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FOCUS

Useful methods for enforcing contracts' arbitration clauses

Judges will toss clauses they determine 'unconscionable'

Arbitration clauses are common in many contracts, and for good reason.

Arbitration is often faster and cheaper than litigation, and many businesses prefer to have their disputes decided by a professional arbitrator rather than an unpredictable jury.

But sometimes, businesses overreach in their arbitration clauses, leading courts to find them unenforceable. If you follow a few simple guidelines, however, you can dramatically increase the likelihood that your arbitration clause will withstand scrutiny.

> Oregon courts have held that contractual provisions **waiving the right** to pursue a claim as a class action are un-enforceable, at least in small consumer transactions.

The most common defect asserted against arbitration clauses is unconscionability, which prohibits the enforcement of overly one-sided contracts. Unconscionability has two aspects: procedural and substantive. Procedural unconscionability focuses on the circumstances of contract formation, such as disparity in bargaining power or concealment of contract terms. Substantive unconscionability focuses on whether a contract term itself is unreasonably favorable to one party.

Avoiding procedural unconscionability. In principle, procedural unconscionability is easy to avoid — if the arbitration clause is actually subject to negotiation, there should be no procedural problem. While these circumstances are common in business-to-business transactions, however, they are difficult to achieve in the business-to-consumer context, where the volume of transactions often makes individual negotiation impossible.

Still, businesses can minimize any perceived procedural unfairness by making sure the arbitration clause is specifically brought to the customer's attention. Consider having the customer separately initial the arbitration clause. Also, train your staff to point out the arbitration clause to the customer and be prepared to discuss it.

GUEST COLUMN

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Avoiding substantive unconscionability. Several typical provisions in arbitration clauses have become frequent targets of substantive unconscionability claims. But careful drafting can increase the odds that a court will uphold your arbitration clause.

1. Cost-splitting or cost-shifting provisions. Arbitration clauses often have provisions stating who will pay the costs of arbitration. The provision may split the costs between the parties, or it may be a "loser pays" provision, in which the non-prevailing party in the arbitration must pay the entire cost of the proceeding.

If a court finds that a cost-splitting provision effectively precludes a consumer from pursuing any remedy at all by making it too costly for the consumer to proceed in arbitration, the court will likely find the provision unconscionable.

To avoid such a result, consider using a "loser pays" provision instead — Oregon courts have made clear that such provisions are not substantively unconscionable. Alternatively, consider capping the consumer's share of arbitration costs at the amount of the filing fee and other fees that the customer would have had to pay in court.

2. Confidentiality Provisions. Lawyers for consumers have frequently argued that confidentiality provisions unfairly favor businesses, who are more likely to be "repeat players" in arbitration and therefore have an information advantage. Fortunately, Oregon courts have generally found confidentiality provisions in arbitration clauses to be enforceable. Still, consider whether confidentiality of the arbitration proceeding is important to you and, if so, consider limiting the scope of the confidentiality provision to those aspects of the arbitration that pose concern.

3. Mutuality. It is important that your arbitration clause be equally binding on both parties. If you require the other contracting party to arbitrate their claims against you while reserving the freedom to pursue your claims in court, a judge could conclude that the arbitration clause is unreasonably one-sided.

4. Class Action Waivers. Oregon courts have held that provisions waiving the right to pursue a claim as a class action are unenforceable, at least in small consumer transactions. Avoid using a class action waiver or, if you must, make sure to include it in a provision that is separate and apart from the arbitration clause.

5. Limitation of Liability Clauses. Businesses frequently attempt to contractually limit their exposure to unpredictable forms of damage, such as non-economic damages and punitive damages. Courts are often hostile to such provisions. To avoid any risk to your arbitration goals, make sure your limitation of liability clause is separate and distinct from your arbitration clause.

6. Severability Clauses. Finally, you should always include a clause in your contract stating that if any particular provision is found to be invalid or unenforceable, the remainder of the contract should remain in full force and effect. Such a clause will increase the odds that, even if the court finds that some particular aspect of your arbitration clause is unconscionable, the overall agreement to arbitrate will be enforceable.

A carefully drafted, fully disclosed arbitration clause will nearly always survive judicial scrutiny. A little attention to the arbitration clause at the outset of a transaction can pay major dividends later.

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