ADR Special Focus

California Supremes Find Anticipatory Jury Trial and Class Action Waivers Unenforceable


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Recent decisions emerging from the California Supreme Court have spoken unambiguously: contracts containing those provisions are not only likely to be unenforceable, but even potentially actionable.

Class Action Waivers

On June 27, 2005, the California Supreme Court issued its long-awaited decision in *Discover Bank v. Superior Court of Los Angeles (Boehr)*, 36 Cal. 4th 148 (June 2005). The key issue in the case is whether class action waivers are valid as a part of an arbitration provision within a consumer contract. In a 4-3 decision the court held that in most circumstances under California law, class action waivers in consumer form contracts are unenforceable, regardless of whether the consumer is being asked to waive the right to class-wide arbitration or the right to class action litigation.

The case arose when a California credit cardholder incurred late fees for payments made on a due date but after the lender's payment cut-off hour of 1:00 p.m. The cardholder filed suit on behalf of a nationwide class as the alleged damages were small individually but large in the aggregate. The court reasoned that a waiver of class-wide remedies is unfair to consumers if the effect would be to allow a large company to unfairly deprive large numbers of its customers of small sums of money without legal recourse. If the party with superior bargaining power attempts to strong-arm large numbers of consumers out of individually small sums of money, the waiver is deemed to be unconscionable as "unlawfully exculpatory." And while the Federal Arbitration Act (FAA) requires the enforcement of arbitration clauses including class action waivers, the *Discover* court held that the FAA does not preempt California's unconscionability defense to the enforcement of such waivers.

Suffice it to say, a contract that is seen by the courts as unilaterally favoring the interests of the party with stronger bargaining powers will not fare well if tested. Furthermore, in the consumer context, it is particularly problematic to retain a provision in a contract which has been held to be unenforceable. Including unconscionable or unenforceable provisions in consumer contracts in California is itself actionable under the Consumers Legal Remedies Act in the Civil Code. (Cal. Civ. Code §1751)

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Clients, it appears, should avoid putting their money on arbitration clauses with "no class action" provisions.

Further complicating the class-action scenario is the recent passage of the federal Class Action Fairness Act (28 U.S.C. §1332), which will effectively channel class-action lawsuits from state courts to the federal system. This seemingly procedural change could have far-reaching implications, as federal courts have traditionally been less sympathetic to class-action cases than certain state venues. The legislation would create federal jurisdiction for most class-action cases in which defendants are from multiple states and claims exceed $5 million. Only when two-thirds of the plaintiffs – and the defendant's business headquarters – are domiciled in the same state would these cases remain in state courts.

Jury Trial Waivers

Another recent California Supreme Court decision effectively invalidates pre-dispute jury trial waivers in California State Courts. *Grafton Partners v. Superior Court*, 36 Cal. 4th 944 (August 2005). The Court, in refusing to enforce a jury waiver provision in a contract entered between Grafton Partners and its "Big 4" accounting firm, held that section 631 of the California Code of Civil Procedure (CCP) preserves as "inviolate" the right to a jury trial in accordance with the California Constitution and does not permit a party to waive the right to a trial by jury *prior to the commencement of a lawsuit*. The bombshell here is that the unenforceability of jury trial waivers applies to *all* consumer contracts in California, whether or not a successful contract-of-adhesion argument is made.

A question remains as to the applicability of this decision on federal cases within California or to cases in other states. There is strong federal policy favoring jury trials as an important – almost inalienable – right arising out of the Seventh Amendment. In *Jacob v. New York*, 315 U.S. 752 (1942), the Court stated: "The right of jury trial in civil cases at common law is a basic and fundamental feature of our

system of federal jurisprudence which is protected by the Seventh Amendment. A right so fundamental and sacred to the citizen, whether guaranteed by the Constitution or provided by statute, should be jealously guarded by the courts." This position was solidified by a landmark Seventh Amendment case, *Simler v. Conner*, 372 U.S. 221 (1963) and other case law which protects the right to jury trials in diversity cases, regardless of state practice. Jury trial waivers have withstood legal challenge in some federal courts depending on the sophistication of the parties entering into the agreements, and the standards of consent (whether a waiver has been knowingly and voluntarily made). *Leasing Service Corp. v. Crane*, 804 F.2d 828 (4th Cir. 1986).

While the *Grafton* decision does not annihilate arbitration provisions in contracts, some serious consideration of reviewing clients' contracts for jury trial waiver provisions may be in order. New contracts, or amendments to existing ones should at least be modified to include limiting language on jury trial waiver clauses such as "to the extent permitted by law," to ensure viability if courts enforce a waiver or if future legislation authorizes it specifically. Barring a comprehensive review of individual contracts, clients with consumer contracts may wish to consider notifying their customers that they will no longer seek to enforce such provisions.

Judicial reference

In what appears to be the final bastion of alternative dispute provisions, an exploration of the lesser known option of judicial reference, addressed under CCP §638 is in order. At first blush judicial reference is appealing as it is expressly provided for in the Code and still seems to accomplish much of what arbitration can accomplish:

> "A referee may be appointed upon the agreement of the parties filed [with the court], or upon the motion of a party to a written contract or lease that provides that any controversy arising therefrom shall be heard by a referee if the court finds a reference agreement exists between the parties:
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> (a) To hear and determine any or all of the issues in an action or proceeding, whether of fact or of law, and to report a statement of decision.
>
> (b) To ascertain a fact necessary to enable the court to determine an action or proceeding."

Section 638 expressly refers to appointing a referee based on a "written agreement or lease" that contains a provision to the effect that any controversy shall be heard by a referee. The good news is that according to CCP §644, the decision of a referee (often retired judges) is the equivalent of a judgment after a bench trial. On the face of it, judicial reference under CCP §638 looks like a strong candidate to replace private arbitration in pre-dispute clauses in contracts in California.

Before placing all eggs in the judicial reference basket, however, consider some of its limitations. One important caveat is that once a party files an action in court, the court must verify that a valid reference agreement exists between the parties. Also, nothing in Section 638 or related sections seems to preclude the bringing of a class action or to preclude the referee from hearing the class action. On the contrary, the *Discover* decision supported class-wide arbitration, so long as parties in a non-adhesion contract have relatively equal bargaining power. California courts have held that mandatory judicial reference, even under the express provisions of the state's Code of Civil Procedure, is unconscionable in certain circumstances. (CCP §1670.5) In *Pardee Construction v. Superior Court*, 100 Cal. App. 4th 1081, a court of appeal held in 2002 that a mandatory pre-dispute judicial reference provision in a consumer home purchase contract was void for unconscionability. The court objected to a perceived lack of clarity and prominence of the reference provision, and held the provision's waiver of punitive damages and waiver of a jury trial to be unconscionably one-sided. More recently, however, a judicial referee provision was upheld by the 5th District Court of Appeal. *Trend Homes Inc. v. Superior Court (Azperren)*, 131 Cal. App. 4th 950 (August 2005). In evaluating the parties' relative bargaining power and the extent to which a provision is veiled, the court determined that because the terms were clearly written and contained no element of surprise, the contract was not overly one-sided. In sum, it is unclear whether the CCP's judicial reference procedure is any more immune from unconscionability attacks in a consumer setting than arbitration clauses have proved to be.

These challenges not-withstanding, the process of alternative dispute resolution itself is not at risk so much as blanket contract provisions requiring these methodologies. To protect clients' interests and avoid professional vulnerability, however, smart money would scour boilerplate language to steer clear of not only these waiver provisions, but any that could be perceived as unconscionable.

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