

Enforceability of Arbitration Agreements

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Many businesses have considered arbitration as an alternative to courtroom litigation as a means to resolve commercial, employment, or consumer disputes. For any number of reasons, going through arbitration can be preferable to submitting a claim to a jury. But there is growing concern that some arbitration agreements may not be enforceable.

What is arbitration and why is it preferable to litigation?

Arbitration is one of several alternative dispute resolution mechanisms that businesses can use to avoid traditional litigation. In short, you can bring your claim to a neutral third party – the arbitrator – who hears witnesses, takes evidence, and decides the case. In many ways, it looks like a trial, just without a jury. There can be flexibility with arbitration. The discovery process may be streamlined. You may also get some accommodation with scheduling that you cannot get in court. Some like it because it can be less costly and bring closure quicker than a trial, though that advantage is debatable. Others like it because they do not like the uncertainties of a jury trial – in other words, the potential of a runaway jury award – or perceived biases against the company that a jury trial might entail.

At what point in time should a business consider arbitration?

Arbitration is usually determined in one of two contexts. First, parties to a dispute that has already arisen can choose to refer their case to an arbitrator. For example, if a company claims that one of its vendors has breached their agreement, the parties (or their attorneys) can decide to bring the matter to an arbitrator rather than file a lawsuit. Second, parties can contract to mandate arbitration before a dispute arises. This is called a mandatory pre-dispute arbitration provision. In other words, the parties decide at the formation or during the relationship that any disputes will be referred to and decided in arbitration instead of litigation. For example, an employer may enter into an agreement with all of its employees that all or many employment related disputes are going to be submitted to arbitration, thus waiving the right to a jury trial.

Mandatory pre-dispute arbitration agreements can have an upside and a downside.

Mandatory pre-dispute arbitration is currently a hot topic in the courts and legal literature. Some companies have begun to incorporate arbitration provisions in agreements with their employees or with consumers who purchase their products. It is especially prevalent in the consumer finance industry. Other businesses have used arbitration provisions to procure the waiver of rights to class action lawsuits. The appeal of these types of agreements is understandable – the company can force arbitration of each dispute with each individual on its own merits before an arbitrator instead of a jury. At the same time there have been concerns that these agreements cause workers or consumers to unwittingly give up statutory rights to a jury trial or waive their option of entering into a class action to enforce their rights. As one well-respected judge has written regarding a potential consumer arbitration, and the possibility that it could not proceed as a class action: “the realistic alternative to a class action is not 17 million individual suits, but zero individual suits, as only a lunatic or a fanatic sues for \$30.”

What has been the approach to enforceability in South Carolina?

Historically, both state and federal courts in South Carolina have supported disputants’ choice of an arbitral forum and enforced arbitration agreements, so long as the general requirements for formation of a contract have been met. The cases recite that our federal and state courts have followed a “liberal policy favoring arbitration agreements.”

More recently, however, South Carolina courts have shown a greater willingness to question the enforceability of arbitration agreements if the agreements were fundamentally unfair, one-sided, or otherwise failed to guarantee due process to the litigants. Especially in the business-to-consumer context, courts have really scrutinized the arbitration provisions, and if they were found to be lacking, they have not been enforced.

Enforceability may depend on the parties.

If the contract is between two sophisticated parties/businesses, the arbitration agreement is much more likely to be found enforceable by the courts. The courts seem to reason that the relatively equal bargaining power (real or perceived) between sophisticated parties lends support to the idea that the arbitration agreement was voluntarily entered into. On this basis, the courts appear to enforce those agreements with more regularity and consistency, even if the arbitration agreement contains some unusual or one-sided provisions.

If the contract is between a business entity and an "unsophisticated" consumer, the court will apply more careful scrutiny and may well refuse to order arbitration if it

finds terms that are oppressive to the consumer or that do not offer a meaningful choice. I think this is motivated, in part, by a perception that public policy requires protection of the consumer in such cases.

How can a business ensure that its pre-dispute arbitration agreement with consumers or employees is enforceable?

Even with the trend toward greater scrutiny of pre-dispute arbitration agreements, South Carolina courts have still left the door open to uphold arbitration clauses which do not contain "oppressive" provisions. It is still reasonable to anticipate that courts will uphold a fair agreement that contains balanced terms. If you want greater assurance that your agreement could pass such a test, you should consult a lawyer who has worked in this area of the law. If you have any questions related to this subject, do not hesitate to contact any member of Wyche's Alternative Dispute Resolution team:

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