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## True Mutuality in the Obligation to Arbitrate Protects Agreement Enforceability

### *Recent Cases Are a Reminder to Make Agreement to Arbitrate Reciprocal*

An arbitration agreement that requires arbitration of all disputes between the parties, but that proceeds to carve out exceptions so broad that nearly every claim that could be brought by one party falls within the exceptions, can be challenged and potentially invalidated on either contract formation or unconscionability grounds. Parties seeking to avoid this risk should mutually promise to arbitrate any disputes that arise.

### *Illusory Promise*

In *Gonzalez v. West Suburban Imports, Inc.*, 411 F.Supp.2d 970 (N.D. Ill. 2006), Gonzalez claimed West Suburban violated the Truth in Lending Act and committed fraud by double counting a trade-in vehicle to increase the sale price of the purchased vehicle. West Suburban sought to compel arbitration, and Gonzales argued that the Arbitration Agreement was unenforceable because there was no mutual obligation to arbitrate.

West Suburban contended that the Arbitration Agreement was just a part of the larger purchase transaction and there was sufficient consideration because they would not have sold the car without the executed Arbitration Agreement.

The court concluded: “The express language of the Agreement makes clear that it is intended to require [Gonzalez] to arbitrate any claims that they could assert against [West Suburban], but it imposes no such reciprocal obligation on [West Suburban].”

The court found that the extensive exceptions listed in the definition of “dispute” left no claim that West Suburban Imports would be required to arbitrate. Accordingly, such promises are illusory and unenforceable because West Suburban had not obligated itself to do anything.

Moreover, the court found West Suburban’s argument that broader consideration existed “unpersuasive.” The Arbitration Agreement was a separate document that contained survival language that bound the parties to arbitration regardless of the survival of any of the separate agreements related to the vehicle purchase.

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As a result, the arbitration agreement was a separate contract that the court reviewed independently of the other purchase documents, and the specific lack of mutuality in

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the obligation to arbitrate caused the court to invalidate the arbitration clause.

### *Unconscionability*

The borrower in *Wisconsin Auto Title Loans, Inc. v. Jones*, No. 2003AP2457 (Wis. May 25, 2006), used his car as collateral to obtain an \$800 loan from Title Loans. The preprinted loan agreement contained an arbitration provision whereby the parties agreed to arbitrate all claims “save and except [Title Loan’s] right to enforce [Jones’] payment obligations in the event of default, by judicial or other process, including self-help repossession.”

Under this provision, if Jones initiated arbitration, he would have to pay the first \$125.00 of the filing fee.

When Jones defaulted, Title Loans sued to recover possession of his car. Jones counterclaimed, and Title Loans moved to compel arbitration

of the counterclaims.

The Court held that the arbitration provision was both procedurally and substantively unconscionable.

Procedural unconscionability turned upon the fact that “[t]he formation of the contract was a product of the parties’ unequal bargaining power and did not reflect a real and voluntary meeting of the minds of the contracting parties.”

The Court’s finding of substantive unconscionability was based almost entirely on the one-sidedness of the carve-out provision allowing Title Loans to seek a replevin and deficiency judgment in court. The Court noted that “[t]he doctrine of substantive unconscionability limits the

extent to which a stronger party to a contract may impose arbitration on the weaker party without accepting the arbitration forum for itself.”

The agreement’s terms allow a

borrower to assert affirmative defenses to a replevin action in court, but require the borrower to take the same arguments to arbitration in order to bring a substantive claim against the lender. The Court found that this

*“[t]he doctrine of substantive unconscionability limits the extent to which a stronger party to a contract may impose arbitration on the weaker party without accepting the arbitration forum for itself.”*

—SUPREME COURT OF WISCONSIN

“possibility of dual forums ... imposes an unnecessary and undue burden on the borrower.”

As further support for its holding, the Court cited to other factors that “compound the substantive unconscionability.” Those factors included the requirement that Jones pay the first \$125 of the filing fee despite his presumed indigence and the reference to “self-help repossession” when Wisconsin law would not allow it.

### *Conclusion*

These cases highlight the risk of creating an arbitration agreement that allows only one party to turn to the courts for a remedy. Such provisions pave the way for courts to invalidate the agreement for a lack of mutuality and are wholly unnecessary because the remedies available in arbitration are the same as those available in court.

For example, arbitrators are empowered to decide rights of possession, and the Federal Arbitration Act entitles parties to court enforcement of the resulting award. Ultimately, parties benefit from drafting truly mutual agreements in which both parties enjoy the advantages of arbitration.

## Did You Know?

Recent United States Supreme Court opinions addressing arbitration issues have displayed a clear trend toward liberal enforcement of private agreements to arbitrate and granting broad authority to arbitrators. Examples:

- *Buckeye Check Cashing, Inc. v. Cardegna*, 12 S.Ct. 1204 (2006), determined that challenges to the validity of the underlying contract containing an arbitration clause are for the arbitrator to decide.
- *Green Tree Financial Corp. v. Bazzle*, 539 U.S. 444 (2003), emphasized that matters of contract interpretation “should be for the arbitrator, not the courts, to decide.”
- *Citizens Bank v. Alafabco, Inc.*, 539 U.S. 52 (2003), indicated that the general practice of commercial lending has sufficient impact on the national economy for the Federal Arbitration Act to govern individual loan transactions.
- *PacifiCare Health Systems, Inc. v. Book*, 538 U.S. 401 (2003), held that arbitrators, rather than courts, have the power to determine the meaning of contractual damages provisions.

It is clear that core principles of arbitration law—respect for private agreements to arbitrate and deference to arbitrator determinations—are alive and well in the nation’s highest court.

## Not All Challenges to Agreement Formation Deserve a Hearing

In proceedings to compel arbitration, there are four ways an opposing party can compel an evidentiary hearing with respect to arbitration agreement formation. The purchaser's counsel in *Linden v. Auto Trend, Inc.*, 923 So.2d 1281 (Fla.App. 2006) failed to utilize any of the four available methods.

Linden filed a complaint against Auto Trend in connection with a car he purchased from its lot. Auto Trend moved to compel arbitration, relying on a purchase order signed by Linden containing an arbitration clause.

At the hearing on the motion to compel arbitration, Linden's attorney argued that the motion required an evidentiary hearing "to address arbitration issues." After pressure from the court, the attorney explained that "we don't believe that there is an arbitration agreement."

When asked by the court if he had addressed the issues in his pleadings, the attorney replied, "Is there a requirement that I have to, Judge? Because I don't see any case law that says that." The court then granted Auto Trend's motion to compel arbitration. Linden appealed.

On appeal, Linden argued that he had raised an issue sufficient to require an evidentiary hearing with respect to the formation of the arbitration agreement. The court found that parties may demonstrate that a "substantial issue is raised" about the formation of the agreement to arbitrate in one of four ways: (1) arguments of counsel at a hearing; (2) filing a written opposition to arbitration; (3) filing affidavits; or (4) review of documents furnished by counsel.

While Linden's attorney attempted to raise the contract formation issue, the court found that he failed to specify any issue requiring an evidentiary hearing. Instead, the attorney stated that "we don't believe that there is an arbitration agreement," without any explanation of the signed arbitration agreement presented in court. Had the attorney legitimately argued that the arbitration agreement was unconscionable, the Court opined, he may have received an evidentiary hearing.

Linden's attorney mistakenly believed that evidentiary hearings are required once a motion to compel is filed. If a party disputes the validity of the agreement, it needs to specify its reasons to a court. Otherwise, a court can conclude there are no disputed "substantial issues" of fact and compel arbitration.

## Online Auction Not Complete Until All Sale Terms Are Satisfied

The District of South Carolina has enforced an arbitration provision in a purchase agreement even though the buyer did not sign the agreement until after he submitted the top bid in an eBay auction.

In *Gossett v. HBL, LLC*, No. 2:06-123-CWH, 2006 WL 1328757 (D.S.C. May 11, 2006) (unpublished), Gossett bought a Porsche Carrera GT for \$380,000 in an online auction on eBay. The terms of the auction required Gossett to pay 10% of the purchase price and contact the seller within 24 hours of the close of the auction. The terms further provided that "before vehicle is released for shipment to buyer, all sale related and title related paperwork must be signed and returned complete to seller."

When the auction closed, Gossett contacted the seller to finalize the purchase. At that time, he made a 10% down payment and signed a purchase agreement providing for mandatory arbitration of all claims except for three enumerated categories, which included claims arising under the Magnusson-Moss Warranty Act (MMWA).

Gossett sued United Auto Group (UAG) when his new car's engine began to knock. UAG moved to compel arbitration based on the purchase agreement.

*In compelling arbitration, the court illustrates that parties can complete large and complex transactions online...*

In opposing the motion to compel arbitration, Gossett argued that the arbitration provision was unenforceable "because the sale was complete at the fall of the electronic hammer." In response, UAG noted that the terms of the auction stated in

the eBay listing required Gossett to complete all sale related paperwork in order to finalize the transaction and that the seller reserved the right to re-list the vehicle if the high bidder failed to complete the paperwork.

The court concluded that the sale was not complete at the fall of the online hammer because paperwork completion was a condition precedent to the sale. In compelling arbitration, the court illustrates that parties can complete large and complex transactions online and still take advantage of dispute resolution provisions enacted after the initial terms (price, etc.) are finalized electronically.

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## Absence of Court Rules is a Benefit of Arbitration

An arbitration clause is not substantively unconscionable merely because it directs an arbitrator not to apply any federal or state rules of civil procedure or evidence.

In *Jones v. Titlemax of Georgia, Inc.*, 2006 WL 562189 (N.D.Ga. 2006), Jones pursued a Truth in Lending Act (TILA) claim against Titlemax after Titlemax acquired a security interest in Jones' car in exchange for a loan.

Jones asserted that the transaction was actually an illicit Payday Loan prohibited by Georgia law. O.C.G.A. §16-17-2. Yet, Jones failed to discuss the impact of the Federal Arbitration Act (FAA) or the enforceability of the arbitration clause in her initial Response.

Instead, Jones argued that the portion of the clause stating that "the arbitrator shall not apply any federal or state

rules of civil procedure or evidence," was "arbitrary, capricious...and designed to achieve a result without the slightest trace of due process."

The court determined that Jones' argument boiled down to an allegation of substantive unconscionability. However, arbitral limitations on traditional court mechanisms are "part and parcel" of the arbitration process, and do not offend due process. See *Caley v. Gulfstream Aerospace Corp.*, 428 F.3d 1359, 1378 (11th Cir. 2005).

Moreover, the clause did not preclude the arbitrator from establishing rules; it merely prohibited the arbitrator from adopting entire sets of court rules. This requirement is consistent with the election of innovative dispute resolution methods and makes arbitration preferable to litigation in many cases.

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