<u>Mandatory Arbitration in Health Care Claims</u>

By

Matt W. Park and Kevin D. Pierce[1]

In the realm of contract law, lawyers often deal with various long-arm transactions between sophisticated commercial entities. Often, these contracts contain binding arbitration clauses in an effort to mitigate the time and cost of going to court over disputes. In the health care arena, the contracts are often drafted with similar arbitration provisions. The difference, of course, is that the patient signing the contract is normally not a shrewd business person and may be suffering from serious medical conditions. These discrepancies can create a potentially difficult situation for defense attorneys defending the mandatory arbitration language in the contract. To that end, the subject of mandatory arbitration clauses is much larger than can be discussed in this space. However, this article will discuss some of the most common challenges considered by courts when deciding whether an arbitration clause is enforceable.

I. Arbitration in New Mexico

There is no question that New Mexico endorses public policy favoring arbitration. *Fernandez v. Farmers Ins. Co.*, 115 N.M. 622, 625, 857 P.2d 22, 25 (1993); *Santa Fe Techs. Inc. v. Argus Networks*, 2002-NMCA-30, ¶ 51, 131 N.M. 772, 42 P.3d 1221 (noting that "[a]rbitration is a form of dispute resolution highly favored in New Mexico.") Accordingly, New Mexico's courts generally enforce arbitration agreements, unless the agreement is determined to have been invalid when executed. *See* New Mexico Uniform Arbitration Act (hereafter the "UAA"), N.M. Stat. Ann. § 44-7A-7(a) (2009) (explaining that an agreement arbitrate generally is "valid, enforceable and irrevocable except upon a ground that exists at law or in equity for the revocation of a contract.").

Because an arbitration agreement constitutes a contractual remedy, the determination of its validity is a matter of state contract law. *See Santa Fe Techs.*, 2002-NMCA-30, ¶ 52; *but see Salazar v. Citadel Commc'ns Corp.*, 2004-NMSC-013, ¶ 8, 135 N.M. 447, 90 P.3d 466 (holding that the Federal Arbitration Act preempts provisions of state law that are hostile to arbitration agreements). In accordance with the UAA, "[a] legally enforceable contract is a prerequisite to arbitration; without such a contract, parties will not be forced to arbitrate." *Heye v. Am. Golf Corp.*, 2003-NMCA-138, ¶ 8, 134 N.M. 558, 80 P.3d 495 (*citing First Options of Chicago, Inc. v. Kaplan*, 514 U.S. 938, 944-45 (1995)). Thus, the contract of which the arbitration agreement is a part "must be factually supported by an offer, an acceptance, consideration and mutual assent." *Heye*, 2003-NMCA-138, ¶ 9. To establish whether an arbitration clause is, in fact, enforceable, requires the court to assess contract formation and the patient's ability to contract.

---

[1] Kevin's invaluable contributions to this article occurred while he was a summer associate at Modrall Sperling in 2008, during which time he was also juggling his assignments as an editor of the *New Mexico Law Review*.

Defense attorneys are no doubt familiar with the following maxim: parties who enter into and execute a contract have a duty to read the contract and generally are presumed to know, understand and agree to its terms. *Smith v. Price's Creameries, a Div. of Creamland Dairies Inc.*, 98 N.M. 541, 545, 650 P.2d 825, 829 (1982). As such, parties are ordinarily bound by the terms of a signed contract. *Id.* However, under certain circumstances courts will relieve a party of its contractual obligation. These circumstances may include a finding that the contract is illusory, a contract of adhesion, procedurally unconscionable and substantively unconscionable. *See generally Guthman v. La Vida Llena*, 103 N.M. 506, 709 P.2d 675 (1985); *Heye*, 2003-NMCA-138 (illusoriness). Accordingly, each of these grounds for unenforceability constitute a potential challenge to the validity of an arbitration agreement. While the topic of arbitration is too large to fully explore in this article, the discussion below will address common challenges in turn.

A. Illusoriness

Parties challenging the validity of an arbitration agreement commonly allege that the agreement is illusory, i.e. that it is not supported by consideration. *See Heye*, 2003-NMCA-138, ¶ 12. Mutuality of obligation, meaning a mutual provision of consideration, is an essential element of a valid contract in New Mexico. *Id.* New Mexico courts, in accordance with the RESTATEMENT (SECOND) OF CONTRACTS, define consideration as "consist[ing] of a promise to do something that a party is under no legal obligation to do or to forebear from doing something he has a legal right to do." *Id.* (*citing* RESTATEMENT (SECOND) OF CONTRACTS §§ 73, 74 at 179, 185 (1981)). A promise is generally sufficient consideration for another promise if it is "lawful, definite, and possible," *Piano v. Premier Distrib. Co.*, 2005-NMCA-018, ¶ 6, 137 N.M. 57, 107 P.3d 11. "However, a promise that puts no constraints on what a party may do in the future – in other words, when a promise, in reality, promises nothing – it is illusory, and it is not consideration." *Id.* (*quoting Heye*, 2003-NMCA-138, ¶ 12) (internal quotation marks omitted).[2]

Although there is scant published law in New Mexico that concerns illusoriness within the healthcare context, our courts have addressed this principle in the employment context. For example, in *Heye*, the New Mexico Court of Appeals held that the disputed arbitration agreement was illusory because the court found that the plaintiff's employer had retained "unfettered discretion to terminate arbitration at any time, while binding Plaintiff to arbitration." *Id.* ¶15. In so holding, the court noted language from the employer's handbook that allowed the employer to

---

[2] The court in *Thompson v. THI of N.M. at Casa Arena Blanca, LLC*, 2006 U.S. Dist. LEXIS 95188, *19, advances the proposition that a finding of illusoriness is insufficient by itself to invalidate a contract. In support of this proposition, the court cites another United States District Court opinion from New Mexico. *Id.* (*citing Dumais v. Am. Golf. Corp.*, 150 F. Supp. 2d 1182, 1191 (D.N.M. 2001). However, that opinion does not appear to stand for that proposition. Instead, the *Dumais* opinion clarifies that a mere imbalance between the parties in the favorability of contract terms does not invalidate the contract unless the imbalance rises to the level of unconscionability. *See Dumais*, 150 F. Supp. 2d at 1191. Moreover, the New Mexico Court of Appeals did not articulate a rule statement in either *Heye* or *Piano* that rendered illusoriness an insufficient basis to invalidate a contract. Accordingly, the proposition advanced in *Thompson* does not appear to be followed by state courts in New Mexico.

"amend, supplement, rescind or revise any policy, practice or benefit described in [the] handbook – other than employment at-will provisions – as it deem[ed] appropriate." *Id*. ¶13. Thus, the court concluded that the employer had retained the ability to abide selectively by its promise to arbitrate thereby rendering that promise illusory. *Id*. ¶ 15.

Similarly, in *Piano v. Premier Distrib. Co.*, 2005-NMCA-018, ¶ 8, 137 N.M. 57, 107 P.3d 11, the New Mexico Court of Appeals found that an employer's promise of continued at-will employment and a reciprocal promise to arbitrate that was subject to unilateral modification provided insufficient consideration to support the arbitration agreement at issue. There, the employer presented the plaintiff-employee with an arbitration agreement nearly three months after she commenced her employment. In consideration for her acceptance of the arbitration agreement, the employer promised the plaintiff-employee continued at-will employment "with the understanding that if she did not sign [the agreement] she would be fired." *Id*. ¶ 2. In holding the arbitration agreement invalid, the court noted that the promise of continued at-will employment was essentially meaningless because it provided nothing beyond what the plaintiff already possessed. *Id*. ¶ 8-9.

Conversely, in *Sisneros v. Citadel Broad. Co.*, 2006-NMCA-102, ¶ 33-35, 140 N.M. 266, 142 P.3d 34, the New Mexico Court of Appeals upheld an arbitration agreement that required the employer to forfeit its right to terminate or amend the arbitration agreement upon the accrual of an employee's claim. In rejecting the plaintiff's argument that the agreement was illusory, the court distinguished the agreement at issue from those invalidated in previous cases, noting that while the employer retained a right to modify the agreement, it forfeited that right upon the accrual of an employee's claim and was thus obligated to arbitrate. Accordingly, the employer had provided consideration for the agreement to arbitrate, making that agreement valid and enforceable.

While each of these cases arose in the employment context, their instructive value extends into the present context of health care contracts. Administrators and attorneys drafting arbitration agreements for admission contracts can take from that decision that the health care facility can retain an element of flexibility in its contracts such that over time it may reconsider its policy toward arbitration and prospectively effect any desired changes. The drafter of the admission contract can find the specific language of an arbitration agreement that affords flexibility in the *Sisneros* contract.[3]

B. Contract of Adhesion

[3] There, the contract read "[Employer] reserves the right to terminate or amend this policy at any time, except that any termination or amendment will not apply to claims which accrued before the amendment or termination." *Sisneros*, 2006-NMCA-102, ¶ 33. Hence, through that clause, the nursing home retains the ability to alter its policy toward arbitration as it sees fit while simultaneously providing the potential resident with sufficient consideration to make the overall agreement valid and enforceable.

Parties may also seek to invalidate an arbitration agreement on the basis that the agreement constitutes a contract of adhesion. An adhesion contract is a 1) standardized contract; 2) imposed and drafted by the party who has superior bargaining strength; 3) which relegates the weaker party to a take-it-or-leave-it proposition, without the opportunity for bargaining. *Guthman*, 103 N.M. at 506 (internal citations omitted).

With respect to the second element, the party challenging the agreement may establish that it was unable to avoid doing business by demonstrating that the "dominant contracting party has monopolized the relevant geographic or product market [or] that all of the competitors of the dominant party use essentially the same contract terms." *Albuquerque Tire Co. v. Mountain States Tel. & Tel. Co.*, 102 N.M. 445, 448, 697 P.2d 128, 131 (1985). As to the third element, the challenging party may establish a lack of opportunity to bargain by "showing that the dominant party has been granted a monopoly, or that it afforded no opportunity to negotiate, or that the party attempted to negotiate and failed." *Guthman*, 103 N.M. at 509. This element is only relevant where the weaker party "objects or has reason to object" to the agreement or one of its provisions. *Id.*

However, establishing the three *Guthman* elements does not *per se* invalidate the agreement. *Id.* Instead, a court will only invalidate a contract of adhesion when the contract or certain of its provisions are found to be unconscionable. *Padilla v. State Farm Mut. Auto. Ins. Co.*, 2003-NMSC-011, ¶ 14, n.3, 133 N.M. 661, 68 P.3d 901. Thus, "[t]he determination that a contract is one of adhesion is simply the first step in deciding whether it should be enforced." *Guthman*, 103 N.M. at 509.

For example, in *Thompson v. THI of N.M. at Casa Arena Blanca, LLC*, 2006 U.S. Dist. LEXIS 95188, *39-40, Judge Browning, applying New Mexico state contract law, found that although the nursing home admission contract at issue was a standard form contract, it was not a contract of adhesion. In reaching that holding, Judge Browning noted that the plaintiff had failed to establish both the second and third *Guthman* elements. *Id.* With respect to the second element, Judge Browning found that although the town in which the plaintiff and his deceased wife lived had only one long-term care facility, a neighboring city only sixty miles away provided other suitable alternatives. *Id.* at *39. Accordingly, plaintiff's and his wife's choice of facility was a matter of convenience rather than necessity, which Judge Browning held did not satisfy the second *Guthman* element. *Id.* As to the third element, Judge Browning found that the plaintiff neither demonstrated a lack of opportunity to bargain nor a failed attempt to bargain. *Id.* at *40. Instead, the plaintiff only offered affidavit testimony that he did not negotiate the terms of the contract, which Judge Browning held insufficient to establish the third *Guthman* element. *Id.* Accordingly, Judge Browning rejected the argument that the admission contract was a contract of adhesion.

It is important for facilities and those preparing their contracts to remember that a contract of adhesion may still be found valid and enforceable if it is not unconscionable. *Padilla*,

2003-NMSC-011, ¶ 14, n.3. This principle affords health care facilities a certain degree of protection in the preparation of their contracts to the extent that they will not be forced to negotiate away important business principles and policies at every patient admission.

C. Unconscionability

Unconscionability is an important contract defense which is related to adhesion. The New Mexico Supreme Court defines an unconscionable contract as "sufficient if the provision is grossly unreasonable and against our public policy under the circumstances." *Cordova v. World Fin. Corp.*, 2009-NMSC-21, ¶ 31. "The doctrine of unconscionability was intended to prevent oppression and unfair surprise, not to relieve a party of a bad bargain." *Drink, Inc. v. Martinez,* 89 N.M. 662, 665, 556 P.2d 348, 351 (1971). A contract may be found unconscionable if the party challenging its enforceability demonstrates that it lacked meaningful choice in the formation of the contract and that the terms of the contract are "unreasonably favorable to the other party." *Guthman*, 103 N.M. at 510. This standard incorporates the two types of unconscionability found under New Mexico law: procedural unconscionability and substantive unconscionability. *See id*. "The weight given to procedural and substantive considerations varies with the circumstances of each case." *Id*. While "there is a greater likelihood of a contract's being invalidated for unconscionability if there is a combination of both procedural and substantive unconscionability, there is no absolute requirement in our law that both must be present to the same degree or that they both be present at all." *Cordova v. World Fin. Corp.*, 2009-NMSC-21, ¶ 24.

1. Procedural Unconscionability

Procedural unconscionability concerns the element of meaningful choice, and is "determined by examining the circumstances surrounding the contract formation, including the particular party's ability to understand the terms of the contract and the relative bargaining power of the parties." *Guthman*, 103 N.M. at 510. A mere disparity in bargaining power is insufficient to establish procedural unconscionability. *Id*. Instead, the inequality in bargaining power must be so significant that the weaker party's choice is essentially non-existent. *Id*. When assessing claims of procedural unconscionability, courts generally consider whether the party seeking to enforce the arbitration agreement used "sharp practice[s] or high pressure tactics" in addition to the "relative education, sophistication or wealth or the parties, as well as the relative scarcity of the subject matter of the contract." *Id*. (noting that businessmen and middle income consumers are less likely to experience the kind of "gross advantage-taking" that constitutes unconscionability).

The form of the arbitration clause is very important. Courts will frequently analyze the placement of the arbitration clause relative to a signature page, the size and shading of the text, the length of the clause, and the type of wording used. An unpublished case often cited by plaintiff's attorneys is *Adkins v. Laurel Healthcare of Clovis, LLC*, No. 26,957 (N.M. Ct. App.,

Dec. 19, 2007). The *Adkins* court noted that the admission agreement was thirty-nine pages long, was written in small type, and contained a multitude of sections and provisions. *Id*. at 4-5, 11. Also, the court observed that the arbitration agreement did not appear until page thirty of the contract and was more than three pages long. *Id*. at 5.

Moreover, an admission contract can be procedurally unconscionable if a patient's poor physical and mental health could prevent the patient from the ability to understand the contractual terms. To support its finding of procedural unconscionability, the *Adkins* court first noted that at the time the decedent reviewed and signed the admission contract, she was suffering from congestive heart failure, chronic obstructive pulmonary disease, arterial fibrillation, and ischemic heart disease, which required the decedent to carry a portable oxygen tank and take numerous prescription medications. *Id*. at 5-6, 11. The evidentiary record also indicated that the decedent appeared extremely tired and short of breath on the day she signed the contract. *Id*. at 11. Furthermore, the evidentiary record established that the decedent had only a tenth-grade education and that her mental health had been progressively deteriorating for almost one year. *Id*. In accordance with all of these findings, the court found that the decedent lacked the ability to understand the contract terms. *Id*. (*citing Guthman*, 103 N.M. at 510 for the proposition the procedural unconscionability looks to a party's ability to understand a contract term).

Adkins provides significant guidance for health care facilities in their future dealings with potential patients. Disclosing the arbitration agreement in the admission contract, e.g. by positioning the agreement prominently in the contract, flagging the pages containing the agreement, may be beneficial to the facility. Similarly, the limited discussion of the contract and failure to provide the materials on the day before the decedent signed the contract both proved fatal in *Adkins*. The court's criticism of such conduct indicates that presenting all contract materials sufficiently in advance of the contract signing, alerting patients to important documents or sections in the materials, like an arbitration agreement, and comprehensively reviewing the materials with the potential patient and his or her family at the time the contract is signed is important. These actions would likely weigh strongly in favor of the facility and the enforceability of the arbitration agreement.

2. Substantive Unconscionability

Substantive unconscionability addresses the particular terms of the contract, specifically those that are allegedly "illegal, contrary to public policy, or grossly unfair." *Guthman*, 103 N.M. at 510. "The touchstone appears to be gross unfairness." *Garley*, 111 N.M. at 390. However, what is grossly unfair depends on the context and circumstances in which the contract was formed. *Guthman*, 103 N.M. at 511 (internal citations omitted). Therefore, the terms of the contract should be analyzed "in light of the general commercial background and the commercial needs of the particular trade or case." *Id.* Regardless of the context though, the threshold for demonstrating substantive unconscionability is high. *Monette v. Tinsley*, 1999-NMCA-40, ¶ 19, 126 N.M. 748, 975 P.2d 361.

In rejecting the plaintiff's substantive unconscionability arguments, the *Guthman* court observed that by entering into the contract, the decedent assumed the risk that she might die sooner than anticipated and forfeit her entrance fee money while the defendant also undertook the risk of "a lower entrance fee against a partial refund at death, as well as that [the decedent] might live longer than seven to twelve years and thus use, to some extent, a portion of the fees paid by others who had died prematurely." *Id*. at 513. Accordingly, the court found that nothing about the plaintiff's decedent's untimely death rendered the admission contract unconscionable. *Id*. at 511. Furthermore, the court held that none of the circumstances surrounding the contract formation suggested substantive unconscionability given the common usage of no-refund policies in the nursing home industry and the decedent's admitted ability to shop comparatively before choosing the defendant's facility.

Likewise, in *Thompson*, Judge Browning rejected the plaintiff's argument that the arbitration agreement at issue in that case was substantively unconscionable. *Thompson*, 2006 U.S. Dist. LEXIS 95188 *43-44. There, the plaintiff argued that the arbitration agreement was unfair because it obligated the plaintiff to arbitrate all potential claims against the nursing home, while the nursing home would only be obligated to arbitrate claims against plaintiff for debt or failure to pay. In rejecting that argument, Judge Browning held that the nursing home was required to arbitrate all claims against plaintiff and rebuffed the notion that the agreement was substantively unconscionable because the nursing home may have fewer possible claims against the plaintiff that would ultimately be subject to arbitration. *Id.*

On the other hand, the New Mexico Supreme Court's recent decision in *Fiser v. Dell Computer Corp.,* 2008 NMSC 46, 144 N.M. 464, 188 P.3d 1215, held an arbitration agreement as substantively unconscionable where a computer purchase agreement that required consumers to individually arbitrate any claims against the vendor and contractually forbade consumers from seeking class action relief against the vendor in either litigation or arbitration. *Id*. at 2-3. Critical to the court's holding was the small amount of damages alleged by the plaintiff, approximately ten to twenty dollars, because the court noted that the prohibitive cost of litigation may prevent consumers with such small claims from seeking relief on potentially legitimate claims. *Id*. at 3, 5-7. Accordingly, the court stated that "Defendant's 'terms and conditions' may not rise to the level of an adhesive contract, we nevertheless conclude that the terms are unenforceable because there has been such an overwhelming showing of substantive unconscionability." *Id.* at 11.

In *Cordova v. World Fin. Corp*., 2009-NMSC-21, ¶ 26, the New Mexico Supreme Court took exception to World Finance's "one sided arbitration provisions." In that case, World Finance reserved a judicial forum for itself in the case of lender default. *Id.* The arbitration provision foreclosed the possibility of a similar election of judicial process for the lenders. *Id.* at ¶ 27. The court found this type of one-sided drafting "egregious" and substantively unconscionable because it was unreasonable and unfair. *Id.* at ¶ 32. Applying this rationale to health care contracts, a facility cannot reserve the possibility of judicial action for non-payment unless it offers a similar judicial forum election to its patients for a likely patient claim. The take

away lesson seems to be that a conservative arbitration clause drafter will send all possible claims for both parties, without reservation, to the arbitrator.

The high threshold for establishing substantive unconscionability claims should provide some comfort to health care facilities wishing to adopt arbitration agreements in their admission contracts or to facilities that already employ such agreements. As the industry specific case law reveals, such agreements will generally be upheld and enforced so long as the agreement comports with industry custom and does not attempt in an illegal or untoward manner to bestow an advantage on the nursing home.

II. Conclusion

As the law currently stands, arbitration enjoys a bright future as a cost-effective and more efficient alternative to litigation. However, it is important for defense attorneys to understand that arbitration clauses are not afforded any exceptional protection by the courts. Rather, they are examined as though they were run-of-the-mill contractual provisions and attorneys must be prepared to analyze the arbitration clauses through the lens of New Mexico's traditional defenses to contract, i.e. illusoriness, adhesion, substantive and procedural unconscionability. Therefore, those attorneys who defend health care facilities may need to be more cautious in assessing contract execution procedures to make sure that these contract defenses do not unwittingly invalidate the facility's arbitration clause.