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Court Throws Out Arbitration Clause With Bar on Class Actions

By Justin Kelly, ADRWorld.com

The West Virginia Supreme Court of Appeals on June 13 in a precedent-setting opinion ruled that arbitration clauses that prohibit class actions and the award of punitive damages are unconscionable and unenforceable.

In *State of West Virginia Ex Rel. James Dunlap v. Honorable Irene C. Berger, Judge of the Circuit Court of Kanawha County, and Friedman's Inc.*, West Virginia's highest court said provisions in an arbitration clause barring class actions and punitive damages limit a consumer from vindicating their rights are unconscionable, rendering the arbitration clause unenforceable (No. 30035, 6/13/02).

Michael J. Quirk, Consumer Rights Fellow at [Trial Lawyers for Public Justice](#) and an attorney on the case, said although there are "number of decisions saying arbitration must provide all substantive rights" to parties, Dunlap is the first state supreme court ruling to hold that it is "unconscionable to take away a consumers right to pursue a class action" by prohibiting class actions in arbitration. The case also is significant

because it specifically addresses the unconscionability of limiting a parties right to recover punitive damages in arbitration, he said.

The opinion is "groundbreaking" in "holding that a business cannot take away a consumers right to a class action" through an arbitration clause, he added.

The case arose out of a dispute between James Dunlap and Friedman's Jewelers over allegations that Friedman's concealed charges for insurance products from consumers that bought items from the company. On May 4, 2000, Dunlap filed suit as a putative class action against Friedman's in Kanawha County Court, and Friedman's moved to dismiss the complaint and compel arbitration under its consumer contract, which calls for arbitration of all claims.

Dunlap, however, argued that he was not aware of the arbitration clause contained in the consumer contract, and that he never voluntarily or knowingly agreed to waive his constitutional right to a jury trial. Dunlap also argued that the provisions in the arbitration clause barring recovery of punitive damages and class action proceedings were unconscionable and unenforceable under the West

Virginia Consumer Credit and Protection Act.

The county court granted Friedman's motion to compel arbitration, finding that the terms of the arbitration clause were not unconscionable. Dunlap appealed to the West Virginia Supreme Court of Appeals, which granted review to determine whether the terms were unconscionable because they limit the rights of the consumer.

Dunlap argued to the high court that the arbitration clause's bar on punitive damages and and class action proceedings were unconscionable exculpatory provisions in a contract of adhesion. He further argued that these provisions deprived him of his constitutional right to a jury trial, but the court said it did not have to address this issue because other issues in the case allow the court to rule without having to address the constitutional right to trial issue.

Friedman's argued that the Federal Arbitration Act's policy prohibiting states from specifically disfavoring the arbitral forum bars Dunlap from asserting that arbitration is an inadequate forum to vindicate his rights because it bars punitive damages and class actions. Friedman's also argued that in *Gilmer v. Interstate Johnson*

Lane Corp. (500 U.S. 20, 1991), the U.S. Supreme Court held that the possible lack of class action relief would not necessarily render an arbitral forum inadequate to vindicate a statutory claim.

However, the West Virginia high court said *Gilmer* is not controlling here and was not addressing the impact of limits in the arbitral forum on an ordinary consumer like *Dunlap*.

According to the court, the prohibition against punitive damages contained in the arbitration clause bars all of *Friedman's* consumers from vindicating their right to use “an important remedy provided by law to punish and deter illegal, willful, and grossly negligent misconduct — and that *Friedman's* would be categorically shielded from any liability for such sanc-

tions, regardless of *Friedman's* level of wrongdoing.”

The ability to pursue claims as a class action, including all the different types of damages resulting from a successful case prosecuted as a class action, is integral to prosecution of consumer, essential to vindicating a consumer’s rights, the court added.

According to the court, adhesion contracts are common in the consumer context, and to permit the drafter of the contract to limit the rights of consumers and shield itself from liability “would go a long way toward allowing those who commit illegal activity to go unpunished, undeterred, and unaccountable.”

The court concluded that the prohibitions on punitive damages and class actions contained in the

arbitration clause are “clearly unconscionable” and ordered the case back to the circuit court rather than arbitration.

John Vail, senior litigation counsel at the Center for Constitutional Litigation, said this is a “significant decision on class action and punitive damages” provisions in arbitration clauses, and he added that he knows of no other state high court that has found these limitations independently unconscionable in the arbitration context.

According to Vail, the decision could have an impact on the thinking of other state courts on the enforceability or unconscionability of arbitration clauses containing limits on recovering punitive damages and the ability to pursue class actions.