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Phone: +1 646 783 7100 | Fax: +1 646 783 7161 | customerservice@law360.com

Case Study: Schnuerle V. Insight

Law360, New York (January 10, 2011) -- On Dec. 16, 2010, the Supreme Court of Kentucky, on an issue of first impression, found that a consumer service agreement's ban on class action litigation was unenforceable. The case is Schnuerle v. Insight Comm. Co. L.P., ___ S.W. 3d ____, 2010 WL 51298950 (Ky. Dec. 16, 2010). The court's holding, while limited specifically to the factual scenario before it, continues a trend of courts to reject class claim waivers in consumer agreements.

Schnuerle in a Nutshell

Plaintiff Schnuerle was a Kentucky resident, who entered into a service agreement with Insight for broadband cable internet service. Evidence supported that Insight was the only broadband cable internet service provider in the surrounding area. In order to receive the service, customers were required to either physically or electronically sign the service agreement.

That agreement contained a "No Class Action or Consolidated Proceedings" clause, which the court noted was "comprehensive and absolute, prohibiting the joining of lawsuits in all situations and in all forums." The agreement also contained an arbitration clause, though the clause allowed for individual customers with a claim of less than $1,500 to be pursued through small claims court instead of proceeding to arbitration.

In April 2006, due to certain upgrade procedures Insight performed on its high speed internet service, many of Insight's customers incurred service outages for varying lengths of time. According to plaintiffs, when they were able to get through to customer support, they were given false and misleading information about the service disruptions. Despite Insight's corrective actions, plaintiffs initiated a class action against Insight based upon alleged violations of the Kentucky Consumer Protection Act, breach of contract and unjust enrichment. The average customer claim was believed to be about $40.00.

In response, Insight moved to dismiss the action and to compel arbitration of the individual claims under the arbitration clause contained in the service agreement.

Plaintiffs countered that the arbitration clause was unenforceable because it was an unconscionable adhesion contract provision imposed by a party with significantly greater bargaining power. Plaintiffs also argued that the arbitration clause was buried in the dense agreement in a manner that insured that few, if any, would read it; that Insight was the only broadband service provider in the area; and that customers could not effectively pursue a small $40.00 claim in either small claims court or before an arbitrator.

The trial court rejected plaintiffs' arguments, granted Insight's motion to compel arbitration and dismissed the class action with prejudice.

The Trial Court is Reversed on the Class Action Waiver Issue

In reversing the trial court on the class action ban, the court noted the issue was one of first impression. And while the court found that the "no class action provision" was unenforceable under the "individualized" facts of the case, it refused to broadly declare a blanket prohibition on class action litigation in consumer adhesion contracts. The court granted

defendant's request to compel arbitration. In effect, the court split the baby, giving defendant the ability to proceed with arbitration, but striking down the no class provision in favor of plaintiffs.

Borrowing heavily from two California Supreme Court decisions, Vasquez v. Superior Court and Discover Bank v. Superior Court, the Schnuerle court articulated three reasons why the ban on class action litigation was unenforceable and produced an improper exculpatory result: 1) the relative small size of each individual claim; 2) the elimination of repetitious litigation of the same issue; and 3) the fact that Insight was the only service provider in the area, leaving consumers with no real choice in choosing a broadband cable Internet service provider.

Take Away Points from Schnuerle

• When consumers have limited choices in selecting a company's service, a class action waiver is far less likely to survive judicial scrutiny.
• The smaller the amount in controversy as to an individual consumer, the more likely a court will strike a class waiver. This is due to the lack of economic incentive for an individual customer to bring the company to court, effectively exculpating the company from liability.
• To the extent a class action waiver is combined with an arbitration provision, if the provision is buried in a long, dense agreement, then a court may find that the customer had no meaningful opportunity to review it and is not bound by its terms.
• The Schnuerle court recognized a split among circuits addressing the issue of class action bans in consumer agreements. The Eleventh, Fourth and Seventh Circuit Courts of Appeals have published decisions upholding arbitration provisions that prohibited customers from joining together in a class action. In contrast, the Ninth, First and Third Circuits, along with various district courts and state supreme courts, have held that similar class action bans were unenforceable. There is some indication based on recent activity that the U.S. Supreme Court may take up this issue of class claim waivers in the next few years.

--By Chad Fuller and Tammy Boggs, Foley & Lardner LLP

Chad Fuller (cfuller@foley.com) is a partner in the San Diego/Del Mar offices of Foley & Lardner. He is the chairman of the San Diego/Del Mar litigation department and co-chairman of the firm's national class action group. Tammy Boggs (tboggs@foley.com) is a privacy and business litigation associate in the firm's San Diego/Del Mar offices, as well as a certified public accountant, and formerly conducted audits of large corporations in the financial, insurance and high technology industries.