common law is based, incredibly large though it may be, is to the commercial life of our country as is a sand castle, not just to the beach on which it sits, but to the globe of which that beach is a part.

This observation should not be taken to mean that case law is therefore irrelevant to commercial practice. Once a dispute has arisen, a lawyer's estimate of how that dispute would be resolved in court will be one of the most important factors she weighs in advising her client on what terms that dispute should be settled. It will not, however, be the only factor. Knowledge of the rules of law is an important, indeed indispensable, tool for the lawyer, but it may be no more important than a number of other ones, such as knowledge of business practices, human understanding, and simple common sense. (2) What are the legal issues that the court is called on to decide? (3) How does the court decide those issues, and why? Then consider the questions that follow the opinion in light of our discussion above.

E. CONTRACT LAW THROUGH CASE STUDY: AN EXAMPLE

We have suggested a variety of perspectives from which the law student (as well as the law teacher, the lawyer, and the judge) can attempt to understand, evaluate, and apply the work of judges as expressed in the reports of decided cases. Reproduced below is a written opinion from the Supreme Court of Nevada. First read the opinion carefully with an eye toward the following questions: (1) What apparently happened between the parties that brought about this lawsuit? (2) What are the legal issues that the court is called on to decide? (3) How does the court decide those issues, and why? Then consider the questions that follow the opinion in light of our discussion above.

Burch v. Second Judicial District Court of Nevada

(Double Diamond Ranch, LLC, and Double Diamond Homes, LLC, Real Parties in Interest)
Supreme Court of Nevada
49 P.3d 647 (2002)

Before SHEARING, ROSE and BECKER, JJ.

OPINION

PER CURIAM:

This petition challenges a district court order granting a motion to compel arbitration in favor of real parties in interest Double Diamond Ranch, LLC and Double Diamond Homes, LLC (Double Diamond). Petitioners James and Linda Burch purchased a new home and a homebuyer warranty from Double Diamond. When problems developed in their home, they contacted Double Diamond to fix them. After attempts at mediation failed, the Burches filed a complaint in district court for damages relating to Double Diamond's construction of their new home. The district court concluded that the Burches had entered into a valid contractual agreement, via the homebuyer warranty, to resolve any disputes concerning their

home through arbitration. We disagree, and we, therefore, grant this petition for a writ of mandamus.

FACTS

In March 1997, the Burches purchased a new Diamond Country home developed and constructed by real parties in interest Double Diamond. In October 1997, approximately four months after closing, Double Diamond gave Linda Burch a thirty-one-page warranty booklet and asked her to sign a one-page "Application for Home Enrollment" for the 2-10 Home Buyers Warranty (HBW) offered by Double Diamond. She signed the "application" form, but she did not read the thirty-one-page booklet.

The HBW purports to be an express limited warranty. It provides one-year coverage that warrants the home will be free from materials and workmanship defects. In the second year, the coverage narrows to electrical, plumbing, and mechanical systems defects. For ten years, the HBW provides coverage that warrants the home will be free from structural defects.

The one-page "Application for Home Enrollment" states in paragraph nine that,

> [b]y signing, Homebuyer acknowledges that s/he has viewed and received a video of "Warranty Teamwork: You, Your Builder & HBW", read the warranty and has received a copy of this form with the Home Buyers Warranty Booklet and CONSENTS TO THE TERMS OF THESE DOCUMENTS INCLUDING THE BINDING ARBITRATION PROVISION contained therein.

The HBW's arbitration clause provides, in pertinent part, that:

> Any controversy, claim or complaint arising out of or relating to Builder's workmanship/systems limited warranty coverages provided by Builder under the terms of this agreement which Homebuyer and Builder do not resolve by mutual agreement shall be settled by *final and binding* arbitration in accordance with the Construction Arbitration Services (CAS) or other [National Home Insurance Company] NHIC/HBW approved rules applicable to the home warranty industry in effect at the time of the arbitration. . . .
>
> Any controversy concerning a claim arising out of or relating to the Builder's ten year structural coverage (insured by NHIC) shall be settled by final and binding arbitration. . . . Arbitration of all structural warranty disputes will be conducted by arbitrators supplied by an NHIC approved arbitration service.

This arbitration clause further provides that the final and binding arbitration is governed by the Federal Arbitration Act (FAA)[1] "to the exclusion of any provisions of state arbitration law."

In January 1999, the Burches complained to Double Diamond about "serious problems underneath [their] house"—saturated floor joists, wet insulation, muddy ground, and a wet, moldy foundation. They requested that Double Diamond remedy the situation by removing the insulation, professionally treating the area with mildew and fungicide controls, installing upgraded insulation with proper venting, constructing a proper water barrier underneath the house, and reimbursing them for all current and future fees for professional inspections. While contesting liability, Double Diamond offered to completely dry the crawl space underneath the

1. 9 U.S.C. §§1-16 (2000).

house, install two additional foundation vents and a six-mill vapor barrier, treat all areas of active fungus with an approved fungicide, and reinstall insulation except at the rim joist.

The Burches were not satisfied with this offer. After both parties stipulated to waive mediation, the Burches filed a complaint for damages with the district court, alleging breach of express and implied warranties, negligence, and fraud and misrepresentation. Double Diamond filed a motion for a stay and a motion to compel arbitration, arguing that the HBW provided for final and binding arbitration of all disputes relating to the construction of the Burch home. The district court found the HBW valid and granted the motion to compel arbitration. The Burches now request that this court issue a writ of mandamus directing the district court to vacate its order compelling the Burches to arbitrate their claims against Double Diamond.

DISCUSSION

Because an order compelling arbitration is not directly appealable, the Burches appropriately seek writ relief from this court. When there is no plain, speedy, and adequate remedy at law, a writ of mandamus is available to compel the district court to perform a required act, or to control an arbitrary or capricious abuse of discretion. Under the circumstances of this case, the HBW is an unconscionable adhesion contract and, therefore, unenforceable. The district court should not have compelled arbitration under the unenforceable clause. Accordingly, we grant the petition for a writ of mandamus.

This court has defined an adhesion contract as "a standardized contract form offered to consumers . . . on a 'take it or leave it' basis, without affording the consumer a realistic opportunity to bargain." "The distinctive feature of an adhesion contract is that the weaker party has no choice as to its terms." Here, the one-page "application" and the HBW were pre-printed, standardized contract forms. The Burches, the weaker party, were not given an opportunity to negotiate the HBW's terms with Double Diamond or its insurer, National Home Insurance Company (NHIC); they were required to "take it or leave it." Therefore, the HBW agreement between the Burches and Double Diamond is an adhesion contract. This court permits the enforcement of adhesion contracts where there is "plain and clear notification of the terms and an understanding consent[,]" and "if it falls within the reasonable expectations of the weaker . . . party." This court need not, however, enforce a contract, or any clause of a contract, including an arbitration clause,[8] that is unconscionable.[9]

Although the FAA establishes a strong public policy favoring arbitration for the purpose of avoiding the unnecessary expense and delay of litigation where parties have agreed to arbitrate,[10] it does not mandate the enforcement of an unconscionable contract or arbitration clause.[11] The United States Supreme Court has interpreted §2 of the FAA and held that "[s]tates may regulate contracts, including

8. See NRS [Nevada Revised Statutes] 38.035 ("A written agreement to submit any existing controversy to arbitration or a provision in a written contract to submit to arbitration any controversy thereafter arising between the parties is valid, enforceable and irrevocable, *save upon such grounds as exist at law or in equity for the revocation of any contract.*" (emphasis added)).

9. See NRS 104.2302(1) (court may refuse to enforce an unconscionable contract).

10. See Allied-Bruce Terminix Cos. v. Dobson, 513 U.S. 265, 270-71, 115 S.Ct. 834, 130 L.Ed.2d 753 (1995).

11. See Doctor's Associates, Inc. v. Casarotto, 517 U.S. 681, 687, 116 S.Ct. 1652, 134 L.Ed.2d 902 (1996) (holding that generally applicable contract defenses, such as unconscionability, may be used to invalidate an arbitration clause).

arbitration clauses, under general contract law principles and they may invalidate an arbitration clause 'upon such grounds as exist at law or in equity for the revocation of *any* contract.'"[12] Unconscionability, therefore, is a legitimate ground upon which to refuse to enforce the HBW and its arbitration clause.[13]

Generally, both procedural and substantive unconscionability must be present in order for a court to exercise its discretion to refuse to enforce a contract or clause as unconscionable.[14] The circumstances present in this case significantly render the HBW procedurally unconscionable. The Burches did not receive a copy of the HBW's terms until after Double Diamond had paid the premium to enroll the Burch home in the warranty program and almost four months after they closed escrow on their home. Double Diamond told the Burches that the HBW's issuance was "automatic" and offered extra protection for their home, when in fact the warranty limited their protection under Nevada law.[15] The Burches did not have an opportunity to read the one-page "application" form, or the thirty-one-page HBW booklet, or to view the HBW video before signing the "application." The arbitration clause was located on page six of the HBW booklet, after five pages of material only relevant to persons residing outside of Nevada. The Burches were not sophisticated consumers, they did not understand the HBW's terms, and the HBW's disclaimers were not conspicuous.[16] Under these circumstances, the Burches did not have a meaningful opportunity to decide if they wanted to agree to the HBW's terms, including its arbitration provision. As a result, the HBW was procedurally unconscionable.

Because the procedural unconscionability in this case is so great, less evidence of substantive unconscionability is required to establish unconscionability.[17] The HBW's arbitration clause is also substantively unconscionable because it grants Double Diamond's insurer, NHIC, the unilateral and exclusive right to decide the rules that govern the arbitration and to select the arbitrators. These provisions are "oppressive terms,"[18] and as such, are substantively unconscionable and unenforceable. We do not hold that a homebuyer warranty with an arbitration clause will always be unconscionable or unenforceable. Under the circumstances in this case, however, the HBW and its arbitration clause *are* unconscionable and, therefore, unenforceable.

We, therefore, grant the petition and direct the clerk of this court to issue a writ of mandamus directing the district court to vacate its order compelling arbitration.

Notes and Questions

1. *Parties to the dispute.* As is apparent from the Nevada Supreme Court's discussion, the dispute in this case is between the home-buying Burches and their seller,

12. *Allied-Bruce Terminix,* 513 U.S. at 281, 115 S.Ct. 834 (quoting 9 U.S.C. §2 (emphasis added)); see also *Doctor's Associates,* 517 U.S. at 687, 116 S.Ct. 1652.

13. See *Doctor's Associates,* 517 U.S. at 687, 116 S.Ct. 1652.

14. See, e.g., First Family Financial Services, Inc. v. Fairley, 173 F.Supp.2d 565, 569-71 (S.D. Miss. 2001); . . . Armendariz v. Foundation Health Psychcare, 24 Cal.4th 83, 99 Cal.Rptr.2d 745, 6 P.3d 669, 690 (2000); . . . Complete Interiors, Inc. v. Behan, 558 So.2d 48, 52 (Fla. Dist. Ct. App. 1990); M.A. Mortenson Co. v. Timberline Software, 140 Wash.2d 568, 998 P.2d 305, 314-15 (2000).

15. Cf. Sierra Diesel Injection Service v. Burroughs Corp., 890 F.2d 108, 113 (9th Cir. 1989) ("[E]xclusions of warranties are generally disfavored. . . . They are subject to the general obligation of good faith and of not imposing unconscionable terms upon a party.").

16. See NRS 104.1201(10) ("Whether a term or clause is 'conspicuous' or not is for decision by the court."); see also *Sierra Diesel,* 890 F.2d at 115 (explaining that even the use of capital letters in disclaimers will not be "effective in all cases").

17. See *Armendariz,* 99 Cal.Rptr.2d 745, 6 P.3d at 690.

18. 24 Hour Fitness, Inc. v. Superior Court, 66 Cal.App.4th 1199, 78 Cal.Rptr.2d 533, 541 (1998).

Double Diamond (actually two legal entities, treated by the court as essentially one). The District Court is named as a defendant only for procedural reasons, as briefly explained in the Supreme Court's opinion; the relief sought (and granted) here was in the form of an order to the lower court to refrain from remitting the parties to arbitration. Decisions rendered by a multi-judge court are frequently in the form of an opinion signed by one judge, with the other judges concurring or dissenting in the opinion. In this case, however, the Nevada Supreme Court employs another common form of judgment, by issuing a "per curiam" ("by the court") decision.

2. *Nature of the dispute.* The underlying dispute between the parties is over the quality of the construction in the home that Double Diamond sold to the Burches in 1997. The Burches apparently claim that defects in their home give them rights against Double Diamond under their original contract of purchase. Those rights might vary, depending upon both the terms of that original contract and the possible application of rules of law (statutory or judicially-created) protecting home buyers against certain kinds of defects in construction. (We will consider some of these possibilities in our discussion of warranties, in Chapter 6.) Because the court does not need to reach that issue, it does not discuss the extent of those rights, except to suggest that the "Home Buyers Warranty" (HBW) offered to the Burches by Double Diamond actually limited their rights from what they would otherwise have been, rather than extending them. As you will learn from both your contracts and your torts classes, defective construction can give rise to different types of claims, sometimes in tort, sometimes in contract, and sometimes both. Here it appears that the Burches' underlying claim would be contractual, although it may not be clear from this opinion whether — apart from the effect of the arbitration clause — the Burches' rights against Double Diamond will be limited to those stated in the HBW.

3. *Litigation vs. arbitration.* In *Burch,* the court must decide whether the dispute will be resolved through arbitration or by litigation in the Nevada state courts. Since early in the last century, arbitration has been increasingly employed by parties to commercial disputes, as a faster and often cheaper mode of dispute resolution than litigation in court. Legislation at both the state and federal level has overcome the initial judicial reluctance to enforce agreements calling for arbitration of disputes that might in the future arise between the parties. The Federal Arbitration Act ("FAA"), referred to by the court in the *Burch* case, was originally intended primarily to require the federal courts to enforce such private arbitration agreements; it has in more recent years been construed by the United States Supreme Court to apply to state as well as federal courts, and to preempt state law (statutory or decisional) that disfavors private arbitration of disputes. Thus, as a matter of federal law, the Nevada Supreme Court in deciding the Burches' petition must make its decision within the parameters of the FAA, as that statute has been interpreted by the U.S. Supreme Court. The Nevada court is also bound by any applicable Nevada statutes, except to the extent that those may be inconsistent with, or "preempted" by, the FAA.

4. *Validity of the contractual agreement to arbitrate disputes.* If arbitration is generally a faster and cheaper way to resolve disputes, you may be wondering why the Burches are resisting the lower court's order that their dispute with Double Diamond proceed to arbitration. Presumably their attorney has concluded that for them arbitration has more disadvantages than advantages. Some of those disadvantages are discussed in the court's opinion, but there may be others, such as the expense of arbitrators' fees, procedural limitations regarding discovery or the rules of evidence, the absence of trial by jury, and the absence of judicial review of the arbitrators' decision. (See generally Professor Knapp's article on the subject, Taking Contracts Private: The Quiet

Revolution in Contract Law, 71 Fordham L. Rev. 761 (2002); references to many other discussions of this topic can be found at p. 763, fn. 7 of that article.) Although the FAA does require courts to send disputes to arbitration when a valid agreement between the parties so provides, the FAA also mandates (as, typically, do the various state arbitration statutes) that an arbitration agreement should not be enforced if that agreement is invalid for some reason under state law. (See the text at footnote 12 of the *Burch* opinion, quoting the statute.) Some of the possible reasons for a contract's invalidity would be fraud, duress, undue influence, or lack of capacity, all of which are addressed later in these materials. In the *Burch* case, as in much of the recent litigation involving enforcement of "mandatory" (i.e., pre-dispute) arbitration clauses, the principal defense to arbitration is that the arbitration scheme called for by the agreement in the circumstances is "unconscionable" and for that reason unenforceable. We will further address the general topic of unconscionability in Chapter 7, but from the Nevada Supreme Court's opinion you are already aware that an unconscionability analysis typically involves two distinct questions: Whether the agreement in question is "procedurally" unconscionable (or, as it is sometimes phrased, whether there was "an absence of meaningful choice" for one of the parties); and whether it is "substantively" unconscionable — so unfair or unjustifiably one-sided that the court determines enforcement would be inappropriate and unjust.

5. *Procedural unconscionability: the "standardized form" contract.* In this case, as in much of present-day contracting, the agreement between the parties was drafted by one party and "signed onto" by the other, with little or no bargaining over its details, and perhaps with one party not understanding or even reading its provisions. (At least this appears to have been true of the HBW; we have no information about the underlying home-sale contract between the Burches and Double Diamond.) As we will see in Chapter 3, contract law has traditionally regarded the process of contract-formation as involving "offer and acceptance" (and perhaps "counter-offers" as well), with the parties bargaining their way toward an eventual agreement that both understand and agree to. The vast majority of present-day contracts do not result from this sort of bargaining, however; they involve the use of "standardized forms," which one party (typically a business entity) prepares and presents to the other (possibly a consumer or employee, possibly another business), either on a "take-it-or-leave-it" basis, or perhaps with bargaining over a few provisions but not over the rest. The Nevada Supreme Court characterizes this sort of contract as a "contract of adhesion," and indicates that it will probably be regarded as "unconscionable" in the "procedural" sense, as not evidencing a "meaningful" choice by the Burches. From your experience, does the court's description of this contract-formation process seem to you to be probably accurate? Not all courts would agree either that the contract in *Burch* is necessarily one of "adhesion," or that every adhesion contract is necessarily unconscionable, even in the procedural sense. At various places in these materials, we will address some of the legal problems created by the use of standardized form contracts, as well as other potential types of unconscionability, both "procedural" and "substantive."

6. *Substantive unconscionability: the presense of "oppressive terms."* The court's discussion of the agreement's unfairness in *Burch* is less extensive, perhaps because of the court's holding that less evidence of substantive unconscionability is required when procedural unconscionability has been amply demonstrated. What are the features of this arbitration scheme that the court finds oppressively unfavorable

to the Burches? It is clear from the past decisions of the United States Supreme Court and other courts, both state and federal, that the mere fact that a party is being remitted to arbitration may not under the FAA be regarded as per se unconscionable, because that would inappropriately "disfavor" arbitration; arbitration is a different method of dispute resolution, but not necessarily an unfair one. There must be something in the particular scheme, or in its application to the particular party, that takes it out of the ordinary run. Besides those identified by the court in *Burch,* other aspects of arbitration that courts have found to be unconscionable include economic hardship stemming from the costs of arbitration, unavailability of relief as great as that afforded by litigation, prohibition of class actions, and undue limitation of the proceedings in various other ways — time limitations, limits on discovery, etc.

7. *Lawyering skills.* Often in these materials we will also be focusing on lawyering issues, critically considering how effectively the attorneys involved in the case performed their roles as drafters, counselors, negotiators, and advocates. The Burches' lawyer presumably counseled them that they should litigate the issue of whether their warranty was subject to arbitration because the disadvantages of arbitration outweighed the advantages to them. See Note 4 above. After the decision, Double Diamond's lawyer might be asked to advise the company about what steps it could take to make it more likely that its arbitration agreement would be enforced in future cases. If you were that lawyer, what advice would you give?

8. *Theoretical perspectives.* As the introductory text illustrates, throughout these materials we will attempt to provide you with excerpts and summaries of scholarly perspectives on various issues of contract law. We have given you only brief descriptions of these scholarly outlooks, but one way to distinguish among them is to consider the kinds of questions that a disciple of a particular scholarly method might ask. For example, a legal realist might ask for articulation and critical consideration of the social values a decision or rule promotes. Adherents of the economic approach to law will typically ask whether a decision or rule promotes or impedes efficiency. A supporter of relational contract theory would ask whether a contract involves parties who have a long-term rather than a discrete relationship and, if so, whether the decision or rule recognizes and supports such relationships. Finally, a scholar employing critical theory might ask which social groups are benefitted and which are harmed by a supposedly neutral rule. Directed to the *Burch* decision, what answers would you give to these questions? Which of these questions seem helpful to you in understanding the court's decision in *Burch*? What other questions would you ask about the opinion?

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