

In the
Supreme Court of Ohio

TAYLOR BUILDING CORPORATION	:	Case Nos. 2006-1890
OF AMERICA,	:	2006-2043
	:	
Plaintiff-Appellant,	:	On Appeal from the
	:	Clermont County
v.	:	Court of Appeals,
	:	Twelfth Appellate District
MARVIN BENFIELD, et al.,	:	
	:	Court of Appeals Case
Defendants-Appellees.	:	No. CA2005-09-083
	:	

**MERIT BRIEF OF *AMICUS CURIAE* OHIO ATTORNEY GENERAL MARC DANN
IN SUPPORT OF DEFENDANTS-APPELLEES
MARVIN AND MARY RUTH BENFIELD**

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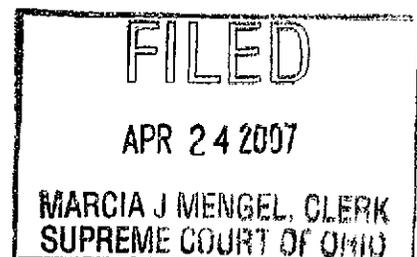


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INTRODUCTION

This case is about shutting the courthouse door to consumers who have signed contracts that contain an unconscionable arbitration provision as one of the contract terms. Mandatory arbitration clauses are commonly used in consumer contracts. While many such clauses may fairly give advantages to consumers and company alike, many such clauses are imbalanced, and effectively deny consumers the opportunity to go to court, while forcing them into a skewed arbitration process. The good arbitration clause offers the consumer an efficient and expedient opportunity to resolve a dispute, preserving every claim and defense. But the anti-consumer clauses, which often cross the line into unconscionability, include arbitration terms that are one-sided. For example, some contracts have unconscionable arbitration terms that make the consumer pay incredibly high costs, forbid discovery, or contain other provisions that prevent any real opportunity for consumers to prosecute claims and seek statutory remedies.

The precise issue here is the standard an appellate court must use to review a trial court's decision to enforce or declare unconscionable a contractual arbitration clause. Unconscionability of contract in Ohio is divided into two parts: substantive unconscionability—which refers to the actual terms of the contract—and procedural unconscionability—which considers the circumstances surrounding the signing of the contract. R.C. 1302.15. In the case of consumer contracts, the facts and circumstances surrounding the contract almost always make it a contract of adhesion—one in which almost nothing except price is negotiable, and in which the consumer is rarely represented by counsel at the time the contract is signed. Arbitration clauses in such contracts sometimes contain harsh provisions, such as liability for both parties' attorney fees, or that severely limits discovery. These clauses are often unconscionable as a matter of law, and therefore amenable to de novo review on appeal.

Nor does it change the analysis to say that Ohio law favors arbitration—Ohio law favors arbitration clauses when they are fair to both sides, not when they are unconscionable. R.C. 2711.01.

This Court should hold that the determination whether a given contract or contract provision is unconscionable is a matter of law and subject to de novo review on appeal.

STATEMENT OF AMICUS INTEREST

Ohio Attorney General Marc Dann acts as Ohio’s chief law officer, and is statutorily responsible for the enforcement of all consumer protection statutes. R.C. 109.02. Under the Consumer Sales Practices Act, R.C. Chapter 1345, the Attorney General is responsible for stopping suppliers from engaging in unfair, deceptive or unconscionable acts or practices in consumer transactions. Consumers also have a private right of action as “private attorneys general” to enforce the consumer protection statutes by seeking both restitution and injunctive relief to stop unfair or unconscionable practices.

Mandatory arbitration clauses with unconscionable terms effectively deny consumers a remedy for violations of the consumer laws. Left unchecked, such clauses allow companies to treat consumers unfairly without legal oversight. The Attorney General, as Ohio’s chief enforcer of consumer laws, wants courts to carefully consider for unconscionably harsh arbitration clauses in consumer contracts before depriving Ohio consumers of full and complete access to the courts. Imposing a de novo standard of review will require such careful consideration.

STATEMENT OF THE CASE AND FACTS

This case began as a foreclosure action against Marvin and Mary Ruth Benfield, who timely filed an answer with affirmative defenses and a counterclaim raising violations of Ohio consumer laws. Before trial, Appellant, Taylor Building Corporation of America (“Taylor Building”) moved to stay judicial proceedings pending arbitration. *Taylor Bldg. Corp. of Am. v.*

Benfield (12th Dist.), 168 Ohio App. 3d 517, 2006-Ohio-4428, ¶ 8. The trial court held a hearing on Taylor Building’s motion to stay proceedings pending arbitration, where the Benfields argued that several of the provisions of the parties’ construction contract were unconscionable and unenforceable, including its arbitration clause. *Id.* at ¶ 8-9. The only evidence submitted was an affidavit of Mary Ruth Benfield. *Id.* at ¶ 9. The trial court partially granted Taylor Building’s motion to stay the case based on the mandatory arbitration provision, although the court did find the provision requiring that arbitration take place in Kentucky to be “substantively unconscionable” and ordered that the proceedings must take place in Clermont County, Ohio. *Id.* at ¶ 10. The Benfields’ then appealed the trial court’s determination that the arbitration clause was enforceable. In review, the Twelfth District Court of Appeals, using a de novo standard of review, found the arbitration clause “unconscionable as a matter of law” and reversed the trial court. *Id.* at ¶ 13. The appeals court held that the “unconscionability of the mediation/arbitration clauses, and other unduly oppressive clauses [in this case] demonstrate the complete lack of meaningful choice and ability to negotiate on [the Benfields’] part in entering into this agreement. Such unfairness permeates this contract to the extent that we find it void and unenforceable in its entirety.” *Id.* at ¶ 50. Taylor Building then filed this appeal.

ARGUMENT

Amicus Curiae Attorney General’s Proposition of Law:

A de novo standard of review applies when reviewing a trial court’s determination of whether the terms of a consumer contract mandating arbitration are unconscionable as a matter of law.

A. The trial court’s determination of whether the arbitration terms of a consumer contract are unconscionable is a question of law, subject to de novo review on appeal.

If a consumer contract on its face contains unconscionable provisions, or if undisputed facts clearly establish that the characteristics of the contract unfairly prevent the consumer from

asserting his or her defenses or statutory claims, the court should declare, as a matter of law, that such contract terms are unenforceable. Thus, this case does not require the Court to change or overrule precedent, but only to clarify that a court must first determine, as a matter of law, whether an arbitration clause in a consumer contract is unconscionable or unenforceable.

When reviewing a trial court's determination of a question of law, an appellate court must use a de novo standard of review. *Goodyear Tire & Rubber Co. v. Aetna Cas. & Sur. Co.*, 95 Ohio St. 3d 512, 2002-Ohio-2842, ¶ 4. When reviewing factual questions, appellate review is based on an abuse of discretion standard. *Powell v. Schiffauer* (8th Dist.), 1989 Ohio App Lexis 345, *4.

The interpretation of contract terms generally is considered a question of law in Ohio. *Alexander v. Buckeye Pipeline* (1978), 53 Ohio St. 2d 241, syl. 1; *Nationwide Mut. Fire Ins. Co. v. Guman Bros Farm* (1995), 73 Ohio St. 3d 107, 108. The Court has also clearly established that "whether a contract provision is unconscionable is a question of law." *Insurance Co. of N. Am. v. Automatic Sprinkler* (1982), 67 Ohio St. 2d 91. In addition, R.C. 1302.15 (A) also indicates that the determination of unconscionability is a question of law.

Lower courts in Ohio divide unconscionability into two parts. Procedural unconscionability concerns the formation of the contract and occurs when no voluntary meeting of the minds is possible. *Propora v. Gatliff Building Co.*, 160 Ohio App. 3d 843, 2005-Ohio-2410, ¶ 6-7. To determine procedural unconscionability, a court looks at the relative bargaining positions of the parties, whether the terms of the provision were explained to the weaker party, whether the party claiming unconscionability was represented by counsel, and whether there are strong indications that the contract was one of adhesion. *Id.*; *Williams v. Aetna Finance Co.*, 83 Ohio St. 3d 464, 473, 1998-Ohio-294; *Insurance Co. of N. Am. v. Automatic Sprinkler* (1982), 67 Ohio St. 2d 91.

Substantive unconscionability refers to the actual terms of the agreement, and applies where the terms of a contract are unfair and commercially unreasonable. *Propora*, 2005-Ohio-2410 at ¶ 8. To prevail on a claim of unconscionability, a party may prove either procedural or substantive unconscionability.

Thus, substantive unconscionability involves examining the contract itself, and is clearly a matter of law which must be reviewed on appeal de novo. And, while the determination of procedural unconscionability does involve some factual investigation into the formation of the contract, procedural unconscionability is also a question of law that must be reviewed de novo.

First, this Court's case law, while not making the substantive-procedural split, indicates that the determination of unconscionability in general is a question of law, even where the facts and circumstances surrounding the formation of the contract are examined. *Insurance Co. of N. Am. v. Automatic Sprinkler* (1982), 67 Ohio St. 2d 91, 98. Similarly, the statute indicates that unconscionability is a question of law, even though it provides for the examination of evidence as to the contract's "commercial setting, purpose and effect" to "aid the court in making the determination." R.C. 1302.15.

Second, at least in the case of consumer contracts, the factors surrounding the formation of the contract will often be the same—consumers rarely have equal bargaining power with a corporation, rarely have provisions in the contract explained in detail, rarely hire a lawyer to buy a dishwasher or even to contract for the building of a house. In addition, many consumer contracts are on pre-printed forms, with no opportunity for bargaining about any of the contract's terms—in other words, they are contracts of adhesion.

While there is no generally accepted list of factors for a court's determination of unconscionability, the Sixth District Court of Appeals, in *Small v. HCF of Perrysburg, Inc.*,

discussed a number of probative factors, such as the “fairness of the terms, the charge for the service rendered, the standard in the industry, and the ability to accurately predict the extent of future liability[,]” which is usually seen as the failure to fully disclose all the costs of arbitration. (6th Dist.), 159 Ohio App. 3d 66, 2004-Ohio-5757 at ¶ 21. Other courts have also considered other informative factors, including whether the location of the arbitration proceeding is a distant forum, whether the parties have the opportunity for discovery, whether the remedies are limited, whether statutory claims will be considered, whether additional parties can be added, whether the fees exceed the amount of similar fees charged by the court, whether basic due process rules similar to the rules of evidence and the civil rules apply such that witnesses can be compelled to attend and documents can be subpoenaed, and whether direct and cross examination will be allowed to challenge credibility. See Ohio Consumer Law 21.6 (H. Williams ed. 2006).

Not directly applicable, but also instructive are the Attorney General’s recently promulgated rules to implement the Homebuyers’ Protection Act, Am. Sub. S.B. 185, 126th Gen. Assembly (2006). One rule defines the factors that should be considered to determine the unconscionability of a mandatory arbitration clause in a mortgage transaction. Under OAC § 109:4-3-28, any one of the following provisions would render a mandatory arbitration provision unconscionable and unenforceable:

- (1) Any clause requiring the consumer to pay the supplier’s attorney fees;
- (2) An unconscionable liquidated damages clause;
- (3) An arbitration clause that is not clearly and conspicuously disclosed to the consumer;
- (4) An arbitration clause that limits, restricts or precludes the applicability of any rights or remedies afforded the consumer under Chapter 1345. of the Revised Code;
- (5) An arbitration clause that provides for a limitation on actions of a shorter duration than provided for by statute under state or federal law;

(6) An arbitration clause that fails to provide the consumer with fair and reasonable access to discover and present information, documents and other evidence necessary to support the consumer's claim or defense;

(7) An arbitration clause that requires that the arbitration decision remain confidential;

(8) An arbitration clause that fails to provide an appeal process for a decision on the basis that the decision is arbitrary, capricious or contrary to law.

While the factors above are not determinative, their endorsement by this Court would assist not only the lower courts with their legal review of the unconscionability of mandatory arbitration clauses, but also the parties drafting and entering into contracts with mandatory arbitration clauses.

Furthermore, a *de novo* review of unconscionable contract terms will not frustrate the legislative intent of the Ohio Arbitration Act, R.C. 2711.01 *et seq.* The drafters of the legislation would not expect the law to be manipulated to permit the enforcement of unconscionable contracts, or to effectively deny consumers the opportunity to seek legal redress to enforce statutory claims. The Ohio Arbitration Act was not designed to eliminate other statutory causes of action or to contractually allow a waiver of fundamental due process rights. See, e.g. R.C. 2711.01 (arbitration clauses enforceable "except upon ground that exist at law or in equity for the revocation of any contract"). Mandatory arbitration clauses with unconscionable terms should not be used to effectively deny consumers the opportunity to pursue their statutory remedies for violations of the consumer laws, while hiding behind Ohio's Arbitration Act. See *Williams v. Aetna Finance Co.*, 83 Ohio St. 3d 464, 473, 1998-Ohio-294 ("[T]he presumption in favor of arbitration should be substantially weaker . . . when there are strong indications that the contract at issue is an adhesion contract, and the arbitration clause itself appears to be adhesive in nature.")

With a de novo standard of review, the trial and appellate courts will more closely examine all the factors that might indicate whether an arbitration provision in a consumer contract is creating a fair and efficient alternative to litigation, or is unfairly manipulating consumers into waiving their right to seek remedies in court. Affirming the appeals court's decision below ensures that the parties', and the state's, interests in expedient and efficient dispute resolution are properly balanced with their interests in fair and conscionable dispute resolution

B. An abuse of discretion standard denies consumers meaningful review of the trial court's determination of law that an arbitration clause is enforceable.

The abuse of discretion standard is inappropriate for the appellate review of unconscionability in consumer contracts, as in some cases it has permitted courts to get rid of consumer cases without any serious scrutiny of the fairness or enforceability of the contract terms. This review must be conducted de novo for the reasons above in Part A, so the Court can stop there. This principle is further confirmed by the case law below, which shows how an abuse of discretion standard can lead to the *under*-protection of consumer rights. That is not to say that it will happen in every case, as trial courts will of course often get it right when faced with an unconscionable arbitration clause, and even when they don't, appeals courts might correct the problem even under an abuse of discretion standard. But at least in some cases, an unconscionable clause will be wrongly enforced, and an abuse of discretion standard makes that mistake harder to fix. And even some bad cases are too many, for those consumers.

For example, in *Cronin v. California Fitness* (10th Dist.), 2005 Ohio App. Lexis 3056, 2005-Ohio-3273, the appellate court started its analysis with a statement that public policy favors arbitration, that all doubts should be resolved in favor of sending a case to arbitration, and that the freedom of contract was fundamental to our society. With those three overriding principles, the unfairness of the contract terms were viewed as a minor concern that should be dealt with in

the arbitration proceeding. However, this analysis presumes an arbitration procedure that will provide the consumer with a fair and reasonable opportunity to present contract defenses and statutory claims. If the arbitration proceedings are cost prohibitive, require a waiver of statutory rights, severely limit damages, or prohibit discovery, the consumer's opportunity to prosecute his or her claims are effectively nullified.

Similarly, in *Sikes v. Ganley Pontiac Honda* (8th Dist.), 2004 Ohio App. Lexis 141, 2004-Ohio-155, the appeals court started its analysis with both a presumption favoring arbitration and a declaration that the trial court decision had to be upheld absent a finding that the court acted unreasonably, arbitrarily or unconscionably. *Id.* at ¶ 8 In this framework, the court was forced to find that several indicia of unconscionability were not enough to overcome the presumption in favor of arbitration. If the court had conducted a de novo review, and began its analysis with the proper construction of the contract terms, it would have looked at the provisions regarding excessive fees, a limitation of damages, and a waiver of rights from the viewpoint of their chilling effect on the consumer's right to seek legal redress. Although the right to contract is fundamental, there is no right to mandate the enforcement of unconscionable contracts. R.C. 1302.15; *Eagle v. Ford Martin Motor Co.* (9th Dist.), 157 Ohio App. 3d 150, 2004-Ohio-829.

To be sure, as noted above, even using the improper standards some courts will get it right. In *Small v. HCF of Perrysburg, Inc.* the appeals court specifically found terms of a nursing home contract requiring arbitration to be unconscionable. 2004-Ohio-5757. The court was particularly troubled by the term of the mandatory arbitration provision that abrogated the American rule prohibiting fee shifting. *Id.* at ¶ 26. Not only was the consumer potentially required to pay the supplier's attorney fees, but the consumer would also have to pay the facility's costs and the costs of arbitration. *Id.* The appeals court was also able to reach the conclusion, based solely on

the face of the contract, that it was a contract of adhesion, because signing the agreement was a requirement of admission. The court expressed concern with the chilling effect of such a policy because consumers would be “discouraged from pursuing claims.” *Id.* The court acknowledged that “there is a broader reason that arbitration clauses in these types of cases must be closely examined. Arbitration clauses were first used in business contracts, between sophisticated businesspersons, as a means to save time and money should a dispute arise. As evidenced by the plethora of recent cases involving the applicability of arbitration clauses, the clauses are now being used in transactions between large corporations and ordinary consumers, which is cause for concern.” *Id.* at ¶ 29. Similarly, in *Sikes*, the court acknowledged that a “weaker presumption exists when an arbitration clause is found in an adhesion contract between a businessman and an unsophisticated consumer.” 2004-Ohio-155 at ¶ 15.

Thus, when an abuse of discretion standard is improperly used in review of arbitration clauses, the consumer may lose significant scrutiny of the contract’s unconscionability. As stated above, in some cases an unconscionable clause will be wrongly enforced, and an abuse of discretion standard often constrains the appellate court’s review of that mistake. If, however, the appellate court reviews the arbitration clause’s unconscionability *de novo*, the parties’ interests remain properly balanced and protected.

C. Only after the trial court finds that the contract is enforceable, should the court determine, as a discretionary matter, whether to stay the case and refer the dispute to arbitration.

The Attorney General does not dispute that if the trial court finds a consumer contract enforceable, after considering all indicia of unconscionability, then the second step to its determination—whether to send the case to arbitration—is a matter of discretion. Under some circumstances, even when a contract is found enforceable, other factors may dictate that the court will more efficiently handle the dispute. For example, in a consumer action where predatory

lending issues are raised, it is not unusual for the consumer to join the mortgage broker, the appraiser, the loan officer, the closing or title agent, and the real estate broker, in addition to the lender. Even if the note or mortgage document included a mandatory arbitration clause, all of the other parties may not be a party to that agreement, so the court would retain jurisdiction over the claims against those parties. In such an event, it would not serve judicial economy to send only one small part of the case to arbitration, so the court should exercise its discretion to keep the case and try all issues, with common facts and witnesses, in one tribunal.

Procedural issues regarding the control of a court's docket have traditionally been considered a matter of discretion, subject to an abuse of discretion standard. *Eckmeyer v. Kent City School Bd. Of Ed.* (11th Dist.), 2000 Ohio App. Lexis 5123, *19. This is precisely why the courts have lost their way and created confusing case law on the standard of review issue when faced with the discretionary decision to send a case to arbitration. It is a procedural question whether to send a case to arbitration or keep it on the court's docket, but such decision should not be made until after the court first determines if the contract itself is enforceable.

In short, the trial court must follow a two-step process. When challenged by a consumer, the court must first interpret the language of the contract as a matter of law and second, if it is determined to be enforceable, then it may exercise its discretion to stay the case and refer it to arbitration. On appeal, a de novo standard of review applies to the court's interpretation of the contract terms, and an abuse of discretion standard applies to the discretionary act of staying the case or referring it to arbitration.

D. The appeals court here properly applied de novo review to the trial court's failure to consider the unconscionability of the contract terms.

The appeals court here properly determined that the trial court had erred by enforcing the mandatory arbitration clause of the Benfields' contract without first finding as a matter of law

that the arbitration terms of the contract were not unconscionable. *Taylor Bldg. Corp. of Am.*, 2006-Ohio-4428. The appellate court could easily ascertain, from the plain language of the contract, and from undisputed facts, that the contract terms were unconscionable. *Id.* at ¶ 23. It found that the pre-printed terms of the contract were a clear example of an adhesion contract. *Id.* at ¶ 28. The contract had an unreasonable liquidated damage provision, required the arbitration proceedings to be conducted out of state, and prohibited consumers from interrupting construction for any reason, even to correct building code violations. *Id.* at ¶¶ 31, 35, 36. Additionally, in the event of litigation, the consumer was forced to waive any right to a jury trial, the action had to be heard out of state, and the consumers were responsible for both parties' legal fees. *Id.* at ¶¶ 32, 37. The appeals court was particularly concerned that the provisions created a "chilling effect" on the consumer's access to legal redress. *Id.* at ¶ 42. Therefore, the Twelfth District correctly found that the terms of the contract, on its face, were so "unfairly one-sided as to render the mediation/arbitration clauses unconscionable." *Id.* at ¶ 49.

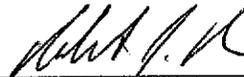
In short, both law and sound public policy support the appeals court's de novo review, and the Attorney General urges this court to affirm.

CONCLUSION

For the reasons explained above, this Court should affirm the judgment below and find that a de novo standard of review must be applied when reviewing whether to enforce an arbitration provision in a consumer contract.

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