IN THE CIRCUIT COURT OF THE STATE OF OREGON FOR LANE COUNTY

DENNIS J. MCHENRY, Plaintiff, v. FEDEX HOME DELIVERY, a division of FEDEX GROUND PACKAGE SYSTEM, INC. a Delaware corporation, and JACK GARTLEY, an individual, Defendants.	Case No. 16-06-22287 OPINION and ORDER

SUMMARY

This declaratory judgment action requires the Court to determine whether the Arbitration Clause contained within the FedEx Home Delivery Standard Contractor Operating Agreement is valid. Preliminary to this decision the Court must decide two issues: (1) whether Plaintiff Dennis McHenry (McHenry) waived his right to challenge the validity of the Arbitration Clause and (2) whether the Federal Aviation Administration Authorization Act of 1994 (FAAAA) preempts McHenry's challenge. The Court rules that McHenry did not waive his rights and finds the FAAAA inapplicable. Therefore, the Court reaches the ultimate question and finds the Arbitration Clause both procedurally and substantively unconscionable and, thus, invalid.

DISCUSSION

I. Factual and Procedural Background

McHenry entered into a Standard Contractor Operating Agreement with FedEx Home Delivery (FedEx) on March 15, 2000. The Agreement is a standard-form, nonnegotiable contract that FedEx prepares and submits to drivers on a "take it or leave it" basis. It includes an arbitration clause and addendum. The clause states as follows:

> **9.3 Arbitration of Asserted Wrongful Termination**
> In the event FHD [FedEx Home Delivery] acts to terminate this Agreement (which acts shall include any claim by Contractor of constructive termination) and Contractor

> disagrees with such termination or asserts that the actions of FHD are not authorized under the terms of this Agreement, then each such disagreement (but no others) shall be settled by arbitration in accordance with the Commercial Arbitration Rules of the American Arbitration Association (AAA) in accordance with the terms and conditions set forth in Addendum 7 to this Agreement.

Addendum 7 to the Agreement requires contractors to send written notice of a demand for arbitration to FedEx and the AAA via certified mail within 90 days of the claimed wrongful termination and failure to do so "constitute[s] an absolute bar to the institution of any proceeding and a waiver of the claimed wrongful termination." The Addendum further prohibits discovery, except with respect to damages, and apparently limits the arbitrator's authority to allocate costs or assign damages, or to provide a written opinion.

FedEx terminated McHenry's contract pursuant to the contract's termination provisions in June of 2005. On November 7, 2006, Plaintiff filed a complaint against FedEx and Jack Gartley alleging seven claims for relief (OJIN 1). Only the seventh claim, a claim for declaratory relief that the Arbitration Clause in the Agreement is unconscionable and therefore unenforceable, is relevant here. Plaintiff filed a Motion to Stay Arbitration Proceedings Pending Judicial Determination of Validity of Arbitration Clause (OJIN 2). The Court granted the motion pending this ruling (OJIN 17). In making its ruling, the Court is informed by the following pleadings: Plaintiff's Supplemental Memorandum Regarding Invalidity of the Arbitration Clause (OJIN 23) and Defendant's Reply to Plaintiff's Supplemental Memorandum Regarding Arbitration (OJIN 26).

II. Legal Analysis

Before making a determination as to the validity of the Arbitration Clause, the court must determine whether (1) McHenry waived his right to challenge the arbitration provision and (2) if the FAAAA preempts McHenry's challenge. Each issue is discussed in turn below.

A. Waiver

FedEx asserts that McHenry's long delay in objecting to the arbitration agreement, along with his participation in the arbitration proceeding, constitutes a waiver of any objection to arbitration. As was required by the arbitration agreement, McHenry initiated arbitration proceedings within ninety days of his termination. Although McHenry's challenge to the validity of the Arbitration Clause was filed eighteen months after FedEx terminated his contract and fourteen months after filing for arbitration, these gaps in time do not amount to a waiver of McHenry's right to challenge the validity of the arbitration clause. No statutory or common law suggests otherwise. Moreover, McHenry's challenge to the validity of the arbitration clause did not occur subsequent to arbitration proceedings. Therefore, McHenry's right to challenge the arbitration provision was not waived.

B. Federal Preemption

FedEx asserts that the FAAAA preempts McHenry's challenge to the Arbitration Clause. The FAAAA, modeled after the Airline Deregulation Act of 1978 (ADA), prohibits states from making laws or regulations having the force and effect of law relating to price, route, or service of a motor carrier. FedEx argues that McHenry's claim is preempted by the FAAAA, because McHenry "attempts to use the doctrine of unconscionability to alter the terms on which FedEx Ground contracts for services along its routes[.]"[1] The United States Supreme Court, along with a number of federal circuit and district courts, has dealt with the issue of preemption under the ADA a number of times. In support of its argument, FedEx cites a number of cases, including *Morales v. Trans World Airlines*, *American Airlines v. Wolens*, and *Lyn-Lea Travel Corp. v. Am. Airlines, Inc*.[2] The cases cited by FedEx are informative, but not directly on point. Here, McHenry challenges the Arbitration Clause of the standard form contract entered into by FedEx and its contractors. Unlike the travel agents in *Lyn-Lea*, whose claims related directly to prices and services, McHenry's claim relates to the manner in which he is able to challenge the termination of his contract with FedEx.[3] McHenry's claim does not call upon this Court to interpret Oregon law in a manner that would affect prices, routes or services as they relate to FedEx. Even if McHenry's claim did have some effect on FedEx's prices, rates, or routes, the effect of state action would be too tenuous and remote to result in preemption.[4] Therefore, the FAAAA does not preempt McHenry's claim.

C. Validity of the Arbitration Clause

Having determined that McHenry did not waive his right to challenge the Arbitration Clause and that his claim is not preempted by the FAAAA, the Court now addresses the validity of the Arbitration Clause.

McHenry asserts that the Arbitration Clause contained within the Agreement is invalid because it is unconscionable. In particular, McHenry asserts that the Arbitration Clause is substantively unconscionable because (1) the cost of arbitration is unreasonably high; (2) McHenry's damages are severely limited; (3) discovery is severely limited; (4) the arbitrator is not allowed to issue a written opinion; (5) the arbitrator can only enforce the terms of the agreement; (6) the agreement is unreasonably one-sided, because FedEx may still sue workers in Court; and (7) it is unreasonable to require that a claim be brought within 90 days.[5] In response, FedEx argues the terms of the Arbitration Clause are not substantively unconscionable, because the Arbitration Clause applies only to suits regarding wrongful termination, and McHenry is free to pursue other causes of action outside the limitations of arbitration.

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[1] Def.'s Resp. to Pl.'s Motion to Stay Aribitration Proceedings at 4.
[2] 504 U.S. 374, 112 S. Ct. 2031, 2040, 119 L. Ed. 2d 157 (1992); 513 U.S. 219, 115 S. Ct. 817, 130 L. Ed. 2d 715 (1995); 283 F.3d 282 (5th Cir. 2002).
[3] *Lyn-Lea Travel Corp.*, 283 F.3d at 287 (finding that the plaintiff's claims had a "significant relationship to the economic aspects of the airline industry").
[4] *Morales*, 504 U.S. at 390, 112 S. Ct. at 2040.
[5] Pl.'s Supp. Memo. Regarding Invalidity of Arbitration Clause at 4-5.

Validity of arbitration clauses is an area of the law subject to much debate in Oregon Courts in the recent past. Since January, the Court of Appeals has issued decisions in two cases dealing specifically with whether or not arbitration clauses contained within contracts were invalid, because the clauses were unconscionable.[6] A reading of both cases makes clear that the law in this area remains constant.

In making a determination as to whether or not a contract provision is invalid because it is unconscionable, the Court considers those facts that existed at the time of contract formation.[7] Unconscionability has both a procedural and substantive component.[8] The two components of unconscionability focus on contract formation and the terms of the contract, respectively."[9] The Court of Appeals recently stated that:

> The primary focus . . . appears to be relatively clear: substantial disparity in bargaining power, combined with terms that are unreasonably favorable to the party with the greater power may result in a contract or contractual provision being unconscionable. Unconscionability may involve deception, compulsion, or lack of genuine consent, although usually not to the extent that would justify rescission under the principles applicable to that remedy. The substantive fairness of the challenged terms is always an essential issue.[10]

Thus, procedural and substantive unconscionability are both relevant in assessing the validity of a contract provision, but only the substantive component is necessary.[11]

In *Vasquez-Lopez*, the Court affirmed the ruling of the lower court and found the arbitration rider to be both procedurally and substantively unconscionable. There, the Court reasoned that "because the parties had unequal bargaining power and because defendant affirmatively concealed the arbitration rider's terms, the arbitration rider was to some significant degree procedurally unconscionable."[12] Similarly, the circumstances surrounding formation of the contract here suggest procedural unconscionability. Like the parties in *Vasquez-Lopez*, McHenry and FedEx entered into a "take it or leave it" contract, the standard contract prepared by FedEx and given to all delivery drivers. McHenry was not presented with the Agreement until the day he reported for work and given only a short time to review the contract before signing it. FedEx does not dispute that it likely would not have accepted significantly different terms from those in the standard Agreement, including terms related to the Arbitration Clause.[13] Here, the parties were not in positions of equal bargaining power. Far from that, FedEx held a significantly larger

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[6] *Vasquez-Lopez v. Beneficial Oregon, Inc.*, 210 Or App 553 (2007); *Motsinger v. Lithia Rose-FT, Inc.*, -- Or App -- (2007).
[7] *Vasquez-Lopez*, 210 Or App at 566.
[8] *Id.*
[9] *Id.* at 566-567.
[10] *Id.* at 567 (quoting *Carey v. Lincoln Loan Co.*, 203 Or App 399, 422-23 (2005), *rev allowed*, 341 Or 449 (2006)).
[11] *Id.* at 567-568 (finding that although the arbitration rider was procedurally unconscionable, the emphasis was clearly on substantive unconscionability); *see also Motsinger v. Lithia Rose-FT, Inc.*, -- Or App -- (2007) (**fill in**).
[12] *Vasquez-Lopez*, 210 Or App at 569. The Court of Appeals found the arbitration rider substantively unconscionable, because its cost sharing provisions put a more onerous burden on the plaintiff, in relation to the cost of trial. *Id.* at 574-575.
[13] Def.'s Reply to Pl.'s Supp. Memo. Regarding Arbitration at 2.

portion of the bargaining power and was able to wield that power during the course of formation of the Agreement. As such, the Arbitration Clause contained in the Agreement is procedurally unconscionable.

While a finding of procedurally unconscionable is important, of greater significance is a finding of substantive unconscionability. This principle was discussed most recently in *Motsinger*, where the Court of Appeals found that the arbitration clause, while procedurally unconscionable, did not contain terms that were so unreasonably favorable to the defendant so as to rise to the level of substantive unconscionability.[14] In *Motsinger*, the Court stated that "[t]he doctrine of unconscionability does not relieve parties from all unfavorable terms that result from the parties' respective bargaining positions; it relieves them from terms that are *unreasonably* favorable to the party with greater bargaining power."[15] In contrast to the arbitration clause in *Motsinger*, the Arbitration Clause here contains several terms that unreasonably favor FedEx, in particular, Paragraphs 1, 3, 4, and 6.

Paragraph 1 provides that written notice of a demand for arbitration must be sent by certified mail within 90 days of the wrongful termination and "[f]ailure to mail written notice . . . within such 90-day period . . . shall constitute an absolute bar to the institution of any proceedings and a waiver of the claimed wrongful termination." A plain reading of this paragraph suggests that any claim a contractor wishes to bring against FedEx is barred if a demand for arbitration is not timely made, whether or not such claim is subject to arbitration. This paragraph is unreasonably favorable to FedEx, because FedEx is not subject to a similar constraint on the pursuit of claims.

Paragraph 3 states that neither party is entitled to discovery from the other, except with respect to damages. While this paragraph, on its face, would seem to subject both parties to the same limitation on discovery, logic suggests otherwise. It is more likely than not that FedEx possesses any number of records related to McHenry's employment, including those related to performance, evaluations, etc. Such documentation seems vital in trying to resolve a claim based on wrongful termination. Paragraph 3 of the Arbitration Clause does not permit McHenry access to theses documents. As such, Paragraph 3 is unreasonably favorable to FedEx.

Paragraph 4 provides that neither party may pursue a suit in law or equity with regards to a dispute that is subject to arbitration, except for certain limited purposes. If the paragraph ended there, then it would seem affect both sides equally; however, the paragraph goes on to state that the paragraph "shall not limit [FedEx's] right to obtain any provisional remedy . . . as may be necessary in [FedEx's] sole subjective judgment to protect its property rights." This paragraph is

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[14] *Motsinger*, -- Or App at --. In *Motsinger*, the Court of Appeals clarified that "an approach that focuses on the one-sided *effect* of an arbitration clause--rather than on its one-sided *application*--to evaluate substantive unconscionability is most consistent with the common law of Oregon regarding unconscionability of other kinds of contractual provisions and with state and federal policies regarding arbitration." *Id.* (citing *Vasquez-Lopez*, 210 Or App at 572).

[15] *Id.* (citing U.C.C. § 2-302, Official Commentary) (emphasis in original). In *Motsinger*, the arbitration clause provided that the plaintiff had to arbitrate any claims she had against the defendant, while the defendant was not held to the same limitations. The Court of Appeals found that the arbitration clause did not impose limits on recovery, exclude certain types of damages or attorney fees, limit discovery or admissible evidence, or impose deadlines on filing claims. Rather, the plaintiff just had to bring her claims in a different forum. *Id.*

unreasonably favorable to FedEx, because it allows FedEx to exercise its own discretion in determining when matters that would otherwise be subject to the limitations of the paragraph are excluded, while not affording McHenry the same exercise of "subjective judgment."

Paragraph 6 states that the arbitrator is to provide the parties with only a written determination of the arbitration, without an accompanying opinion. FedEx suggests that the arbitrator could choose to issue an opinion if the arbitrator so chooses, but a plain reading of Paragraph 6 does not show that this is in fact the case. Instead, the arbitrator is limited to a written determination, which does not alter, amend or modify the terms or conditions of the Agreement, a standard form agreement prepared by FedEx. As such, Paragraph 6 is unreasonably favorable to FedEx.

In addition to the above, arbitration of the single claim could have a preclusive effect on McHenry's other claims for relief pending in this Court. Under Oregon law, "issue preclusion arises in a subsequent proceeding when an issue of ultimate fact has been determined by a valid and final determination in a prior proceeding."[16] Principles of issue preclusion extend to determinations made by an arbiter during arbitration proceedings.[17] If McHenry and FedEx did arbitrate the wrongful termination claim, the effect of the arbiter's decision could reach beyond just that particular claim. In his complaint, McHenry asserts claims for breach of contract, breach of implied covenant of good faith and fair dealing, fraud, and intentional interference with contract or prospective business advantage, among others. The factual bases for these claims are likely the same as those for McHenry's wrongful termination claim. In reaching his decision, the arbiter could draw conclusions regarding the facts that are relevant to the claims McHenry brings in this Court. As a result, issue preclusion could severely limit, if not completely eliminate, McHenry's other claims for relief. This potential preclusive effect further demonstrates how enforcement of the Arbitration Clause unreasonably favors FedEx, resulting in substantive unconscionability.

For the foregoing reasons, the Court determines that the Arbitration Clause is substantively unconscionable and, therefore, invalid.

The Court having previously granted the Motion to Stay Arbitration Pending Judicial Determination of Validity of Arbitration, and having heard argument from the parties regarding the validity of the Arbitration Clause and now being fully advised;

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[16] *Nelson v. Emerald People's Util. Dist.*, 318 Or 99, 103 (1993); *see also Westwood Const. Co. v. Hallmark Inns & Resorts*, 182 Or App 624, 632 (2002) (stating that "when an issue common to separate claims has been determined in a *prior separate* action, general principles of issue preclusion may apply") (emphasis in original), *rev. den.*, 335 Or 42 (2002).

[17] *Westwood Const. Co.*, 182 Or App at 632 (finding that "[failure] to give preclusive effect to matters resolved by arbitration, where the requirements of issue preclusion are otherwise satisfied, would frustrate the legislative design"); *see also Barackman v. Anderson*, 192 Or App 176, 180 (2004) (stating that "[i]t is well established in Oregon . . . that issue and claim preclusion generally apply to decisions in binding arbitration proceedings"), *aff'd*, 338 Or 365 (2005).

IT IS HEREBY DECLARED AND ORDERED that the Arbitration Clause contained within the Agreement is both procedurally and substantively unconscionable, and that the Arbitration Clause is invalid.

Dated: April 9, 2007.

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Karsten H. Rasmussen, Circuit Judge

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