Nagrampa Sets the Standard for California Arbitration Agreements in Franchise Contracts

The Nagrampa decision of the Ninth Circuit Court of Appeals in December 2006 can be summarized as follows:

In Nagrampa v. MailCoups, Inc. the Ninth Circuit considered a challenge by a franchisee to the enforceability of the arbitration provision contained in her franchise agreement. To the surprise of many, the court agreed with the franchisee and voided the entire provision as "unconscionable."

A determination that a contract -- including a franchise agreement -- or a specific provision contained in a contract is unconscionable requires a finding that it is both "procedurally unconscionable" and "substantively unconscionable." In determining overall unconscionability, courts generally apply a "sliding-scale" whereby a greater degree of substantive unconscionability will require a lesser degree of procedural unconscionability, and vice-versa.

"Procedural unconscionability" relates to the interaction between the parties in connection with the entering into of the contract, and may be based on "oppression" (such as unequal bargaining power and the contractual terms being offered on a take-it-or-leave-it basis) and/or "surprise" (such as certain terms being buried in a contact or worded in confusing way). "Substantive unconscionability" relates to the actual terms of the contract, and may be found if a contract or contract provision is "overly harsh" or "unfairly one-sided."

Even though there was a relatively low degree of procedural unconscionability in connection with the franchise agreement in Nagrampa, the court found that the following factors presented a sufficient level of substantive unconscionability to invalidate the *entire* arbitration provision: (1) The provision permitted the franchisor -- but not the franchisee -- to step outside the arbitration context and go into a court in order to obtain injunctive relief with respect to intellectual property issues. (2) It designated a burdensome venue for arbitration (Boston), far from the location of the franchisee (in California). (3) The franchise agreement stated that the venue provision may be unenforceable under California law, which led the franchisee to believe that it was unlikely that she would be forced to travel across the country to assert her claims. (4) It required the parties to split the fees of arbitration, a provision which, like the venue provision, would impede the franchisee's ability to seek recourse under California law because it would require the franchisee to incur significant fees that she would not otherwise incur were she to attempt to vindicate her rights via the court system.