied to contracts of the more typical market transaction").

65. In the words of one commentator:

> The weaker party, in need of the goods or services, is frequently not in a position to shop around for better terms, either because the author of the standard contract has a monopoly (natural or artificial) or because all competitors use the same clauses. . . . Freedom of contract enables enterprisers to legislate by contract and, what is even more important, to legislate in a substantially authoritarian manner without using the appearance of authoritarian forms. Standard contracts in particular could thus become effective instruments in the hands of powerful industrial and commercial overlords enabling them to impose a new feudal order of their own making upon a vast host of vassals.

Kessler, *supra* note 18, at 632, 640.

66. 28 Cal. 3d at 818-19, 623 P.2d at 171-72, 171 Cal. Rptr. at 610-11.

67. *Id.* at 818-19, 623 P.2d at 172, 171 Cal. Rptr. at 611; *see supra* notes 20-28 and accompanying text.

68. *See generally* Sybert, *supra* note 20, at 310-11. Kessler early recognized that the primary purpose of adhesion theory was the protection of the weak, observing that courts allowing recovery on adhesion contracts were trying to "protect the weaker contracting party against the harshness of the common law and against what they think are abuses of freedom of contract." Kessler, *supra* note 18, at 636.

69. *See, e.g.*, Gray v. Zurich Ins. Co., 65 Cal. 2d 263, 419 P.2d 168, 54 Cal. Rptr. 104 (1966).

70. *See, e.g.*, Tunkl v. Regents of Univ. of Cal., 60 Cal. 2d 92, 383 P.2d 441, 32 Cal. Rptr. 33 (1963).

71. *See* Sybert, *supra* note 20, at 310-11.

72. Accordingly, the hospital patient in *Wheeler*, who had some limited choice, really had no way to protect himself from signing the hospital form. He was unable to dicker over the terms or realistically to look elsewhere for better terms, 63 Cal. App. 3d 345, 366, 133 Cal. Rptr. 775, 789 (4th Dist. 1976), and there was no practical opportunity to organize others similarly situated and thereby exert pressure on the hospital. *Cf.* Madden v. Kaiser Foundation Hosps., 17 Cal. 3d 699, 552 P.2d 1178, 131 Cal. Rptr. 882 (1976). Given *Madden*'s approval of organizetional bargaining as an exercise of individual choice, *see supra* notes 24-28 and accompanying text, it is likely that the *Wheeler* court would not have found the contract adhesive if the patient had the power, resources, and opportunity to organize with others similarly situated.

73. *See* Neal v. State Farm Ins. Co., 188 Cal. App. 2d 690, 695, 10 Cal. Rptr. 781, 784 (1st Dist. 1961) ("Here the party of superior bargaining power not only prescribes the words of the

ceived that she had no choice but to accept the state negotiated health plan, the court nevertheless concluded that the contract was not adhesive since she could have looked elsewhere for more favorable terms.[74] Clearly, a party need not exercise available options to have a realistic choice in a transaction.

Similarly, that Graham did not exercise his options of either bargaining with the union or organizing with other promoters is irrelevant because the salient point is that he had such realistic options. Unlike adhering parties in early California cases,[75] Graham had the resources to exert pressure on the union and obtain concessions or changes in the contract's language. It is conceivable that Graham could have changed the contract language in negotiations with the union—Graham's inability to change the clause in "negotiations" with Scissor-Tail arose not from the union's overwhelming bargaining strength but from Scissor-Tail's lack of authority to consent to a change.[76] Graham is a prominent promoter and he conceivably could have had an impact on the

instrument but the party who subscribes to it lacks the economic strength to change such language."). One with the economic strength to change contract terms cannot, by definition, be subjected to a contract of adhesion.

74. *See supra* text accompanying note 28.

75. *See supra* notes 22-23 and accompanying text.

76. Bargaining power gives a contracting party the ability to dictate the contract's provisions to another party. Such power may arise from a number of circumstances. First, a superior position exists when one party has more knowledge than the other and is therefore in a better position to determine the risks involved. *See* Hurd & Bush, *supra* note 18, at 8-11. The stronger party may have a kind of "monopoly" of judgment, brains, and foresight. *See* Comment, *Contractual Exculpation from Tort Liability in California—The "True Rule" Steps Forward*, 52 CALIF. L. REV. 350, 354 (1964).

Second, bargaining position is determined by one's resources. This factor gives a party the ability to affect the other party by either buying or selling. It also gives the party time to shop for better terms. *See* Hurd & Bush, *supra* note 18, at 11-12.

Third, bargaining power may arise out of necessity, where the weaker party is in urgent need of a good or service for which there is no immediate substitute and over which the stronger party has a monopoly. *See* Comment, *supra*, at 354.

Graham's bargaining power arises from the second situation. His resources arguably gave him the power to dictate terms or to look elsewhere for more favorable terms. The following passage describes Graham's great bargaining strength:

> A rangy, rawboned man with hair-trigger temper, Graham had the vocabulary of a tough New York street kid (which he once was) and the style of a New York cab driver (likewise). But in an often sleazy industry, Graham delivered class acts to his audience and an honest box-office count to his performers. The formula may sound simple, but it made Graham a millionaire several times over.
>
> But executive burnout is an occupational hazard in showbiz, especially in the trendy youth segment, and it happened to Bill Graham. It first struck in 1971, when he closed the Fillmores and announced his retirement from the rock scene, blaming rock stars' "greed and arrogance." But, Graham, a certifiable workaholic, was soon back at it, producing concerts in the Bay Area and handling tours for the likes of Bob Dylan, George Harrison and Elton John. His miniconglomerate of companies (set design, sound equipment rental, celebrity T-shirt and poster merchandising, retail stores and artist management, as well as concert promotion) grossed about $15 million in fiscal 1977; and close to $2 million of that was pretax profit for sole-owner Graham.

Melton, *Counter Counterculture Shock*, Forbes, Nov. 15, 1977, at 103, col. 1.

union if he had shut down his promotional activities for a short period. While the *Graham* court made it clear that Graham needed the union,[77] it did not discuss the possibility, relevant to the adhesion issue, that the union may have needed Graham as well.

Moreover, *Madden* establishes that organizational bargaining is an alternative that removes the taint of adhesion. If Graham had negotiated with the union, he could have invoked the union's organizational bargaining powers and thereby could have effectively bound union members to the contract.[78] Graham could also have organized with other promoters to exert even more pressure on the union. Such alternatives have successfully been used in the construction industry.[79] By simply signing the union form contract Graham failed to exhaust the reasonable alternatives at his disposal. The *Graham* court, however, deferred to Graham's unreasonable perception that he had no choice but to sign the union contract and therefore erroneously concluded that the contract was adhesive.[80]

2. Graham's *Impact on Freedom to Contract*

Graham strikes a severe blow to the freedom to contract principle by discouraging strong commercial entities from bargaining with one another. By not requiring interorganizational bargaining when it is a reasonable alternative, *Graham* protects parties presented with form contracts by other commercial entities even though such parties are capable of arm's length bargaining.

The extension of adhesion theory to union form contracts is consistent with the demise of free bargaining and the increasing attack on

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77. The *Graham* court reasoned that Graham needed the union to promote high quality concerts, because all significant performers are union members. 28 Cal. 3d at 818-19, 623 P.2d at 171-72, 171 Cal. Rptr. at 610-11.

78. In *Madden*, the court ruled that an association representing the interests of a party may negotiate for and effectively bind the party to the contract. Though the party must take or leave the resulting contract, the contract is not adhesive if it is negotiated by an agent with sufficient bargaining power. 17 Cal. 3d at 711, 552 P.2d at 1185, 131 Cal. Rptr. at 889. Similarly, the union in *Graham* would have been able to bind its members to a contract negotiated with Graham or an association of promoters.

79. *See* J. SWEET, LEGAL ASPECTS OF ARCHITECTURE, ENGINEERING, AND THE CONSTRUCTION PROCESS 765-66 (2d ed. 1977).

80. The *Graham* court concluded that:

> In these circumstances it must be concluded that Graham, whatever his asserted prominence in the industry, was required by the realities of his business as a concert promoter to sign A.F. of M. form contracts with *any* concert artist with whom he *wished* to do business—and that in the case before us he, *wishing* to promote the Russell concerts, was presented with the nonnegotiable option of accepting such contracts on an 85/15 or 90/10 basis or not at all.

28 Cal. 3d at 818-19, 623 P.2d at 172, 171 Cal. Rptr. at 611 (emphasis added to "wished" and "wishing"). Graham's desire to promote Russell concerts may have been unreasonable to the extent that it put him in a take-it-or-leave-it position. The court did not discuss this possibility.

principles underlying freedom to contract.[81] If free bargaining does not exist because of a divergence of bargaining power between the parties,[82] contract rules based on freedom to contract, such as the rule that objective manifestations of consent are binding, fail to prevent the inclusion of harsh or oppressive terms.[83] One way to solve the problem is to change contract principles when free bargaining does not exist. Adhesion theory attempts this change but should only be applied when parties cannot protect themselves.[84] If parties can provide their own protection, freedom to contract principles should still be applicable.

Courts should at the same time recognize that a divergence of power does not mean that freedom to contract principles are always inapplicable, because strong institutions may still bargain freely with one another. To salvage the freedom to contract courts could encourage or require large commercial entities who represent the interests of weaker parties to negotiate contracts for their members. This result could be accomplished by recognizing interorganizational bargaining as a choice removing the taint of adhesion from a contract even if such a choice were not exercised. In particular, the *Graham* court could have rejected Graham's argument that the contract was adhesive and directed him to bargain with the union. By not requiring such bargaining the court may have signaled the end to institutional bargaining when it is a reasonable alternative.

The key issue should be whether such institutional bargaining is indeed a reasonable alternative. In many situations it would be unfair to require individuals to organize in order to bargain freely with stronger entities or to require them to bargain on an individual basis with such entities because they lack the resources to organize or to delay acquisition of the needed good or service. However, when a well-endowed commercial entity deals with another such entity, albeit indirectly through members or affiliates required to use the latter entity's form contracts, it would be reasonable to require the entities to deal directly with one another or to organize with other entities to equalize the bargaining power. If the entities choose not to bargain, they should be unable to challenge the resulting contract on adhesion grounds, because they had the ability, if not the desire, to negotiate.

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81. *See* Tobriner & Grodin, *The Individual and the Public Service Enterprise in the New Industrial State*, 55 CALIF. L. REV. 1247 (1967). For a general discussion of the benefits and difficulties with freedom to contract notions, see CALAMARI & PERILLO, *supra* note 29, at 4-6.

82. For a discussion of the divergence of power in the United States and its implications, see Tobriner & Grodin, *supra* note 81.

83. *See* Hurd & Bush, *supra* note 18, at 14.

84. *See supra* note 68 and accompanying text.

B. Unconscionability

1. The Court's Rule of Unconscionability

Graham's impact on the use of potentially biased arbitrators is unclear because the court failed to delineate the basis for its decision. The court simply concluded that the arbitration clause should be "denied enforcement on the grounds of unconsionability"[85] and did not specify whether the arbitration clause would only be unconscionable when contained in adhesion contracts or whether it would be unconscionable regardless of bargaining defects. If the court was objecting to the contract because it was adhesive and therefore procedurally unconscionable, then the defect may be cured by free negotiation. If, however, the court meant to prohibit the use of the union arbitration as substantively unconscionable, then it could not be included in an agreement whatever the bargaining context.[86]

The *Graham* court was critical of the unfairness of the union procedure and apparently intended to prevent its use on substantive unconscionability grounds. The court stated that the arbitration procedure "would be denied enforcement under any circumstances."[87] This indicates that the court would still refuse to enforce the arbitration provision despite the absence of defects in the formation of the contract at issue in *Graham*.

That substantive unconscionability is the basis for *Graham* is demonstrated by the court's rule. The court imposed a requirement of "minimum levels of integrity" upon dispute settlement arrangements.[88] When an arbitrator is "so identified with the party as to be in fact, even though not in name, the party,"[89] the court concluded that minimum levels of integrity are clearly not met. This rule does not refer to adhesion as an element of minimum levels of integrity. An arbitrator "identified" with a party would be no more identified with that party in an adhesion contract than in a freely negotiated agreement. Arbitrators may be more frequently identified with one party in cases of adhesion,[90] but this is an empirical result, not a basis underlying the *Graham* rule.

The court, however, was not willing to detach completely its mini-

85. 28 Cal. 3d at 827, 623 P.2d at 177, 171 Cal. Rptr. at 616.

86. *See supra* notes 32-34 and accompanying text.

87. 28 Cal. 3d at 828, 623 P.2d at 178, 171 Cal. Rptr. at 617.

88. *Id.* at 827, 623 P.2d at 177, 171 Cal. Rptr. at 616.

89. *Id.* at 825, 623 P.2d at 176, 171 Cal. Rptr. at 615.

90. *See* Sybert, *supra* note 20, at 311 (adhesion contracts usually contain limits on liability or obligations under the contracts); Madden v. Kaiser Found. Hosps., 17 Cal. 3d 699, 711, 552 P.2d 1178, 1186, 131 Cal. Rptr. 882, 890 (1976) (adhesion contracts frequently contain oppressive terms).

mum levels of integrity rule from its adhesion discussion,[91] stating that minimum levels of integrity must be met "most especially in circumstances smacking of adhesion."[92] Thus, while the court apparently objected to the union arbitration provision on substantive grounds, it attempted to buttress its holding by relying on adhesion theory.[93]

It is more reasonable, however, to read *Graham* as holding that the union arbitration is substantively unconscionable and would thus be denied enforcement in any contract between Graham and a union member. While the court devoted much attention to an adhesion discussion, the thrust of its objection to the arbitration clause was substantive. The court admitted in its adhesion discussion that unconscionability is applicable to all contracts, not just adhesive ones.[94] That the court stated that the clause should be denied enforcement especially in cases of adhesion does not mean that absent adhesion the clause would not have been unconscionable. The adhesion may have aroused the court's sympathies but it was not the basis for the minimum levels of integrity rule. Under this interpretation of *Graham* the court's discussion of adhesion theory is dictum because the holding rests on substantive, not procedural, flaws in the contract.

Despite the opinion's broad language, *Graham* should not be read as prohibiting the use of union arbitration under all circumstances. As the next section explains, there may be circumstances in which union arbitration would meet minimum levels of integrity and therefore pass judicial muster.

2. *Applying the Rule: Minimum Levels of Integrity*

Graham did not clearly delineate the kinds of relationships creating sufficient potential bias to violate minimum levels of integrity and thus justify vacation of an arbitration award. Some level of potential bias must be acceptable because the Code of Civil Procedure implicitly

91. While purporting to deny enforcement of the arbitration clause under any circumstances, the court in the same breath stated that "clearly it cannot stand in a case which, like that before us, requires the careful and searching scrutiny appropriate to a contract with manifestly adhesive characteristics." 28 Cal. 3d at 828, 623 P.2d at 178, 171 Cal. Rptr. at 617. If the court intended to rule against the arbitration on substantive grounds, then this language is dictum because the presence of adhesion does not make a contract substantively unconscionable. On the other hand, if the arbitration clause was refused enforcement because it was contained in an adhesion contract, then this languge tying nonenforcement to circumstances of adhesion is very important to the court's holding.

92. *Id.* at 825, 623 P.2d at 176, 171 Cal. Rptr. at 615.

93. The *Graham* decision is clouded by yet another possible interpretation of its holding—that the substantive and procedural defects of the case combined to produce an unconscionable result. It is conceivable that without the procedural flaws the degree of substantive unfairness would have been insufficient to render the arbitration clause unconscionable.

94. 28 Cal. 3d at 820, 623 P.2d at 173, 171 Cal. Rptr. at 612.

permits the use of nonneutral arbitrators and defers to privately arranged arbitration agreements.[95] In addition, the *Graham* court conceded that the California Arbitration Act does not preclude the use of arbitrators who, by reason of a relationship to a party or for some other reason, are expected to adopt something other than a neutral stance.[96]

Graham is concerned with potential bias establishing the likelihood that actual bias occurred in the arbitration process. Under the court's rule, each party must be given a realistic and fair opportunity to prevail in the dispute.[97] If the arbitrator is incapable of deciding the dispute on the basis of the evidence presented, then he is presumptively biased[98] and minimum levels of integrity have been violated.[99] While it is possible to read *Graham* as a case concerned with apparent bias,[100] it is more reasonable to view its standard as presumptive bias.[101] This

95. *See supra* notes 40-45 and accompanying text.

96. 28 Cal. 3d at 824, 623 P.2d at 175-76, 171 Cal. Rptr. at 615; *see also* Commonwealth Coatings Corp. v. Continental Casualty Co., 393 U.S. 145, 150 (1968) (White, J., concurring):

> [A]rbitrators are not automatically disqualified by a business relationship with the parties before them if both parties are informed of the relationship in advance, or if they are unaware of the facts but the relationship is trivial. I see no reason to disqualify the best informed and most capable potential arbitrators.

97. 28 Cal. 3d at 825, 623 P.2d at 176, 171 Cal. Rptr. at 615.

98. *Id.* at 821, 623 P.2d at 173-74, 171 Cal. Rptr. at 612-13. The *Graham* court framed the issue as follows:

> We are thus brought to the question whether the contract provision requiring the arbitration of disputes before the A.F. of M.—because it designates an arbitrator who, by reason of its status and identity, is presumptively biased in favor of one party—is for that reason to be deemed unconscionable and unenforceable. Graham, although couching his arguments in other terminology, essentially maintains that it is—the thrust of his position being that to allow the A.F. of M. to sit in judgment of a dispute arising between one of its members and a contracting noumember is so inimical to fundamental notions of fairness as to require nonenforcement.

Id.

99. *Id.* at 825, 623 P.2d at 176, 171 Cal. Rptr. at 615.

100. Courts in other contexts have cited the appearance of unfairness as the harm to be prevented. *See* Riehards v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 64 Cal. App. 3d 899, 903, 135 Cal. Rptr. 26, 28 (2d Dist. 1976) (quoting Rex v. Sussex Justices [1924] 1 K.B. 256, 259) ("[J]ustice should not only be done, but should manifestly and undoubtedly be seen to be done."); Commonwealth Coatings Corp. v. Continental Casualty Co., 393 U.S. at 150 ("[A]ny tribunal permitted by law to try cases and controversies not only must be unbiased but also must avoid even the appearance of bias.").

The appearance of bias standard would prohibit proceedings conducted by arbitrators apparently, though not necessarily presumptively, biased. This appearance of bias standard would not require arbitrators to have as great an interest in the outcome as the presumptive bias standard requires. While the appearance of bias standard may be satisfied by casual relationships, the presumption of bias standard would require a greater degree of mutual interest before minimum levels of integrity are violated.

101. It is more reasonable to view *Graham* as concerned with the degree of potential bias leading to a presumption of actual bias. If apparent bias is to be prevented, then nothing is left of the disclosure cases purporting to shield certain relationships creating an appearance of bias if the relationship is disclosed. *See infra* notes 113-123 and accompanying text. Moreover, the *Graham* court was apparently concerned only with the effects of actual bias. It reasoned that the union was not just casually interested in the conditions of its members but was primarily motivated to fight

conclusion follows from the court's heavy reliance on *Hines v. Anchor Motor Freight, Inc.*,[102] which was concerned with actual, rather than apparent, unfairness in arbitration proceedings.[103]

The *Graham* court's standard for measuring the potential bias of an arbitrator is one "so identified with the party as to be in fact, though not in name, the party."[104] Under this rule, the court found that the union arbitrator possessed interests identical to those of fellow members and that therefore minimum levels of integrity were unsatisfied.[105] Thus, we now have a definitional starting point from which minimum levels of integrity may be analyzed, but no case law to guide the analysis. Factors that should be considered in determining whether an arbitration panel is presumptively biased include the arbitrators' interest in the outcome, the arbitrators' institutional bias, and any procedural rules that will be applied to the arbitration.

To be presumptively biased, an arbitrator must have a direct and significant interest in the outcome of an arbitration.[106] There are two ways that a substantial interest in the outcome may arise. First, the arbitrator, because of some special relationship to a party, may have an interest in that party's well-being. *Graham* provides a prime example of one such relationship—the union arbitrator had a direct interest in its members' welfare.[107] Second, an arbitrator may have an interest in the outcome because of a direct and significant personal interest, such as a financial interest, in the results of the arbitration.[108]

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for their interests. The court accordingly spoke in terms of a party's right to a fair and realistic opportunity to prevail, not in terms of a party's right to arbitrate without an appearance of bias clouding the proceeding. 28 Cal. 3d at 824-25, 623 P.2d at 176, 171 Cal. Rptr. at 615.

102. 424 U.S. 554 (1976); *see supra* notes 61-63 and accompanying text.

103. The *Hines* Court found that minimum levels of integrity were violated when the union actually failed to meet its statutory duty to fairly represent an employee. 424 U.S. at 571. *Hines* was thus concerned with actual prejudice in the proceedings rather than potential bias that does *not* lead to a presumption of actual bias.

104. 28 Cal. 3d at 825, 623 P.2d at 176, 171 Cal. Rptr. at 615 (quoting Cross v. Brown, 4 A.D. 2d 501, 505, 167 N.Y.S.2d 573, 576 (1957)).

105. *Id.* at 827-28, 623 P.2d at 177-78, 171 Cal. Rptr. at 616-17.

106. Because the presumption of bias standard requires a high degree of potential bias to raise the presumption, *see supra* notes 97-102 and accompanying text, courts should require the arbitrator to have an interest that hinges on the outcome of the arbitration (direct interest) and is substantial enough to influence the arbitrator's decision (significant interest).

107. *See infra* note 122 and accompanying text.

108. To violate minimum levels of integrity, such an interest must be more than a financial interest arising out of a continuing relationship or possible future dealings, but must be a direct and significant consequence of the resolution of the dispute. For example, suppose that the arbitrator has purchased a condominium that is under construction. The arbitrator would have a direct and significant financial interest in an action against the contractor to stop the construction and would therefore be presumptively biased in favor of the contractor.

On the other hand, suppose that the arbitrator has an interest in the continuing success of the contractor because they sporadically supply business to one another. *See, e.g.*, San Luis Obispo Bay Properties, Inc. v. Pacific Gas & Elec. Co., 28 Cal. App. 3d 556, 567-69, 104 Cal. Rptr. 733,

The potential for bias is also increased if there is an institution exerting pressure, either overtly or covertly, on the arbitrator to render his or her decision in favor of one of the parties. For the presumption of bias to arise, this institution must be one that actively pursues the interests of its membership.[109] *Graham* involved this institutional bias—the union's presence may have pressured the arbitrator to decide in Scissor-Tail's favor. If the institution actually controls the arbitration machinery and appoints the arbitrators, as in *Graham*, this institutional bias is particularly keen.

Finally, any procedural rules to be applied in the arbitration should be considered in determining whether the arbitration is presumptively biased. For example, where a panel of arbitrators is involved, *Graham* requires that the panel as a whole meet minimum levels of integrity.[110] In addition, rules governing each arbitrator's separate power to make the decision should be considered.[111]

Of course, these factors can only provide general guidance. As the *Graham* court explained, courts must determine whether minimum levels of integrity have been met "largely on a case by case basis."[112] The next section considers *Graham*'s implications for particular types of arbitration cases.

741-42 (2d Dist. 1972) (referral of cases to one another once or twice a year for no consideration did not require disclosure). An adverse ruling would not put the contractor out of business but would damage the continuing relationship between the contractor and arbitrator. This interest would not violate minimum levels of integrity because it would be insubstantial and only indirect and insignificant. If the continuing relationship were financially significant, however, it is possible that the arbitrator would be presumptively biased.

109. *See infra* note 122 and accompanying text.

110. An inquiry must be made to determine whether on balance, considering the individual potential biases of the arbitrators, the panel can be said to be presumptively biased.

111. Even where there is a panel that, on first inquiry, appears not to be presumptively biased, the rules governing the arbitration may give the power to make the decision to one or each arbitrator. For example, assume that there is a three person panel, with two nonneutral and one neutral arbitrator. Under the balancing test, the composition of the panel does not appear to be presumptively biased. Now assume that the rules of arbitration require a unanimous vote for there to be a judgment against the defendant. The defendant's designated arbitrator votes against liability and the action thus fails. The decisional power was thus exercised by a single arbitrator who had interests conceivably identical to one party. The arbitration therefore violated minimum levels of integrity.

Similarly, just as the rules may convert presumptively fair panels into unfair ones, they may also convert presumptively unfair panels into fair ones. Suppose, for example, that there are three arbitrators on a panel who favor one party, one arbitrator who favors the other party, and one neutral arbitrator. This panel is presumptively unfair on its face. However, assume that there is a rule giving the single nonneutral arbitrator three votes. This rule would bring the panel into balance by equalizing the power each party has to influence the decision.

112. 28 Cal. 3d at 825, 623 P.2d at 176, 171 Cal. Rptr. at 615.

3. Graham's *Impact on Existing Law*

a. *The Disclosure Cases*

The disclosure cases are apparently still good law, even though under *Graham* disclosure may no longer insulate potentially biased arbitrators from challenge if the potential bias violates minimum levels of integrity. Prior to *Graham*, there was a line of cases requiring arbitrators to disclose to the parties circumstances indicative of potential bias.[113] Once on notice, the parties could then accept or reject the potentially biased arbitrators. *Graham*, however, suggests that certain relationships will unconscionably violate minimum levels of integrity even if disclosed to the parties.

Graham's impact on the disclosure cases may be understood by comparing the level of potential bias needed to violate minimum levels of integrity under the *Graham* rule and that requiring disclosure under the *Commonwealth*[114] rule. The potential bias triggering the *Graham* rule must be such that actual bias may be presumed,[115] but the potential bias requiring disclosure must only create an impression of possible bias. The degree of potential bias needed to create a presumption of bias is thus greater than that needed to create an impression of possible bias.

Accordingly, the union arbitrator in *Graham* may have had a greater propensity to favor fellow union members than the arbitrators in the disclosure cases had to favor their personal or business acquaintances. In other words, potential bias violative of minimum levels of integrity would require disclosure but the level of potential bias requiring disclosure would not necessarily violate minimum levels of integrity.

Relationships not requiring disclosure easily meet the *Graham* standard because the level of potential bias would be quite low. Examples of such relationships are those based on personal acquaintance[116] and those created by referrals of work to others.[117] Conversely, relationships that create an appearance of bias do not necessarily reach a level of presumptive bias. Examples of such relationships include employment relationships[118] and business dealings.[119] It is not clear

113. *See supra* notes 46-50 and accompanying text.

114. *Id.*

115. *See infra* notes 97-103 and accompanying text.

116. *See* Gonzales v. Interinsurance Exch., 84 Cal. App. 3d 58, 63-65, 148 Cal. Rptr. 282, 284-85 (2d Dist. 1978).

117. *See* San Luis Obispo Bay Properties v. Pacific Gas & Elec. Co., 28 Cal. App. 3d 556, 567-69, 104 Cal. Rptr. 733, 741-42 (2d Dist. 1972).

118. *See* Wheeler v. St. Joseph's Hosp., 63 Cal. App. 3d 345, 369-72, 133 Cal. Rptr. 775, 791-93 (4th Dist. 1976).

whether such relationships violate minimum levels of integrity, even though they may require disclosure. If the relationships also violate minimum levels of integrity then the disclosure cases are overruled by *Graham* to the extent that disclosure of the relationships would not insulate the arbitrators from challenge for presumptive bias.

A recent case, *San Luis Obispo Bay Properties, Inc. v. Pacific Gas & Electric Co.*,[120] however, casts doubt on whether the distinction between the disclosure cases and the *Graham* standards is correct. In *Bay Properties*, a precedent ignored by *Graham*, the comembership in the same professional organization of one party's appraiser and the arbitrator was "in itself hardly a credible basis for inferring even an impression of bias."[121] Thus, while *Graham* establishes that membership in the same union violates minimum levels of integrity, *Bay Properties* apparently holds that comembership in a professional organization does not even reach the lower level of potential bias requiring disclosure.

The *Graham* and *Bay Properties* cases may be reconciled by observing that the level of potential bias in the latter was much lower than that in *Graham*. *Graham* did not say that membership in the same organization automatically creates potential bias violative of minimum levels of integrity. Rather, it is comembership in an organization, like the musicians' union, that actively pursues the interests of its members. which meets the threshold of presumptive bias.[122] It is doubtful whether the professional organization in *Bay Properties* was interested in its membership to the same extent that a labor union is interested in its members' welfare. Most professionals have already obtained many of the economic and other advantages that unions strive for. Most professional organizations thus perform educational or consulting functions. The potential bias created by comembership in a labor union is therefore greater than that in a professional organization. In fact, it is plausible, as the *Bay Properties* court held, that the level of potential

119. Johnston v. Security Ins. Co., 6 Cal. App. 3d 839, 843, 86 Cal. Rptr. 133, 136 (2d Dist. 1970).

120. 28 Cal. App. 3d 556, 104 Cal. Rptr. 733 (2d Dist. 1972).

121. *Id.* at 567, 104 Cal. Rptr. at 741.

122. The *Graham* court stressed the union's high degree of interest in its members' welfare:

> A labor union is an association or combination of workers organized for the purpose of securing through united action the most favorable conditions as regards wages or rates of pay, hours, and conditions of employment for its members; the primary function of such an organization is that of bargaining with employers on behalf of its membership in order to achieve these objectives. . . . By its very nature, therefore, a labor union addresses disputes concerning compensation arrangements between its members and third parties with interests identical to those of the affected members; to suppose that it would do otherwise is to suppose that it would act in a manner inconsistent with its reason for being.

28 Cal. 3d at 827, 623 P.2d at 177-78, 171 Cal. Rptr. at 616-17 (citations omitted).

bias by comembership in such an organization is so low as not even to require disclosure.

In sum, the disclosure cases are still viable. After *Graham*, they do not countenance disclosed potential bias in every case but still require disclosure if an impression of possible bias may be created by such disclosure. Even with disclosure, however, the arbitration procedure may nevertheless violate the *Graham* rule if the potential bias violates minimum levels of integrity.[123]

b. *Cases Rejecting Potential Unfairness as a Ground for Vacating Arbitration Awards*

Prior to *Graham*, potential bias arising from nonneutral arbitration panels was not a ground for vacating an arbitration award.[124] *Graham* confused the impact of its decision because it overrules *Federico*[125] but not *Arrieta*.[126] Moreover, by not explaining the difference between its rule and that enunciated in *Richards*,[127] *Graham* fails to clarify whether potentially biased arbitrators can ever be used.

Arrieta rejected a challenge to the New York Stock Exchange arbitration because the parties had the ability to disqualify biased arbitrators. *Graham* distinguished *Arrieta* on the ground that in *Arrieta* there existed procedures for disqualifing biased arbitrators.[128] This factor, however, was not the only basis for the *Arrieta* decision. Relying on *Federico*, the *Arrieta* court also stated that potential bias from nonneutral arbitrators is not a ground for vacation and relied on that proposition to reject the appellant's due process and equal protection arguments.[129]

After *Graham*, little remains of *Arrieta*. Contrary to *Arrieta*'s basic holding, an arbitration clause that designates a potentially biased arbitrator is in violation of minimum levels of integrity and may be held unconscionable and denied enforcement. *Arrieta* cannot be distinguished on the ground that the New York Stock Exchange arbitration did not violate minimum levels of integrity whereas the union arbitration in *Graham* did because a recent case establishes that the stock exchange arbitration violates minimum levels of integrity.[130] As the *Graham* court observed, however, *Arrieta* can logically be distinguished on the ground that the arbitration clause contained a disquali-

123. *See supra* text accompanying notes 95-112.
124. *See supra* notes 51-60 and accompanying text.
125. For a discussion of *Federico*, see *supra* notes 58-60 and accompanying text.
126. For a discussion of *Arrieta*, see *supra* notes 55-57 and accompanying text.
127. For a discussion of *Richards*, see *supra* notes 51-54 and accompanying text.
128. 28 Cal. 3d at 823, 623 P.2d at 174, 171 Cal. Rptr. at 613-14.
129. *Id.*
130. *See* Hope v. Superior Court, 122 Cal. App. 3d 147, 175 Cal. Rptr. 851 (1st Dist. 1981).

fication procedure while the *Graham* clause did not.[131]

Arrieta is therefore still good law for the proposition that an arbitration clause that designates a presumptively biased arbitrator is nonetheless enforceable if it contains a legitimate disqualification procedure.[132] Where the procedure is illusory, the arbitration clause is unconscionable because it requires the use of a presumptively biased arbitrator.[133] If despite the existence of a legitimate disqualification procedure, a presumptively biased arbitrator presides over the dispute, this event does not make the arbitration provision unconscionable since unconscionability must be determined at the time of the contract's creation.[134] A court, however, may still refuse to honor the arbitrator's decision in such situations by relying on due process arguments.[135]

Similarly, a reading of *Richards* and *Graham* together clouds whether presumptively biased arbitrators can ever be used. While *Graham* prohibits the use of presumptively biased arbitrators, *Richards* views potential bias rising to the level of presumptive bias as only one factor to consider. Another factor, the primary basis for the *Richards* holding, is notice as to the arbitration procedure. The *Richards* court would have enforced the award had the customer been given notice of the Exchange's power to appoint arbitrators.[136] The *Graham* court, however, would refuse to enforce such procedures regardless of notice.

Graham therefore overrules *Richards* to the extent that notice as to presumptively biased procedures prevents challenge to these procedures on grounds of presumptive bias. One may try to distinguish *Richards* on the ground that the level of potential bias in *Richards* did not violate minimum levels of integrity. *Richards*, unlike *Graham*, involved an arbitration panel selected by lot from a pool, the majority of which are persons not engaged in the security business.[137] This distinc-

131. 28 Cal. 3d at 823, 623 P.2d at 174, 171 Cal. Rptr. at 613-14.

132. If a presumptively biased arbitration clause contains such a procedure, *Graham* would not prohibit its enforcement because it does not *require* the use of an arbitrator who is presumptively biased. *See supra* note 98.

133. For example, if a disqualification results in the appointment of another presumptively biased arbitrator, the disqualification procedure is illusory. It is also illusory if a party is given the right to disqualify an arbitrator but is nonetheless forced by the stronger party to accept that party's designated arbitrator and not to exercise the right to disqualify. Finally, where the right to disqualify is only the right to peremptorily challenge one member of a presumptively biased arbitration panel, such a right would be illusory. *See* Hope v. Superior Court, 122 Cal. App. 3d 147, 175 Cal. Rptr. 851 (1st Dist. 1981).

134. *See supra* note 39 (the unconscionability statute provides that unconscionability is measured at the time of the contract's creation rather than at the time the dispute arises).

135. The appellate court hearing *Graham* held that an arbitration process in which a presumptively biased arbitrator presides does not comport with due process. Graham v. Scissor-Tail, 162 Cal. Rptr. 798 (2d Dist. 1980), *officially depublished pursuant to* CAL. CT. R. 976(d) (West 1982).

136. *See supra* note 54 and accompanying text.

137. 64 Cal. App. 3d 899, 903, 135 Cal. Rptr. 26, 28 (2d Dist. 1976).

tion, however, is belied by *Hope v. Superior Court*,[138] a case relying on *Graham*'s minimum levels of integrity test. *Hope* held that the potential bias created by the Exchange rules violated minimum levels of integrity even though the arbitration panel was composed of many arbitrators who were not engaged in the securities business.

c. *Impact on the Use of Nonneutral Arbitrators*

One commentator has argued that minimum levels of integrity prohibit the use of nonneutral arbitrators.[139] This is not an entirely correct interpretation of *Graham*. *Graham* does not require that arbitrators be completely neutral but only not so identified with a party as to be presumptively biased. Moreover, *Graham* speaks repeatedly of minimum levels of integrity as applicable to an entity or body.[140] The court was therefore really imposing a requirement that the arbitration panel as a whole, rather than each arbitrator individually, not be presumptively biased.

This distinction becomes important in arbitrations involving multiple arbitrators. In particular, there have been challenges to tripartite arbitration panels for which each party chooses an arbitrator who is often nonneutral.[141] The two designated arbitrators then choose a third neutral arbitrator to resolve deadlocks. In this tripartite situation the partisan arbitrators nullify each other's impact and no party controls the arbitration's outcome. Minimum levels of integrity are met because, unlike *Graham*, each party has a "realistic and fair opportunity to prevail in a dispute."[142] In *Graham*, however, the union arbitration was presided over by only one arbitrator whose integrity alone determined the integrity of the entire proceeding.

The drafters of the Code of Civil Procedure might have had tripartite panels in mind in permitting the use of nonneutral arbitrations.[143] The tripartite panel maintains the system's integrity because losing par-

138. 122 Cal. App. 3d 147, 154-55, 175 Cal. Rptr. 851, 856 (1st Dist. 1981).

139. *See* Note, *Non-neutrality Prohibited:* Graham v. Scissor-Tail, 8 PEPPERDINE L. REV. 1156 (1981).

140. *See* 28 Cal. 3d at 825, 623 P.2d at 176, 171 Cal. Rptr. at 615.

141. *See, e.g.*, Tipton v. Systron Donner Corp., 99 Cal. App. 3d 501, 160 Cal. Rptr. 303 (1st Dist. 1979).

142. 28 Cal. 3d at 825, 623 P.2d at 176, 171 Cal. Rptr. at 615. At least one post-*Graham* court has upheld the validity of the tripartite arbitration panel. *See* Dinong v. Superior Court, 120 Cal. App. 3d 300, 174 Cal. Rptr. 590 (3d Dist. 1981).

143. The drafters left open the possibility that nonneutral arbitrators may be used, *see supra* notes 40-45 and accompanying text, but did not intend "to authorize litigants to submit their cases and controversies to arbitration boards that might reasonably be thought biased against one litigant and favorable to another." *See* Commonwealth Coatings Corp. v. Continental Casualty Co., 393 U.S. 145, 150 (1968). It follows that nonneutral arbitrators may only be used when the arbitration board as a whole is not presumptively biased. One such board is the tripartite panel.

ties are not subjected to an unfair procedure. Rather, they may rest assured that either the neutral arbitrator or their own appointed arbitrator ruled against them.

This multiple arbitrator method is not the only way in which nonneutral arbitrators may be used. Even in single arbitrator proceedings the arbitration need not be dead-center neutral[144]—some level of potential bias is tolerable under minimum levels of integrity. Moreover, in the case of multiple arbitrators there need not be a complete offset of potential bias toward each side. If two arbitrators are potentially biased for one party and the third is potentially biased for the other party the panel may pass judicial muster if the presumption of actual bias is not raised.[145] Moreover, the third "neutral" arbitrator may be potentially biased yet not so potentially biased as to violate minimum levels of integrity.

Thus, *Graham* does not signal the end to the use of nonneutral arbitrations but limits their use to situations in which the sole arbitrator or the panel as a whole is not presumptively biased.

d. Unconscionability and Judicial Activism

Graham suggests that California courts will take a more active role in policing potentially unconscionable contracts. *Jacklich*,[146] the leading case on unconscionability prior to *Graham*, criticizes the content of a contract in terms of price unconscionability. *Graham* similarly critizes the content of the union arbitration agreement.[147]

Graham's unconscionability rule, however, apparently goes much further than that of *Jacklich*. *Jacklich* did not prohibit the inclusion of a particular term but ruled against the contract's gross imbalance.[148] On the other hand, *Graham* flatly forbade the union arbitration clause.[149] Hence, had Graham received something in exchange for the clause's inclusion, its enforcement would nevertheless have unconscionably violated minimum levels of integrity. The *Graham* court could have struck the clause on price unconscionability grounds. It recognized that there was an imbalance of consideration, stating that Graham could only negotiate terms of relatively minor significance.[150]

144. 28 Cal. 3d at 825, 623 P.2d at 176, 171 Cal. Rptr. at 615. The *Graham* court recognized that "the leeway in structuring dispute settlement arrangements . . . may permit the establishment of arrangements which vary to some extent from the dead-center of 'neutrality.'" *Id.*

145. *See generally* Gear v. Webster, 258 Cal. App. 2d 57, 63, 65 Cal. Rptr. 255, 258 (5th Dist. 1965).

146. For a discussion of *Jacklich*, see *supra* notes 36-39 and accompanying text.

147. *See supra* notes 85-94 and accompanying text.

148. *See supra* notes 36-39 and accompanying text.

149. *See supra* notes 87-90 and accompanying text.

150. 28 Cal. 3d at 819, 623 P.2d at 172, 171 Cal. Rptr. at 611. Though this observation could

The court, however, based its decision on the presumptive unfairness of the arbitration clause standing alone.

In addition, *Graham* may signal an end to the California judiciary's reliance on procedural defects in invalidating unfair contract terms. Prior to *Graham*, when courts reviewed the enforceability of harsh clauses in contracts they refused to enforce them on the basis of defects in the contract's formation.[151] Though armed with the ability to render a contract unenforceable on grounds of substantive unconscionability, courts nevertheless chose to decide cases on procedural grounds. The *Graham* court, however, rendered the contract unenforceable on substantive grounds. While the court stated that there were no procedural defects, it is conceivable that the court could have based its decision on a procedural flaw by, for example, finding that the arbitration, as it was in fact conducted, did not comply with Graham's reasonable expectations.[152]

Though entirely consistent with notice cases, *Graham* represents a significant change of judicial attitude toward harsh provisions in adhesion contracts. *Graham* directs courts to police provisions and contracts for substantive abuses rather than encouraging them to search for procedural flaws on which to base their decisions. The next Section considers the desirability of this increased judicial involvement in policing contracts for substantive unconscionability.

4. Criticism of the Rule: Party Autonomy

The *Graham* court should not have rendered the union arbitration substantively unconscionable because such a rule unjustifiably interferes with the ability of equally strong parties to negotiate freely. There is no compelling reason for judicial activism if there has been an exchange of valuable consideration and no procedural flaws in the bargaining process.

Instead, the *Graham* court should have either found the contract

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have led the *Graham* court to conclude that the contract was one-sided in consideration, the court chose not to do so. Arbitration clauses are valuable because they represent a forfeiture of the right to litigate. *See* Wheeler v. St. Joseph's Hosp., 63 Cal. App. 3d 345, 361, 133 Cal. Rptr. 775, 786 (4th Dist. 1976) ("by agreeing to arbitration, the [party] does forfeit a valuable right"). Similarly, giving up the right to arbitrate a dispute before a neutral panel is a forfeiture of a valuable right to an impartial dispute resolution process.

151. *See supra* note 54 and accompanying text.

152. The *Graham* arbitration proceedings offer several instances of results interpretable as inconsistent with *Graham*'s reasonable expectations. Examples include the initial union award to Scissor-Tail without a hearing, the union's placement of Graham on a list of persons in default on payment, with whom union members could not do business, and the denial of Graham's request to have the proceedings transcribed by a court reporter. 28 Cal. 3d at 814-15, 623 P.2d at 169-70, 171 Cal. Rptr. at 608-09. It was possible for the *Graham* court to conclude that these arbitration procedures vitiated Graham's reasonable expectations.

unconscionable because of the imbalance of consideration or grounded its holding on the contract's adhesive character. Finding the contract price unconscionable would have been less intrusive to the parties' freedom to bargain. The contract could have been viewed as imbalanced because, as the court observed, only provisions of relatively minor significance could be negotiated.[153] A finding of such an imbalance would not have prohibited the parties from bargaining over the union arbitration but would have directed them to cure the imbalance.

The court's interference with party autonomy is more onerous than prior judicial interference with contracts on price unconscionability grounds. If there is gross disparity of consideration, courts do not prohibit the inclusion of a specific term but only condemn the imbalance of the consideration as a whole. *Graham*, however, prohibits the union arbitration clause whatever the consideration exchanged.

Basing the nonenforcement on adhesion grounds would also have been less intrusive to party autonomy. There are good reasons to deny enforcement of harsh terms contained in adhesion contracts—adhering parties have no choice as to the terms and cannot protect themselves from abuse by stronger parties.[154] It is therefore reasonable and desirable for courts to intervene to protect such adhering parties.

Judicial interference is not justified, however, if a contract has been freely bargained for and valuable consideration has been exchanged. If Graham had obtained a substantial sum of money or other favorable terms in exchange for the presumptively biased arbitration it would not be unfair to enforce the arbitration award—Graham would have received valuable consideration for undertaking the risk of a presumptively biased arbitration.

It can be argued, however, that the use of presumptively biased arbitrations is a poor means of allocating risk. The argument would be that the outcomes, and hence risks, that flow from such procedures are difficult to predict and direct risk allocation would be simpler and less frustrating. Moreover, though the value of being able to choose an arbitrator who would be presumptively biased may be calculated actuarially,[155] the parties selecting the arbitrator would always be in a better

153. 28 Cal. 3d at 819, 623 P.2d at 172, 171 Cal. Rptr. at 611.

154. *See supra* notes 64-72 and accompanying text.

155. The value equals the probability of prevailing multiplied by the expected monetary award, plus a risk premium. For example, suppose the probability of a favorable judgment is 90% with a presumptively biased arbitrator on your side, and the size of the average or expected dispute is $50,000. The expected value of the "stacked" arbitration is thus $45,000 (90% x $50,000). Risk averse businessmen, however, would require a risk premium to compensate for the risks undertaken and the uncertainty of outcome. Assuming this premium to be $2,000, the value of the presumptively biased arbitration would be $47,000.

position to evaluate the value of the arbitration clause.[156] If this were true, one may conclude that no reasonable, risk averse businessman would agree to binding arbitration before an arbitrator selected by the other party because the latter would always be in a better position to price the value of the presumptive bias. Courts may therefore wish to prohibit the use of such procedures entirely.

Despite this possible criticism, parties should be able, and traditionally have been able, to allocate risks in any legal manner that they choose.[157] Businessmen know better than courts how to structure their commercial affairs. Further, by prohibiting the use of the arbitration clause on the basis of its failure as a risk allocation device, courts would be denying enforcement on public policy grounds. Private arbitration procedures, however, do not fall within the "public interest" and the *Graham* court itself realized that union arbitration procedures do not concern public policy.[158]

Moreover, courts are not competent to say what a reasonable businessman would do in a given situation nor to dictate to parties what they can and cannot bargain for in their agreements.[159] Though it has been said that judicial activism is within the courts' role as reformers of contract law[160] and in defining the limits of permissibility,[161] it is more properly within the legislature's role and expertise to pass judgment on the appropriateness of particular subject matter.[162] Courts are not well-equipped to make judgments on the fairness of the content of con-

156. If the person choosing the arbitrator always has a better idea about his ability to choose a biased arbitrator and the likelihood that such an arbitrator will decide in his favor, that person will always be in a better position to price the arbitration clause than the party being subjected to the presumptively biased arbitration.

157. Once the risks have been allocated, the court may then determine whether the terms of the agreement bear a reasonable relation to the business risks undertaken in the performance of contractual obligations by the superior party. *See* Hurd & Bush, *supra* note 18, at 45-46. If there is no such reasonable relation, the court may strike the contract or certain terms on unconscionability grounds.

158. According to the *Graham* court:

> Another factor which may have a profound and decisive effect on the reasonable expectations of the 'adhering' party is the extent to which the contract in question may be said to be one affecting the public interest. (See Tunkl v. Regents of University of California (1963) 60 Cal. 2d 92, 101 [32 Cal. Rptr. 33, 383 P.2d 441, 6 A.L.R. 3d 693]; see generally Tobriner & Grodin, *The Individual and the Public Service Enterprise in the New Industrial State* (1967) 55 Cal. L. Rev. 1247.) The instant contract is not claimed to be—nor do we find it to be—such a contract.

28 Cal. 3d at 820 n.18, 623 P.2d at 173 n.18, 171 Cal. Rptr. at 612 n.18.

159. *See* Sybert, *supra* note 20, at 319 (procedural regulation is "theoretically more acceptable").

160. *See* Slawson, *supra* note 23, at 50 ("It also comes close to speaking nonsense to argue that the kinds of legal changes herein suggested are beyond the proper constitutional authority of the judiciary. The legal doctrines coucerning the determination of what is a contract and of contract damages were created by judiciaries.").

161. *See* Llewellyn, *Book Review*, 52 HARV. L. REV. 700, 704 (1939).

162. *See* Federico v. Frick, 3 Cal. App. 3d 872, 876, 84 Cal. Rptr. 74, 76 (2d Dist. 1970) (it is

tracts. Even in cases of price unconscionability, where the concept of gross disparity of consideration is fairly simple, courts frequently err in evaluating the fairness of price because the market mechanism in setting prices is a complex process.[163]

While it may appear that courts are competent to measure the fairness of dispute resolution procedures such as that in *Graham* because procedural fairness is part of the judicial trade,[164] there is a great danger that courts will erroneously evaluate the fairness of arbitrations. For example, in *Graham* the court concluded that the union arbitration was unfair simply from its finding that the arbitrator shared Scissor-Tail's interest, but just as price may be influenced by a complex set of factors, the fairness of an arbitration process may also be a complex question.

Fairness within the arbitration context is not determined by the impartiality of arbitrators alone. Rather, fairness may necessitate a balancing of the need for impartiality and the need for expertise where complicated issues are involved.[165] A single determination of whether an arbitration panel is presumptively biased is not always dispositive of the fairness issue. After all, presumptively biased arbitrators may, under certain circumstances, nonetheless make the best arbitrators if they are the experts in their field.

The union arbitrator's expertise may have been invaluable in the *Graham* dispute. A fair resolution would then require an arbitrator who understands the issues. If union officials have more expertise than

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up to the legislature rather than courts to exclude adhesion contracts from coverage under the California Arbitration Act).

163. Courts should not interfere with issues that are beyond their limited competence or too complex to evaluate accurately. For example, courts should be cautious even when using the market to test the fairness of price. *See* Comment, *supra* note 198, at 1170-71, 1077 ("price, as a factor of unconscionability, is a function of forces far more complex than the mere imbalance of bargaining power for which courts have traditionally searched"). Also, courts should avoid economic regulation because courts "have neither the expertise nor the time for involvement in large-scale economic regulations." *See* Sybert, *supra* note 20, at 312.

164. *See generally* Slawson, *supra* note 32, at 558. The author discusses how to measure a court's competency:

> A court is generally competent to review administered terms if three requirements are met: there must be available standards which the court can apply; the standards must be easily derived; and the standards must retain their relevance long enough to be usable. Standards must exist because it is only by reference to standards that a court gains its legitimate power to make law in a democratic society.

Id.

The fairness of an arbitration clause arguably may be evaluated competently by courts against judicially created standards of the integrity of the system. Courts may review arbitrations for such integrity with standards that will endure since integrity has always been and will most likely continue to be a vital concern of the judicial system.

165. The need for experts to decide disputes involving complex subject matter has been long recognized and is one reason why arbitrations are favored over court proceedings in complicated cases. *See* M. DOMKE, THE LAW AND PRACTICE OF COMMERCIAL ARBITRATION 202 (1968).

other candidates it may not have been unreasonable for Graham to prefer presumptively biased arbitrators with great expertise over other arbitrators who are neutral but who lack the understanding necessary to make an informed decision.

Commentators have argued that courts should be given the express power to rule on substantive hardships, such as presumptively biased arbitrations, because otherwise courts would resort to covert tools such as straining to interpret terms against their plain or unambiguous meaning, to strike down supposedly oppressive terms.[166] Such covert methods have drawbacks: they encourage parties to focus on clearing up ambiguous or unclear terms rather than on the true issue of substantive fairness, and by relieving courts of the necessity of facing the substantive issue, they hinder the development of standards by which to measure substantive abuses. In addition, such methods may later embarrass good faith efforts to construe contracts realistically.[167]

The argument that courts will covertly render provisions substantively unconscionable if they otherwise lack explicit power is, however, not persuasive. This rationale is equivalent to saying that the drinking age should be reduced because some juveniles drink anyway. It is better to force courts to strain to interpret terms against their plain meanings than to permit them to reach what they think are fair results in an overt fashion under a substantive rule of unconscionability.

A final argument that has been advanced for permitting courts to rule on substantive abuses is that contract law, and adhesion theory in particular, does not adequately preclude the appearance of oppressive terms in contracts.[168] A substantive rule of unconscionability, such as

166. *See* Sybert, *supra* note 20, at 316 ("The reasonable expectations test . . . may be only a covert tool to reach what the court considers a 'fair' result."); Llewellyn, *supra* note 161, at 702 ("A court can 'construe' language into patently not meaning what the language is patently trying to say."); *see also* Ehrenzweig, *Adhesion Contracts in the Conflict of Laws*, COLUM. L. REV. 1072, 1090 (1953).

For example, in Raulet v. Northwestern Nat'l Ins. Co., 157 Cal. 213, 107 P. 292 (1910), the supreme court seemed to ignore the plain meaning of the terms to interpret the word "encumbrance" to mean "substantial encumbrance." The court reasoned, "[w]hatever may be the definition of the word 'encumbered' when matters of title are considered in connection with contracts of sale, viewed as an insurable risk Mrs. Raulet's personal property was never 'encumbered.'" *Id.* at 219, 107 P. at 294. *Cf.* Windsor Mills Inc. v. Collins & Aikman Corp., 25 Cal. App. 3d 987, 993, 101 Cal. Rptr. 347, 351 (2d Dist. 1972) (refusing to enforce arbitration clause on ground that offeree is not bound to inconspicuous language contained in a document whose contractual nature was not obvious, thus apparently invoking a technical rule of contract to reach what it probably thought to be a fair result).

167. *See* Llewellyn, *supra* note 161, at 702-03.

168. It has been argued that the classical model of relatively equal strength parties dickering over terms no longer approximates reality in this day of centralization and growth of power. *See supra* notes 81-84 and accompanying text. It is said that traditional adhesion theory, designed to ameliorate abuses by construing terms consistent with the adhering party's reasonable expectations, still leaves gaps in the policing of harsh contracts. *See* Hurd & Bush, *supra* note 18, at 37

the minimum levels of integrity rule, permits courts to strike harsh terms that have escaped the traditional limits on the enforcement of contracts. This argument, however, presupposes that it is within the court's province and competency to police contracts for abusive terms. As previously discussed,[169] courts are not competent to review the fairness of contract terms, and this argument that courts should fill the "gaps" of contract law is thus unconvincing.

When courts are given the power to strike provisions on unconscionability grounds there is a danger that they will strike clauses that may be unfair but nevertheless do not shock the conscience. For example, since *Graham* there has been another case, *Hope v. Superior Court*,[170] relying on *Graham* in holding that the New York Stock Exchange arbitration procedure is unconscionable. The stock exchange arbitration, however, was much more fair than that in *Graham*. The exchange rules required the use of arbitrators independent of the securities business in addition to those engaged in that business.[171] Despite this effort to neutralize the arbitration, the court held that it suffered the same defect as the arbitration in *Graham*.[172] The *Hope* case is a manifestation of the danger of over-intrusive lawmaking by courts armed with substantive unconscionability.

The *Graham* court should not have imposed its minimum levels of integrity requirement on arbitration. The union arbitration cannot be considered unfair if Graham received valuable consideration for the arbitration clause. Moreover, courts are not competent to evaluate the fairness of the arbitration clause. Finally, the *Graham* rule of unconscionability is overly intrusive and opens the door to even more judicial interference with arbitration procedures than the *Graham* court may have intended.

CONCLUSION

This Note examined the *Graham* decision and argued that it was incorrectly decided. While the adhesion finding may seem consistent with the realistic choice standard and with outmoded notions of freedom to contract, on closer examination the court's holding is contrary to the spirit and purpose of adhesion theory—the protection of the

("If one knows what he is getting into, then the developing doctrine would provide little basis for him to complain about the oppressiveness of the terms he accepted."). These gaps are created by the tension between the inequality of bargaining power today and existing contract law that assumes that parties are of equal bargaining power and that, therefore, abuses do not exist. *Id.* at 15 (the freedom of contract model "assumes a priori that this characteristic of abuse does not exist").

169. *See supra* notes 159-65 and accompanying text.

170. 122 Cal. App. 3d 147, 175 Cal. Rptr. 851 (1st Dist. 1981).

171. *Id.* at 150, 175 Cal. Rptr. at 853.

172. *Id.* at 154-55, 175 Cal. Rptr. at 856.

weak. Graham, unlike traditional adhering parties, had ample means to protect himself and should not have been additionally protected by the court. Further, the court should not have rendered the union arbitration substantively unconscionable for its presumptive bias. By doing so, the *Graham* court opened the door to judicial tampering with freely negotiated but presumptively biased arbitration agreements.

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