

Class-Action Waivers in Arbitration Agreements: The Evolving Case Law

BY JEREMY GILMAN

From the recent proliferation of consumer class actions has emerged an evolving body of case law addressing this issue: Are class-action waivers in consumer contracts containing arbitration clauses enforceable? If they are, then a plaintiff's putative class action will either be dismissed or stayed pending arbitration. If not, then the putative class action may proceed, and the arbitration clause may be deemed a nullity.

Many variations of the underlying fact pattern are possible, but most cases share certain recurring themes. Consider these two recent cases involving DirecTV, Inc., one from the Northern District of Ohio and one from the Northern District of Georgia, decided less than four months apart in 2009.

First, let's look at the Ohio case, decided July 13, 2009.¹ Two former DirecTV customers filed a putative class action against DirecTV, alleging violations of the Ohio Deceptive Trade Practices Act, the Ohio Consumer Sales Practices Act, and common-law claims. Specifically, the plaintiffs challenged an early cancellation fee DirecTV assessed against them. Their customer agreement with DirecTV contained a broad arbitration clause, as well as a class-action waiver, the latter providing as follows:

Neither you nor we shall be entitled to join or consolidate claims in arbitration by or against other individuals or entities, or arbitrate any claim as a representative member of a class or in a private attorney general capacity . . . If, however, the law of your state would find this agreement to dispense with class arbitration procedures unenforceable, then this entire Section 9 is unenforceable.

DirecTV moved to dismiss the action pending arbitration and to compel arbitration. The plaintiffs responded by claiming that they never agreed to the customer agreement, that no viable contract existed, and that even if it did, the arbitration clause was unenforceable under Ohio law because it was both substantively and procedurally unconscionable.

Now shift to Georgia.² The plaintiff brought a putative class action against DirecTV, claiming that it assessed excessive "tax" charges and lease fees. She brought claims for breach of contract, unjust enrichment, and accounting, injunctive, and declaratory relief. DirecTV moved to compel arbitration, citing what was largely the same arbitration clause and class-action waiver as in the Ohio case.

The Northern District of Ohio granted DirecTV's motion, found the class-action waiver not unconscionable, and enforced the arbitration clause.

The Northern District of Georgia denied DirecTV's motion, found the class-action waiver unconscionable, and

nullified the arbitration clause.

Why the diverging opinions?

In the Northern District of Ohio, the plaintiffs' claim that they didn't read the arbitration was unavailing. As for whether that clause was unconscionable, the court noted that "[t]o demonstrate that an arbitration clause is unenforceable, the party asserting unconscionability must prove that the clause is both substantively and procedurally unconscionable under Ohio law." Was it?

As for procedural unconscionability, the court looked to the following factors: (1) was the "arbitration clause . . . presented on a 'take-it-or-leave-it basis'"; (2) was there "a disparity in bargaining power . . . between the parties"; (3) was "the arbitration clause . . . hidden in small print within the document"; and (4) could "one of the parties . . . unilaterally modify the agreement?"

The court found that the arbitration clause was not procedurally unconscionable, noting, among other factors, that under Ohio law, preprinted sales contracts containing arbitration clauses are not necessarily unenforceable, and that adhesion contracts are not per se unconscionable. The court also noted that "satellite television services are not a necessity" and that DirecTV "is not the only provider of those services." Also, mere imbalance in bargaining power will not, by itself, render a contract unenforceable. Instead, there must be evidence that the imbalance coerced or defrauded the "weaker" party into signing the arbitration clause, and the court found no such evidence. As for the type-size of the arbitration clause, it was prominent—not hidden—in the contract. DirecTV's unilateral ability to modify the customer agreement also didn't render the arbitration clause procedurally unconscionable: The plaintiffs could have canceled the contract if dissatisfied with any modification.

As for substantive unconscionability, the court framed the issue like this: Was the contract "commercially reasonable" under Ohio law? The plaintiffs argued that the class-action waiver would "frustrate the remedial purposes of the" Ohio Consumer Sales Practices Act, but the court wasn't persuaded, finding that nothing within that statute precluded arbitration clauses in consumer sales contracts. Also, the arbitration clause did not contain a confidentiality provision, did not impose "prohibitive" arbitration costs on the plaintiffs, and did not seek to limit the recoverability of attorney fees, which were statutorily available to the plaintiffs if they prevailed in the proceeding. Perhaps most importantly, the court failed to find any cases under Ohio law "that stand for the proposition that a class action waiver alone establishes substantive unconscionability in an arbitration clause."

Having found the arbitration clause neither procedurally

nor substantively unconscionable, and that the plaintiffs' dispute fell within its scope, the court granted DirecTV's motion to dismiss and to compel arbitration.

About 15 weeks later, the Northern District of Georgia struck the arbitration clause in the plaintiff's customer agreement with DirecTV, finding the class-action waiver unconscionable under Georgia law. In so holding, the court employed a totality-of-the-circumstances test and found that the class-action waiver "effectively prevents the consumer from asserting statutory or common law claims against the entity with which he or she has a contract." Why? Because if the plaintiff, individually, were to succeed on her claim, she would "stand to recover a very small amount"—too small, relative to the attendant costs, to motivate plaintiffs and their attorneys to pursue these claims in arbitral settings. The net result, according to the court, was that the class-action waiver essentially divested both the plaintiff and the putative class members of any remedy.

Having found the class-action waiver unconscionable, the court found the entire arbitration clause unenforceable and denied DirecTV's motion to compel arbitration.

Two courts, same issue, opposite results. Not surprisingly, appellate courts have been addressing the issue. In *G.R. Homa v. American Express Co.*, the U.S. Court of Appeals for the Third Circuit engaged in a two-part analysis upon holding that a "class-arbitration waiver" in a contract between American Express Centurion Bank and its customers was unconscionable, and therefore unenforceable, under applicable law.³

First, it examined whether the Federal Arbitration Act barred courts from applying state law unconscionability principles to void a class-arbitration waiver, and held that it did not.

Then it engaged in a choice-of-law analysis, which proved to be dispositive in the case. The plaintiff—a New Jersey resident who filed suit in the District of New Jersey and sought certification of a class of New Jersey customers—claimed that New Jersey law applied notwithstanding the Utah choice-of-law provision of the plaintiff's credit card agreement, and that class-arbitration waiver ran afoul of New Jersey public policy in "small-sum cases." American Express, on the other hand, contended that Utah law—which permitted class-arbitration waivers in consumer credit agreements—applied.

The court found that New Jersey law applied because "New Jersey has a materially greater interest than Utah in the enforceability of a class-arbitration waiver that could operate to preclude a New Jersey consumer from relief under the [New Jersey Consumer Fraud Act]."

Having determined that New Jersey, and not Utah, law applied to the dispute, the court held that the class-action waiver was unconscionable, and therefore unenforceable, when "the claims at issue are of such a low value as effectively to preclude relief if decided individually." The court therefore reversed the district court's order compelling arbitration.

Another federal appellate court that has addressed this issue is the First Circuit, which, in *Skirchak v. Dynamics Research*

Corp., held that a class-action waiver of Fair Labor Standards Act claims in a company-imposed, dispute-resolution program was unconscionable under the circumstances of the case, and therefore unenforceable under Massachusetts law.⁴ In so holding, the First Circuit, like the Third Circuit in *Homa*, held that the Federal Arbitration Act did not preclude courts from applying state law unconscionability principles to invalidate arbitration agreements.⁵ The court based its unconscionability holding on a variety of factors specific to the case before it. It found, for example, that the class-action waiver had been "obscured" and lacked "prominence and clarity." An announcement regarding the defendant's new dispute-resolution program had been emailed to employees two days before Thanksgiving, with the program attached, and nothing in that five-line announcement indicated that the attachments modified "the employees' terms of employment or employment contract [or] restricted the employees' rights to a judicial forum [or] that they waived class actions." Additionally, "no response to the e-mail was required, nor were employees asked to acknowledge reading the documents." In short, a confluence of factors led the court to conclude that the class-action waiver in that case was unconscionable, and therefore unenforceable.

The law continues to evolve. The Ninth Circuit, in *Chalk v. T-Mobile USA, Inc.*, found that an arbitration clause with a class-action waiver, while not procedurally unconscionable, was substantively unconscionable, and thereby invalidated the entire arbitration clause.⁶ And on January 4, 2010, the Eleventh Circuit certified questions to the Florida Supreme Court in an effort to resolve the issue of whether the district court correctly granted the defendant's motion to compel arbitration in light of an arbitration clause and class-action waiver contained in the plaintiff's wireless phone contract with Sprint Nextel Corp.⁷ More appellate activity in this area is certain to follow.

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Endnotes

1. *Stachurski v. DirecTV, Inc.*, 642 F. Supp. 2d 758 (N.D. Ohio 2009).
2. *Jones v. DirecTV, Inc.*, F. Supp. 2d, 2009 WL 3646197 (N.D. Ga., Oct. 29, 2009).
3. 558 F.3d 225 (3rd Cir. 2009).
4. 508 F.3d 49 (1st Cir. 2007).
5. In so holding, both courts cited *Doctor's Associates, Inc. v. Casa-rotto*, 517 U.S. 681, 687 (1996).
6. 560 F.3d 1087 (9th Cir. 2009).
7. *Pendergast v. Sprint Nextel Corp.*, —F.3d—, 2010 WL 6745 (11th Cir. Jan. 4, 2010).