

Preserving The Validity Of Agreements To Arbitrate: The Need For Mutuality In Business-to-Consumer Transactions

Stacie M. Otte

NATIONAL ARBITRATION FORUM

The prototypical arbitration agreement takes the form of a mutual promise between contracting parties to bring disputes that would otherwise be litigated in court to arbitration. In practice, however, a business party contemplating a consumer arbitration agreement may consider drafting some exceptions to the obligation to arbitrate.

The exercise of drafting these exceptions, of course, most often limits the scope of the drafting party's obligation to arbitrate while ensuring that the non-drafting party is fully bound to bring all of their disputes to arbitration. And in some situations, a limited lack of mutuality may be appropriate. However, parties who draft non-mutual arbitration obligations in the consumer context subject themselves to the risk that a reviewing court will refuse to enforce the arbitration agreement, exposing the drafter to all of the vagaries of the litigation process that the arbitration agreement was designed to avoid.

There is ample authority for the proposition that consumer arbitration agreements will not be enforced where they – either functionally or on the face of the agreement – permit a business to access a judicial forum for claims they would likely assert against a consumer, while requiring the consumer to assert all claims in arbitration. Because state contract law governs the enforceability of arbitration agreements, 9 U.S.C. § 2, the doctrine of unconscionability is a potential defense to a non-mutual, or unilateral, arbitration agreement.

No *per se* rule invalidates a unilateral arbitration agreement based on unconscionability. Instead, the doctrine is applied on a case-by-case basis with varying degrees of flexibility. See *Pro Tech Indus., Inc. v. URS Corp.*, 377 F.3d 868, 872-73 (8th Cir. 2004) (noting that the court must look “to the entire atmosphere in which the agreement was made”); *Hughes Training Inc. v. Cook*, 254 F.3d 588, 593-94 (5th Cir. 2001) (“The substantive aspect of unconscionability is concerned with the fairness of an agreement and must be settled on a case by case basis.”).

Demonstrating the risk that non-mutual arbitration agreements create, several state supreme courts and federal circuits have held arbitration agreements lacking mutuality to be substantively unconscionable. See, e.g., *Iberia Credit Bureau, Inc. v. Cingular Wireless LLC*, 379 F.3d 159, 169 (5th Cir. 2004); *Ferguson v. Countrywide Credit Indus., Inc.*, 298 F.3d 778, 784-86 (9th Cir. 2002); *Wisc. Auto Title Loans, Inc. v. Jones*, 714 N.W.2d 155, 173 (Wis. 2006); *Taylor v. Butler*, 142 S.W.3d 277 (Tenn. 2004).

Stacie M. Otte is Senior Legal Counsel at National Arbitration Forum. For additional recommendations about drafting effective arbitration provisions, Ms. Otte can be reached at (952) 516-6440.



Stacie M. Otte

Examples Of Lack Of Mutuality

In some arbitration agreements, the inequality is quite plainly stated. In *Iberia Credit Bureau v. Cingular Wireless*, the arbitration terms drafted by wireless provider Centennial Beauregard Cellular explicitly bound the customer but not the provider: “[y]ou agree that instead of suing in court, you will arbitrate any and all disputes and claims arising out of this Agreement or the Service.” 379 F.3d at 168. The court noted that the patent one-sidedness of the arbitration obligation “raises a serious question as to the clause’s validity,” and ultimately denied Centennial’s motion to compel arbitration. *Id.* at 171.

In most situations, however, the inequality is less obvious. The Wisconsin Supreme Court recently held that “the broad, one-sided, unfair ‘save and except’ parenthetical in the arbitration provision of the loan agreement allowing [the lender] full access to the courts, free of arbitration, while limiting the borrower to arbitration renders the arbitration provision substantively unconscionable.” *Wisc. Auto Title Loans*, 714 N.W.2d at 160.

In *Wisconsin Auto Title Loans*, Jones received a short-term loan and granted a security interest in her automobile. The loan contract arbitration agreement broadly required arbitration of “[a]ny and all disputes... arising out of or related to this Agreement,” but parenthetically stated: “(save and except the LENDER’s right to enforce the BORROWER’s payment obligations in the event of default, by judicial or other process, including self-help repossession).” *Id.* at 160-61. After Jones defaulted on the loan, Title Loans sued and Jones’ answer alleged numerous counterclaims on behalf of a putative class of borrowers. Title Loans moved for a stay pending arbitration. *Id.* at 162.

The court analyzed substantive unconscionability by determining whether the terms were “commercially reasonable” or unreasonably favorable to the more powerful party. *Id.* at 166. The court noted that the “save and except” parenthetical did more than simply allow recourse to court to replevy the loan collateral. It also permitted Title Loans to go to court to enforce payment obligations in the event of default. In fact, the exception permitted the lender to litigate using “any... proce-

dures that a lender might pursue to satisfy the borrower’s obligation under the loan agreement.” *Id.* at 172.

The court concluded that this lack of mutuality was “too broad” and that the “doctrine of substantive unconscionability limits the extent to which a stronger party... may impose arbitration on the weaker party without accepting the arbitration forum for itself.” *Id.* at 173.

Similarly, in *Taylor*, a used car buyer took possession of a vehicle “pending the purchase of the installment sales contract by a financing institution” and subject to the dealer’s right to rescind if proper financing could not be obtained within three days. 142 S.W.3d at 280. One week after the sale, the dealer notified the purchaser that financing had not been approved and eventually repossessed the car. The purchaser sued under state consumer protection statutes and for fraudulent inducement. The dealer moved to compel arbitration. *Id.* at 281.

The arbitration agreement stated that “Dealer... may pursue recovery of the vehicle... and Collection of Debt due by state court action.” *Id.* at 284. The court concluded that the dealer had reserved a judicial forum “for practically all claims that it could have,” stating that “it is hard to imagine what other claims it would have... other than one to recover the vehicle or collect a debt.” *Id.* at 286. Accordingly, the court refused to enforce the arbitration agreement. *Id.* at 287.

Finally, courts have also applied this type of unconscionability analysis where the contract language was facially neutral (giving each party a choice to arbitrate), but the effect was to allow the business to sue, while forcing the customer or employee to arbitrate. See, e.g., *Lytle v. Citifinancial Servs., Inc.*, 810 A.2d 643 (Pa. Super. 2002) (remanding facially neutral clause permitting neither party to arbitrate foreclosure claims or matters involving \$15,000 or less in damages for unconscionability determination).

Remedies For Unconscionable One-Sidedness

Parties drafting unilateral arbitration agreements risk losing the benefits of arbitration. Courts may find the entire arbitration agreement unenforceable. In such a case, a court would resolve the dispute and the quicker, more efficient, and less expensive resolution process elected by the parties – arbitration – would no longer be an option.

The range of remedies for unconscionable provisions in an arbitration agreement include:

- Holding the entire arbitration agreement unenforceable such that neither party will be allowed to arbitrate disputes. See, e.g., *Iberia Credit Bureau*, 379 F.3d at 171; *Wisc. Auto Title Loans*, 714 N.W.2d at 178.

- Severing the unconscionable provisions and enforcing the remainder of the arbitration agreement. See *Kinkel v. Cingular Wireless, LLC*, 828 N.E.2d 812 (Ill. App. 2005) (severing unconscionable class action prohibition clause from arbitration agreement).

- Refusing to enforce the entire contract because of the unconscionable provision. See, e.g., CAL. CIV. CODE § 1670.5(a).

When a widely used form contract is invalidated, there is a significant risk that other jurisdictions will use the opinion as persuasive precedent to strike down the clause in other litigation. In these cases, dispute resolution is returned to the regimen of civil litigation, jury trials, and class actions.

Avoiding Potential Challenges For A Non-Mutual Arbitration Agreement

Because unconscionability determinations are dependant upon particular facts and circumstances, it is extremely difficult to predict how a court will apply the doctrine to unilateral arbitration agreements. And unconscionability tests vary across jurisdictions. Also, mutuality is rarely weighed in isolation: there are most often other substantive unconscionability elements that must also be considered. Finally, the court must also take procedural unconscionability considerations into account.

What is clear is that these risks disappear if the arbitration agreement is balanced and mutual. Several options are available to avoid mutuality problems when drafting an arbitration agreement:

- Both parties agree to arbitrate all disputes. Arbitrators are permitted to award all legally available remedies, including awards permitting repossession of goods, so reserving the judicial forum for certain types of claims is unnecessary.

- If the business party still wants to reserve certain types of disputes to be resolved in a judicial forum, it should carve-out equivalent exceptions for both itself and the other contracting party.

- If unilateral carve-outs are retained, they should involve procedures or remedies that courts have clearly held do not violate mutuality (such as self-help repossession).

Conclusion

In the majority of jurisdictions, a lack of mutuality in the obligation to arbitrate disputes can render an arbitration agreement unenforceable on unconscionability grounds. Potential remedies include invalidating all or part of the arbitration agreement, or invalidating the entire contract.

To eliminate the risk that an arbitration agreement will be held invalid, parties should draft truly mutual obligations and take advantage of the fact that all legally available remedies can be obtained in arbitration. See, e.g., National Arbitration Forum *Code of Procedure* Rule 20(D). For example, both replevin/possession actions and actions for damages can be decided in arbitration, eliminating any perceived need by the business party to resort to court for its most important classes of relief.

Even when the business party is able to successfully rebuff an unconscionability challenge by arguing facts and circumstances or business necessity, they must incur litigation expenses and delays, and manage the non-trivial risk of an adverse court decision. The safest course is to eliminate the expense and delay of litigating difficult threshold issues such as unconscionability by maximizing both facial and actual mutuality when drafting any consumer arbitration agreement.

Please email the author at sothe@adrforum.com with questions about this article.