IN THE SUPREME COURT OF ALABAMA

WALTER LEONARD and EVALINA LEONARD,	*	
APPELLANTS,	*	
v.	*	CASE NO.: 1010555
TERMINIX INTERNATIONAL COMPANY, *et al.*,	*	
APPELLEES.	*	

APPEALED FROM THE CIRCUIT COURT OF JEFFERSON COUNTY, ALABAMA, CIVIL ACTION NUMBER CV-97-2755

CONDITIONAL AND PROPOSED BRIEF OF *AMICI CURIAE* TRIAL LAWYERS FOR PUBLIC JUSTICE, AARP, AND THE NATIONAL ASSOCIATION OF CONSUMER ADVOCATES IN OPPOSITION TO APPLICATION FOR REHEARING

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In holding Appellee Terminix's arbitration clause unconscionable because it bars class actions and thus "foreclos[es] the Leonards from an attempt to seek practical redress" *Leonard v. Terminix Int'l Co.*, 2002 WL 31341084, *8 (Ala. Oct. 18, 2002) [hereinafter *Leonard*], this Court has held that Alabama businesses may not use arbitration clauses to insulate themselves from small value consumer claims. This holding is entirely consistent with generally applicable Alabama law, which favors the class action remedy in cases involving small claims and discourages exculpatory clauses in all contracts. The Court's position is also easily reconcilable with the Federal Arbitration Act ("FAA"), which contains no language on the availability of class action relief and thus does not preempt state law on this point. Furthermore, this Court's decision is in line with decisions from state and federal courts throughout the country that have found similar bans on class action relief unconscionable given those states' interest in providing a remedy for consumers with small claims. In short, this Court has made the correct decision, and should let it stand.

ARGUMENT

I. This Court's Holding that a Ban on Class Action Relief is Unconscionable is Consistent with Alabama Law as well as with Decisions from Many Other States

As this Court stated in *Leonard*, the Alabama Constitution guarantees that "every person, for any injury done him, . . . shall have a remedy by due process of law." *Leonard* at *8 (quoting Ala. Const. Art. I, § 13). As the Court properly held, by restricting consumers to individual arbitration procedures, each one of which would almost certainly be more expensive than the potential award, Terminix had effectively stopped consumers from bringing small claims against the company - thus denying them the remedy required under the Constitution. *Id.*

This Court has long understood that the class action mechanism allows access to justice for plaintiffs with small claims. This Court has noted that Alabama's class action rule "promotes the policies of allowing plaintiffs access to judicial relief, affording the offensive tactic of asserting large dollar claims against the defendant, and promoting economy." *Ex parte Water Works and Sewer Bd. of City of Birmingham*, 738 So. 2d 783, 793 (Ala. 1998). *See also First Baptist Church of Citronelle v. Citronelle-Mobile Gathering, Inc.*, 409 So. 2d 727, 729 (Ala. 1981) ("[T]he class action

provides a framework within which to seek redress for claims that it may be unfeasible economically to bring in individual actions.").

Several federal courts sitting in this state also have held that cases involving small claims often are viable only because of the availability of class action relief. For instance, an Alabama federal court recently noted that the named plaintiff's claim of approximately $300 in fees could not have been feasibly brought as an individual action, since "the transaction costs associated with an individual dispute would certainly (if not exponentially) outweigh the financial benefits that could accrue," whereas a class action would make vindication of the plaintiff's claim "an outcome worth pursuing." *Bank United v. Manley*, 273 B.R. 229, 249-50 (N.D. Ala. 2001); see also *Wright v. Circuit City Stores, Inc.*, 201 F.R.D. 526, 553 (N.D. Ala. 2001) (noting that one of the "principal functions" of class actions is to "provid[e] a feasible means for asserting the rights of those who 'would have no realistic day in court if a class action were not available.'") (citation omitted); *Thornton v. Mercantile Stores Co.*, 13 F. Supp. 2d 1282, 1289 (M.D. Ala. 1998) ("[C]lass actions provide a method of

protecting the rights of those who would not otherwise bring individual claims for practical reasons such as cost or ignorance.").

As these decisions indicate, though the class action mechanism taken in a vacuum may be a "procedural device" (the argument made by Appellees' *amici* Alabama Defense Lawyers Association), Terminix's act of taking away this device has the effect of barring consumers from *any* potential remedy for their claims. Thus, Terminix has effectively insulated itself from liability for its actions and denied customers the remedy owed to them under the Alabama Constitution. The fact that a barrier to recovery is "procedural" does not mean that it cannot render a contractual provision unconscionable. For example, while a forum's filing fees are unquestionably a "procedural" matter, the U.S. Supreme Court has made clear that if a party proves that an arbitration clause imposes "prohibitive costs" upon consumers, then the clause is not enforceable. *Green Tree Financial Corp. v. Randolph*, 531 U.S. 79, 90 (2000).

In the instant case, this Court merely has followed its own precedent of striking down any party's attempt to

relieve itself of liability at the expense of the other, weaker party. For example, in *Ex parte Foster*, 758 So. 2d 516, 520 n.4 (Ala. 1999), this Court defined substantive unconscionability as including a situation where the drafting party in an adhesion contract includes terms that "attempt to alter . . . fundamental duties otherwise imposed by the law." And in *Morgan v. South Central Bell Tel. Co.*, 466 So.2d 107, 117 (Ala. 1985), this Court affirmed the general Alabama rule that "exculpatory clauses affecting the public interest are invalid" where the party invoking exculpation has the stronger bargaining position, uses a standardized adhesion contract, and makes no provision whereby the weaker party may bargain for protection against negligence. An analogous case exists here: Terminix has used its superior bargaining power to hold customers to a non-negotiable contract wherein they have no meaningful remedy for small claims. The fact that Terminix achieved this result by banning a procedural mechanism, class actions, renders the result itself no less substantive, and no less unconscionable.

A number of other state and federal courts have considered the issue and likewise held that a contract that

effectively bans class actions insulates companies from any consumer claim that is so small as to be economically infeasible to bring as an individual action. This year, a federal district court examined an arbitration clause that, like the one at issue here, used the American Arbitration Association (AAA) rules, and found that without the class action mechanism, customers simply could not bring a small claim under these rules either because they could not obtain counsel or because the potential individual recovery was just too small. In that case, *Ting v. AT&T*, 182 F. Supp. 2d 902 (N.D. Cal. 2002) (appeal pending), the court examined an extensive factual record, including testimony from numerous fact and expert witnesses. The court also looked at class action cases that had been brought against the defendant in the past several years, and heard testimony to the effect that these cases could not have been brought as individual actions. After examining this record, the court found that these cases simply would and could not have been brought had AT&T's ban on class actions been in effect when they were litigated:

> It would not have been economically feasible to pursue the claims in these cases on an individual basis, whether the case was brought in court or in arbitration. If the [class action ban contained

> in AT&T's contract] had governed customers' rights in these situations, it is highly unlikely any of the claims would have been prosecuted. It is undisputed that the lawyers who represented the plaintiffs in these cases would not have taken them if the only claim they could have pursued was the claim of the individual plaintiff. The reasons for this are not hard to see. The actual damages sought by the named plaintiffs are relatively insubstantial. . . . Consequently, it would not make economic sense for an attorney to agree to represent any of the plaintiffs in these cases . . . . The lawyer would almost certainly incur more in costs and time charges just getting the complaint prepared, filed and served than she would recover, even if the case were ultimately successful. Simply put, the potential reward would be insufficient to motivate private counsel to assume the risks of prosecuting the case just for an individual on a contingency basis.... [I]t would not make economic sense for an individual to retain an attorney to handle one of these cases on an hourly basis and it is hard to see how any lawyer could advise a client to do so. *The net result is that cases such as the ones listed above will not be prosecuted even if meritorious.* Thus, the prohibition on class action litigation functions as an effective deterrent to litigating many types of claims involving rates, services or billing practices and, ultimately, would serve to shield AT&T from liability even in cases where it has violated the law.

Ting, 182 F. Supp. 2d at 918 (emphasis added).

Similarly, in *Szetela v. Discover Bank*, 118 Cal. Rptr. 2d 862 (Cal. Ct. App. 2002), the court held that such a ban essentially acts as a "get out of jail free" card for corporate defendants:

> It is the manner of arbitration, specifically,

> prohibiting class or representative actions, we take exception to here. The clause is not only harsh and unfair to Discover customers who might be owed a relatively small sum of money, but it also serves as a disincentive for Discover to avoid the type of conduct that might lead to class action litigation in the first place. By imposing this clause on its customers, Discover has essentially granted itself a license to push the boundaries of good business practices to their furthest limits, fully aware that relatively few, if any, customers will seek legal remedies, and that any remedies obtained will only pertain to that single customer without collateral estoppel effect. . . . Therefore, the provision violates fundamental notions of fairness.

Id. at 868. *See also Luna v. Household Fin. Corp.,* 2002 WL 31487425 at *8 (W.D. Wash., Nov. 4, 2002) ("the prohibition on class actions allows the Arbitration Rider to be 'used as a sword to strike down access to justice instead of a shield against prohibitive costs.' This finding weighs heavily in favor of a finding of substantive unconscionability.") (quoting *Mendez v. Palm Harbor Homes, Inc.*, 45 P.3d 549, 604 (Wash. Ct. App. 2002) and *ACORN v. Household Int'l, Inc.*, 2002 WL 1563805 at *14 (N.D. Cal., June 21, 2002) (finding that the ban on class actions "compel[s] the conclusion that the arbitration agreement is unconscionable under California law and, therefore, unenforceable.").

Other courts similarly have found arbitration clauses that ban class actions to be unconscionable, and thus

unenforceable, based on the fact that such bans take away any potential remedy for consumers with small claims. In *West Virginia ex rel. Dunlap v. Berger*, 567 S.E.2d 265, 278 (W. Va. 2002), for example, the defendant's arbitration clause, like the clause here, was silent as to the availability of class actions in arbitration. Since, under West Virginia law, this silence had the effect of barring class actions, the court held that it was unconscionable. The court began by noting that the plaintiff's claim (amounting to $8.46) "is precisely the sort of small-dollar/high volume (alleged) illegality that class action claims and remedies are effective at addressing." The court added that:

> In many cases, the availability of class action relief is a *sine qua non* to permit the adequate vindication of consumer rights. . . . [P]ermitting the proponent of such [an adhesion] contract to include a provision that prevents an aggrieved party from pursuing class action relief would go a long way toward allowing those who commit illegal activity to go unpunished, undeterred, and unaccountable.

Id. at 278-79. *See also Powertel v. Bexley*, 743 So. 2d 570, 576 (Fla. Ct. App. Dist. 1999) (arbitration clause unconscionable, in part, because "Powertel has precluded the possibility that a group of its customers might join

together to seek relief that would be impractical for any of them to obtain alone."); *Bailey v. Ameriquest Mortgage Co.*, 2002 WL 100391, *7 (D. Minn. Jan. 23, 2002) ("[T]he inability to proceed collectively . . . has the effect of rendering plaintiff's individual claims impractical to pursue. The right to proceed collectively is particularly critical to these plaintiffs, who . . . have relatively small individual claims.")*.*

To the extent that any of the cases cited by Terminix or its *amici* reaches opposite conclusions, this reflects a difference between the varying law of exculpatory clauses in different states. There is a growing body of law around the nation addressing whether contracts of adhesion may prohibit consumers from bringing their claims on a class action basis in cases that do not involve arbitration. It is clear from this body of law that entirely apart from arbitration issues, different states have reached different conclusions. *Compare America Online v. Superior Court*, 90 Cal. App. 4th 1, 8 (2001) (forum selection clause that required consumers to bring claims in Virginia, which does not permit class actions, held unconscionable under California law because consumers could not effectively vindicate their rights in

this forum) (case not involving arbitration), *with Gilman v. Wheat, First Securities*, 692 A.2d 454 (Md. 1997) (enforcing identical forum selection clause, as it was not unconscionable under Maryland law) (case not involving arbitration).[1]

Terminix and its *amici* also cite a great many cases that do not involve state law unconscionability issues, or state law limitations on exculpatory clauses, but instead address questions of federal statutory interpretation. Decisions such as *Randolph v. Green Tree*, 244 F.3d 814 (11th Cir. 2001) and *Johnson v. W. Suburban Bank*, 225 F.3d 366 (3d Cir. 2000), *cert. denied*, 531 U.S. 1145 (2001), involve discussions of the language and legislative history of the Truth in Lending Act. These cases say nothing about state law with respect to exculpatory clauses.

Given the Alabama Constitution's emphasis on guaranteeing the right to a remedy for all citizens of the state, and the state's case law indicating the importance of

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[1] This rule of Maryland state contract law, which differs from the law in some other states, explains why the Fourth Circuit's decision in *Snowden v. CheckPoint Check Cashing*, 290 F.3d 631 (4th Cir. 2002), does not conflict with this Court's decision here but instead merely involves an application of a different state's contract law. The Fourth Circuit's holding that a contract involving Maryland residents and a Maryland business was not unconscionable because it banned class actions is an application of Maryland state law as expressed in the *Gilman* decision. It does not conflict with the decision here.

the class action mechanism as the tool that allows for that remedy in small consumer claims, this Court should not reverse its decision that an arbitration clause effectively barring consumers from bringing class actions is unconscionable.

II. This Court Has Not Undermined the FAA by Holding Terminix's Arbitration Clause Unconscionable Under State Law

Contrary to the assertions of Terminix and its *amici*, the FAA does not preempt this Court's holding that the arbitration clause is unconscionable because consumers cannot bring class action claims. As the United States Supreme Court has indicated, the scope of federal preemption under the FAA is not complete. Instead, state law is preempted only to the extent that it stands in direct conflict with federal law. *Volt Info. Sciences v. Leland Stanford Jr. Univ.*, 489 U.S. 468, 477 (1989). As the FAA contains no language relating to the availability of class actions, there can be no conflict between the FAA and state law on this point. *Id.* at 476 n.5 (noting that "[the act] itself contains no provision designed to deal with the special practical problems that arise in multiparty disputes when some or all of the contracts at issue include

agreements to arbitrate," and noting that at least one state has allowed for consolidated arbitration proceedings).

In fact, this Court's decision is squarely in line with the U.S. Supreme Court's direction that arbitration clauses are enforceable to the extent that they permit a party to "effectively vindicate" his or her rights. *E.g.*, *EEOC v. Waffle House Corp.*, 122 S. Ct. 754, 755 n.10 (2002); *Gilmer v. Interstate/Johnson Lane Corp.*, 500 U.S. 20, 28 (1991). In other words, "by agreeing to arbitrate a statutory claim, a party does not forgo the substantive rights afforded by the statute; it only submits to their resolution in an arbitral, rather than a judicial, forum." *Id.* at 26. Thus, this Court's holding that an arbitration clause that takes away the substantive right of one party to bring a small claim against the other is entirely consistent with *Gilmer*.

Because the FAA is silent on the availability of class actions, and thus does not conflict with state law on that point, the only real restriction on this Court's analysis of Terminix's arbitration clause is that it must not treat arbitration differently from other contracts but instead must use only "generally applicable contract defenses, such as fraud, duress, or unconscionability" to evaluate the

arbitration clause. *Doctors' Assocs. v. Casarotto*, 517 U.S. 681, 687 (1996). In applying state unconscionability law to Terminix's arbitration clause, this Court did not violate this rule. Instead, it is Terminix *itself* that has attempted to treat arbitration differently from other contract terms by using the arbitration mechanism to ban class actions - a move that would not be allowed in a non-arbitration contract situation. The FAA does not allow this kind of escape from state contract liability "merely because the prohibiting or limiting provisions are part of or tied to provisions in the contract relating to arbitration." *Dunlap*, 567 S.E.2d at 280.

Moreover, while Appellees and their *amici* argue that this Court's application of state unconscionability law to bans on class actions necessarily would bar arbitration in all cases where a class action might be pursued, and therefore that such law is preempted by the FAA, in fact there is nothing inherent to arbitration that bars class-wide relief. Though current Alabama law does not allow courts to require classwide arbitration where the agreement is silent, *see Med Center Cars, Inc. v. Smith*, 727 So. 2d 9, 20 (Ala. 1998), no one disputes that Terminix could have

drafted a contract that explicitly permits consumers to bring appropriate claims on a class action basis, but simply chose not to do so. No legal doctrine "forced" Terminix to draft their contract of adhesion in a way that would insure that their customers with small claims never could effectively vindicate their rights.

In short, this Court has acted entirely within its authority in applying state contract law to Terminix's arbitration clause, and in finding that the clause is substantively unconscionable and unenforceable because it denies consumers with small claims any effective remedy. That Terminix chose to draft this contract without affirmatively allowing class action claims does not make the clause any less substantively unconscionable and, in fact, indicates that Terminix was trying to use the arbitration mechanism as an end run around Alabama's requirement that all its citizens have a remedy under the law.

CONCLUSION

This Court should uphold its original decision, and deny Appellees' request for rehearing.

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