



COMMERCIAL LENDING ALERT

ONE-WAY ARBITRATION IS ENFORCEABLE IN MISSOURI

January 2007

Lender Liability Concerns

In response to the threat and reality of lender liability claims prevalent in the 1980's and early 1990's, lenders reacted in various ways, including requiring borrowers to waive their right to a jury trial in any lender-borrower suit and lobbying for statutes to protect lenders against claims by borrowers that contradicted written agreements signed by borrowers. An example of the latter is Section 432.047 R.S.Mo., which has been discussed in prior *Alerts*.

One-Way Arbitration; Initial Interpretation

Some major commercial and consumer lenders and sellers of big-ticket consumer goods (e.g., new homes, mobile homes) have required borrowers and buyers to sign agreements requiring mandatory arbitration of "all claims" arising out of a loan or installment contract arrangement while reserving for the lender or seller the right to utilize the courts to foreclose upon collateral or obtain other redress against debtors and buyers.

In our February 2006 *Alert*, we discussed a 2005 United States District Court case (*Sadler v. Green Tree Servicing LLC* (No. 05-4226-CV, W.D. Mo. 2005), in which a federal district court predicted that Missouri courts would invalidate a one-way arbitration clause in a consumer transaction because it allowed the seller access to the courts but denied the consumer such access to challenge the actions of the seller. The federal court predicted that Missouri courts would adopt the theory that such a clause lacked "mutuality of obligation" and therefore was unenforceable.

2006 Missouri Appellate Case

The federal courts got it wrong, so says the Missouri Supreme Court in *State ex. Rel. Vincent v. Schneider*, 194 S.W. 3d 853 (Mo. Banc. 2006). In that case, purchasers of new homes from a builder signed pre-printed purchase contracts that gave the builder the unilateral right to require the buyers to submit to binding arbitration any claim arising out of the contract of the purchased home. The buyers initialed their contracts in the margin next to the arbitration clause acknowledging that they had read, understood and agreed to the clause.

After discovering various alleged problems with their homes, the buyers filed suit. The builder then invoked the arbitration clause to resolve the claims.

The Missouri Supreme Court validated the use of the one-way arbitration clause, holding that the agreement which contained the requirement to arbitrate was not a "contract of adhesion" (even though it was pre-printed) because the homebuyers could have gone elsewhere to buy their homes.

More importantly, the court held that the legal requirement of "mutuality" was satisfied because there was consideration flowing to both parties (e.g., buyers got their houses with certain warranties and sellers received the purchase price) as to the whole agreement, regardless of whether the arbitration clause was one-sided.

The court also gave weight to the preference under Missouri statutes and case law for the arbitration of disputes.

Some Provisions Unenforceable

The entire arbitration clause, however, was not enforced as written. First, the clause gave the president of the local homebuilders association (who also happened to be the president of the builder/defendant in this suit!) the sole discretion to choose the arbitrator. The court held that the person selecting the arbitrator must be unbiased and looked to the Missouri Arbitration Act (Section 435.360, R.S.Mo.), which allows a party to petition the court to appoint an arbitrator if the selection method in the contract fails for any reason.

Second, the court held that the portion of the arbitration clause that required the buyer to pay all of the builder's fees incurred in the arbitration proceeding was also unconscionable and unenforceable. Again, the Missouri Arbitration Act (Section 435.395, R.S.Mo.) filled this gap by providing that, in the absence of an effective provision in the agreement regarding payment of arbitration fees and expenses, the arbitrator should determine which party or parties should pay the fees and expenses of arbitration.

Guidance

This recent case by the highest court of Missouri, en banc, clearly validates the use of

one-way arbitration. The court's opinion, however, includes the following guidance to assure enforceability as written:

- make the clause conspicuous and consider requiring the debtor/buyer to initial the clause acknowledging that he/she has read and understands it;
- provide an unbiased process for selection of the arbitrator; and
- require each party to the arbitration to pay its own fees and expenses or require the arbitrator to determine who should pay.

Conclusion

If as a business matter a commercial, or for that matter consumer, lender, credit provider or seller determines to require debtors/buyers, but not lender/seller, to submit claims to binding arbitration, Missouri courts should enforce that clause but may excise any provisions creating potential bias and may require the parties to utilize the "default" provisions of the Missouri Arbitration Act to fill the gaps created by specific arbitration terms that are held not to be enforceable.

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