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# The Enforceability of Class Action Waivers in Consumer Agreements

## Introduction

When used properly, the class action mechanism is a valuable procedural tool for both plaintiffs and defendants. When abused, however, it can become a menace to defendants. The same features which make class actions swift and efficient also create economies of scale that can dissuade even the most confident defendant from risking trial.

For this reason, companies sometimes attempt to minimize their risk by using class action waivers in the contracts with consumers. Often such waivers occur in arbitration clauses. Class action waivers have sometimes become controversial, with plaintiffs challenging their validity and enforceability. While some courts have been receptive to such arguments, the majority agree that class action waivers are generally enforceable.

Plaintiffs generally attack class action waiver provisions in two ways. First, they claim that such provisions are unconscionable. Second, plaintiffs argue that these provisions limit certain statutory claims, thus violating legislative intent. Both arguments have had limited success.

## Unconscionability

Plaintiffs often claim that class action waivers are unconscionable and therefore unenforceable. They argue that the relatively high cost of arbitration or court proceedings, combined with the relatively low value of certain consumer claims, makes the pursuit of a remedy under such contracts economically unfeasible without the class action vehicle. For example, if the only recovery sought in an action is $500, and the cost of the arbitrator, meeting space, lawyer, and other fees is $1500, then the actual value of the claim may be negative $1000. With such economics, there may be no incentive for a plaintiff to bring a claim, and no reason for a lawyer to represent him.

While the law varies from state to state, in most jurisdictions a contract must be both substantively and procedurally unconscionable to be unenforceable. See Gillman v. Chase Manhattan Bank, N.A., 73 N.Y.2d 1 (N.Y. 1988). A provision is substantively unconscionable when it is so grossly unfair that no reasonable person would accept it, and may be procedurally unconscionable when the weaker party either has no bargaining power at all, or no alternative but to enter the contract.

Companies often use standardized contracts with consumers. Plaintiffs attack these as "boilerplate" and as contracts of adhesion, arguing that they are therefore procedurally unconscionable. Plaintiffs emphasize the economic disparity between the consumer customer and the seller, and the absence of meaningful bargaining. Nonetheless, such standard contracts generally survive scrutiny for two simple reasons.

First, most courts acknowledge that consumers do not have to contract with a company; they are free to go elsewhere or without. Furthermore, while the market does much of the bargaining, the consumer achieves a certain price in exchange for accepting the company's goods or services on certain conditions; this is quid pro quo. Therefore, many courts are reluctant to deem all standard contracts procedurally unconscionable, and may dismiss a consumer's claim before even addressing whether a bargain is substantively unconscionable.

For a contractual provision to be substantively unconscionable, it must do more than merely advantage one party; the judge's role is not to balance contractual benefits, and it is not illegal to strike a hard bargain or to get the best of a deal.

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Substantive unconscionability must shock the conscience. As the Alabama Supreme Court puts it, the contract must be "such as no man in his sense and not under delusion would make on the one hand, and no honest and fair man would accept on the other." Sears Termite & Pest Control, Inc. v. Robinson, 883 So. 2d 153, 158 (Ala. 2003). To be sure, the bar is set high.

Class action waiver provisions in consumer transactions are generally not found unconscionable unless the provision grants de facto immunity from liability for the defendant by removing the plaintiff's only economically feasible means of recovery. If the contract provides one or more viable alternative means for pursuing the statutory remedies involved, it should be permissible regardless of the waiver.

For example, a contract which prohibits class action participation may also provide for the consumer's costs in initiating arbitration. In this case, arguments involving the cost of arbitration become moot, and the provision should not be unconscionable. In fact, if the plaintiff brings her claim under a statute which contains incentives such as fee-shifting provisions, or treble damages, the court is unlikely to deem the provision unconscionable regardless of the contractual provisions. Further, if the contract continues to allow access to small claims court, a court is unlikely to deem it unconscionable.

In brief, while many jurisdictions recognize that class waiver provisions could be unconscionable, they acknowledge that they are generally enforceable, especially when the contract or controlling statute provides economically viable alternatives to the class action mechanism.

## Can Waive Class Action for Statutory Violations

Plaintiffs may also argue that a class action waiver violates the statutory rights available under certain state and federal laws because it removes an intended, efficient procedural vehicle for vindicating those rights. The Supreme Court has written that when a party waives some procedural right related to a statutory claim, the party "should be held to [the bargain] unless Congress has evidenced an intention to preclude a waiver of judicial remedies for the statutory rights at issue." Gilmer v. Interstate/Johnson Lane Corp., 500 U.S. 20, 26 (1991).

Therefore, for a plaintiff to successfully argue that a class action waiver provision limits her statutory remedies, she would need to show that "Congress intended to preclude parties from contracting away their ability to seek class action relief" under the particular statute, or that such a waiver is "inherently inconsistent with [the act's] enforcement scheme." Randolf v. Green Tree Fin. Corp.-Alabama, 244 F.3d 814, 817-18 (11th Cir. 2001).

A plaintiff is unlikely to make such a showing because consumer protection acts are often silent as to the class action mechanism and additionally provide incentives to litigants and lawyers to pursue claims (such as fee-shifting and treble damages). Moreover, companies often agree to pay arbitration initiation costs in the contract. Most importantly, an arbitrator (or judge) typically has the discretion to allocate costs as he sees fit in accordance with applicable law and can shift costs away from the consumer.

## Consumers Class Action Waivers in Alabama

The seminal consumer class action waiver case in Alabama is Leonard v. Terminix International Co., where a plaintiff argued, among other things, that such a waiver made arbitration of its contractual claims "inaccessible." 854 So. 2d 529, 534 (2002). A closely divided Alabama Supreme Court agreed that the particular provision at issue, under those particular facts, was not enforceable.

The Court carefully distinguished its reasoning from the broader argument that mere economic hardship might render an arbitration clause unconscionable for certain consumers. The issue was not whether the Terminix contract was burdensome on the plaintiffs, but whether "economic feasibility precluded presentation of the claims" for any potential claimant. Id. at 537. Because the case involved an adhesion contract which limited the recovery of "indirect, special, and consequential damages," required arbitration, and precluded class action treatment, it essentially "restrict[ed] the [plaintiffs] to a forum where the expense of pursuing their claim far exceed[ed] the amount in controversy." Id. at 539. Further, the Terminix contract was silent as to who should pay arbitration costs. Thus, the Court found the class action waiver restriction unconscionable.

While Leonard v. Terminix opened the door for unconscionability in Alabama, its holding should be confined to its fact specific circumstances, particularly with the 5-4 split on the Court. Further, the Court reaffirmed its holding that mere economic hardship did not constitute substantive unconscionability. The holding leaves standing room for other Alabama courts to enforce less restrictive class action waivers in line with other cases such as Med. Ctr. Cars Inc. v. Smith, 727 So. 2d 9 (Ala. 1998); e.g., Taylor v. Citibank USA, N.A., 292

F. Supp. 2d 1333, 1345 (M.D.Ala. 2003) (distinguishing Terminix). Leonard v. Terminix should not ultimately be a threat to a well drafted waiver provision.

## Consumer Class Action Waivers in the 11th Circuit

In a number of representative cases, the Eleventh Circuit upheld class action waivers challenged as unconscionable. The court acknowledged that a party can avoid arbitration on the basis of costs if she can demonstrate "that she faces such 'high costs' if compelled to arbitrate her claim . . . that she is effectually precluded from vindicating [her federal statutory] rights in the arbitral form." Musnick v. King Motor Co., 325 F.3d 1255, 1260 (11th Cir. 2003).

In Billips v. Bankfirst, a consumer credit card holder argued that the arbitration clauses in her card member agreements were unenforceable. Billips v Bankfirst, 294 F. Supp. 2d 1265 (M.D.Ala. 2003). The court held that the case was distinguishable from Leonard v. Terminix because the defendant bank agreed to pay the fees associated with the plaintiff's initiating the arbitration, because the federal statute under which the plaintiff brought the suit awarded costs and attorney's fees, and because the contract did not limit the damages available to the plaintiff. Billips, 294 F. Supp. 2d at 1276. The court enforced the waiver, and its reasoning was reaffirmed in a very similar case, Battels v. Discover Bank, in 2004.

## Consumer Class Action Waivers in Mississippi

While Mississippi does not have a large amount of case law on class action waivers, it appears the law follows the national trend of enforcing such waivers. For instance, in Steed v. Sanderson Farms, Inc., 2006 WL 2844546 (S.D.Miss. Sept. 29, 2006), the court confronted a contract clause that effectively barred class actions in arbitration. The court found this was not unconscionable and wrote that "courts generally uphold waivers of class action in arbitration agreements, even in the context of an adhesion contract and even where the right to proceed by class action derives from statute."

## Consumer Class Action Waivers in Georgia

Likewise, Georgia follows the national trend and generally allows class action waivers. For instance, in Jenkins v. First American Cash Advance of Georgia, LLC, 400 F.3d 868 (11th Cir. 2005), the Eleventh Circuit (ruling on a Georgia state law claim) upheld a class action waiver, reversing the district court. The Jenkins court held that the provision was not unconscionable (the claim had been brought by two borrowers against payday lenders). The court noted that class action provisions in arbitration agreements are not per se invalid or unenforceable in a number of other federal circuits. Id. at 877. It also disagreed with the contention that the plaintiffs would not be able to find legal representation without the class action vehicle. Id. at 878.

## Consumer Class Action Waivers Nationally

The clear national trend is to uphold class action waivers in consumer arbitration agreements. Jurisdictions that have explicitly upheld such waivers in consumer transactions include (among others) Colorado, Delaware, Illinois, New Jersey, New York, North Carolina, Kansas, Tennessee, Washington, and the Third, Fourth, Fifth, Sixth, Seventh, and Eleventh Federal Circuits.

Nevertheless, a few jurisdictions, such as New Jersey and California, have found unconscionability in holdings similar to Leonard v. Terminix. Even New Jersey does not represent a serious departure from the national trend. For instance, New Jersey, like Alabama, has not held that such waivers are invalid per se, and has upheld them in some contexts. See Corp v. Harris, 912 A.2d 104 (N.J. 2006). California was willing to apply Delaware law under a choice-of-law analysis, even though that law possibly contradicted California's. Discover Bank v. Superior Court, 36 Cal. Rpt. 3d 456 (Cal. Ct. App. 2005). The court reasoned that the only defendant resided in Delaware, a Delaware statute mandated that its laws apply to disputes between Delaware banks and their cardholders, and the claims asserted against the bank were all under Delaware law. Id.

It should be noted, however, that California law may be moving against this clear trend. E.g. Shroyer v. New Cingular Wireless Services, Inc., 2007 WL 2332068 (9th Cir. August 17, 2007); Oestreicher v. Alienware Corp., 2007 WL 2302490 (N.D.Cal. Aug. 10, 2007).

Finally, Utah must be mentioned as the first state to explicitly validate class action waiver provisions in consumer arbitration agreements by statute. See 2006 Utah Laws Ch. 172 (S.B. 252) (to be codified at UTAH CODE ANN. (published by LexisNexis) § 70C-4-102 (2006)) The law applies specifically to revolving and installment consumer credit transactions, and

will be an important tool for all contracts drafted under Utah law.

## Conclusion

While courts will protect consumers from bad actors who seek to avoid liability for their conduct, most jurisdictions are generally amenable to consumer class action waivers, and enforce them. Companies may take preventative steps to ensure that their waivers will be enforced and you may wish to contact counsel to draft the most appropriate provision.