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Preserving Your Ability to Enforce Arbitration

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The idea of being embroiled in litigation can be daunting. Litigation brings uncertainty into your daily life, may cause embarrassment and can lead to loss of business. It is a significant, unwanted and often unplanned expense that rarely improves the bottom line.

In an effort to hedge against these concerns, many businesses include alternative dispute resolution ("ADR") clauses in their contracts. Unfortunately, businesses often lose their right to compel ADR due to defects in the ADR provision or mistakes that are created during the contracting process. Recent cases in California have further limited a business's ability to enforce ADR clauses. However, with a little planning, a business can avoid the common pitfalls that courts rely upon when denying a motion to enforce ADR.

Typically, businesses include ADR clauses in the "pre-printed" portion of a form contract. Without being technically enforceable, California courts have historically been hostile towards ADR provisions where they believe the parties to be in unequal bargaining positions and will invalidate provisions if the court finds them to be "unconscionable." To be unconscionable, an agreement or contractual provision must be both procedurally and substantively defective, though not necessarily in equal parts. Less of one can be offset by more of the other.

Procedural unconscionability is a primary reason cited by courts to invalidate ADR clauses. The most common procedural mistake is the tendency to bury the ADR provision deep in a contract or fail to make it clear that the customer is agreeing to ADR. This defect is compounded when consumers sign contracts without being provided sufficient time to review the contracts. Consumers also oppose attempts to enforce ADR with testimony that they were not given an opportunity to actually read what they were signing and/or that they felt rushed, and courts often give great weight to this evidence.

Although a court will not invalidate an ADR clause simply because it is included in a pre-printed form, in such situations, the court will scrutinize every other provision in the ADR clause. In a recent decision, the court in *Sanchez v. Valencia Holding Company, LLC* (2nd District Court of Appeal-10/24/11) found that the arbitration clause on the back side of the last page of a three page contract failed to sufficiently put the buyer of a used car on notice that the dealership wanted to arbitrate all claims arising out of the purchase of the vehicle. Even though the consumer was unaware the contract contained an arbitration clause, the court was not yet prepared to invalidate the arbitration agreement. The *Sanchez* court turned to the actual terms of the arbitration clause and found that several provisions clearly favored the business. The one-sidedness of the arbitration clause combined with the fact the consumer was not made aware of the clause or the terms caused the court to deny the car dealer the right to enforce arbitration.

Courts also now look beyond the arbitration provision and consider parole evidence. An otherwise enforceable agreement may be negated by the court based on discussions that take place between the parties prior to contracting. While parole evidence is generally inadmissible to alter the terms of a contract, another recent decision approved the introduction of extrinsic evidence to drastically limit the scope of the arbitration provision in an integrated contract with the effect of voiding it. *Burch v. Premier Homes, LLC* (2011) 2011 WL 4471805, 2011 Daily Journal D.A.R. 14,777.

In *Burch*, the plaintiff filed a construction defect action and the defendants moved to compel arbitration. The parties used a stan-

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ORANGE COUNTY BUSINESS JOURNAL

dard California Association of Realtors form contract for the sale which included a standardized arbitration provision. The plaintiff argued that she never intended to submit construction defect claims to binding arbitration and attempted to introduce evidence of the parties' discussions leading up to her signing the purchase contract. The court considered the plaintiff's testimony and found that the parties never agreed to submit the construction defect claims to arbitration. What is alarming about the decision is that the court did not discuss unconscionability or the substance of the arbitration provision. Instead, the opinion relied entirely on the plaintiffs' testimony that she never intended to arbitrate defect claims.

If you are relying on an arbitration clause in your current contract to reduce litigation expenses and shorten the dispute resolution process, make sure that you do not fall victim to your own assumptions. Do not assume that a pre-printed form that includes an arbitration provision will protect your business. You need to take a moment and make sure that the arbitration clause in your contract is conspicuous. One-sided provisions will make it more difficult to enforce arbitration. If you do not want to give up certain one-sided aspects of your arbitration provision, then it is equally important that you define the process by which you are going to advise customers that you intend for disputes to be arbitrated. Take the time to revisit your ADR provision as well as your process of advising the customer. Doing so may allow you to keep the ADR that you originally intended.

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