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Supreme Court of Kentucky

2008-SC-000789-DG
2009-SC-000390-DG

MICHAEL SCHNUERLE, AMY GILBERT, LANCE GILBERT AND ROBIN WOLFF, — APPELLANTS/ CROSS-APPELLEES

V.

ON REVIEW FROM COURT OF APPEALS
CASE NO. 2006-CA-002121-MR
JEFFERSON CIRCUIT COURT NO. 06--CI-004267

INSIGHT COMMUNICATIONS COMPANY, L.P. AND INSIGHT COMMUNICATIONS MIDWEST, LLC — APPELLEES / CROSS-APPELLANTS

OPINION OF THE COURT BY JUSTICE VENTERS

REVERSING AND REMANDING

Appellants, Michael Schnuerle, Amy Gilbert, Lance Gilbert, and Robin Wolff, individually and on behalf of all others similarly situated, appeal from an opinion of the Court of Appeals which affirmed an order of the Jefferson Circuit Court dismissing their class action complaint against Appellees, Insight Communications Company, L.P., and Insight Communications Midwest, LLC (collectively, Insight). The circuit court then determined, and the Court of Appeals agreed, that a provision contained in Insight's Broadband High Speed Internet Service Agreement (Service Agreement) barring class action litigation against Insight by its customers was enforceable. The Appellants' complaint was accordingly dismissed. Because of that disposition, the circuit court and the Court of Appeals did not address other issues, including Appellants'

challenge to the enforceability of the Service Agreement's general arbitration clause and other specific provisions contained therein.

We granted discretionary review to consider Appellants' challenges to the enforceability of the arbitration agreement and to the class action ban and confidentiality clauses contained therein. We granted Appellees' cross-petition for discretionary review to enable a more complete resolution of the whole controversy, including the disputed choice of law provisions of the agreement and the effect of severability of the challenged provisions from the remaining portion of the arbitration agreement.

For the reasons stated below, we reverse the Court of Appeals, and conclude that, under the circumstances present herein, the contractual ban on class action litigation is void and unenforceable. We also determine as follows: 1) the Service Agreement's choice of law provision is not enforceable, and that Kentucky law, rather than New York law, is applicable to our review; 2) that the Service Agreement's general arbitration provision is not unconscionable, that it comports with Kentucky's public policy preference favoring arbitration, that it is severable from the provisions banning class actions and imposing confidentiality, and is therefore enforceable; and 3) that the provision imposing a confidentiality requirement upon the litigants to arbitration proceedings is void.

I. FACTUAL AND PROCEDURAL BACKGROUND

Appellants are Kentucky residents who entered into the Service

Agreement with Insight for broadband Internet service. In order to receive service, the customers were required to either sign the Service Agreement or manifest their assent to the Service Agreement via the Internet.

The Service Agreement contains an arbitration clause. Within the arbitration clause are provisions under which customers agree not to enter into a class action lawsuit against Insight and not to divulge the results of any settlement reached through arbitration. The clause, however, does permit individual customers to pursue any claim of less than $1,500.00 through small claims court instead of proceeding to arbitration.

In April 2006, Insight upgraded its high-speed Internet service. Because of the upgrade procedures, many Insight customers, including Appellants, incurred service outages for varying lengths of time. Those outages generated a high volume of calls into Insight's customer service department, which resulted in long wait times for customers to receive assistance. According to Appellants, once customers did get through, they received false and misleading information concerning the service interruption. They further allege that Insight acted improperly by failing to timely inform its customers about the outage, and by failing to protect customers "from deletion of information."

Insight argues that it timely acknowledged the service outage problem, and issued credits to 2,595 customers who notified the company about their particular outage problem. The company later issued a public apology for the disruptions and set up a voucher system allowing any other dissatisfied

customers to request a credit for the interrupted service. Insight admits to monetary liability for any time billed to its customers while their Internet connection was down, and maintains that any dispute would simply require calculating the actual outage time, which it is willing to do under its customer service procedures.

Notwithstanding Insight's efforts to address the problem, on May 11, 2006, Appellants filed a complaint in Jefferson Circuit Court on behalf of themselves individually, and, pursuant to CR 23, on behalf of the putative class of all other Insight customers in Kentucky similarly situated. Causes of action were asserted based upon violations of the Kentucky Consumer Protection Act, Kentucky Revised Statutes (KRS) 367.170, *et seq.*, breach of contract, and unjust enrichment. The complaint alleged improper practices by Insight, including "the failure to provide High Speed Internet Service to its consumers, failure to properly and promptly notify its consumers of the failure on the part of Insight to provide such services, failure to promptly remedy the lack of services, failure to provide an alternative high-speed Internet service, the dissemination of misleading or incorrect information to consumers regarding such failures, failure to protect its consumers from deletion of information contained in services, and the imposition of charges to its consumers for contractual-services not provided by Insight."

In response, Insight moved to dismiss the action and to compel arbitration pursuant to the mandatory arbitration clause contained in the

Service Agreement. As noted before, the arbitration clause does not mandate arbitration in all instances but, rather, allows for litigation in small claims court of claims less than $1,500.00. There is no allegation that the claim of any individual customer would exceed $1,500.00; rather, it is suggested that the average claim would be in the range of $40.00. Thus, it is not disputed that aggrieved customers would have the option of filing a lawsuit in small claims court or proceeding to arbitration.

Appellants responded by arguing that the arbitration clause was unenforceable on the grounds that it was an unconscionable adhesion contract provision imposed on them by a party with significantly greater bargaining power. Appellants also argued that the arbitration clause was communicated to customers in a manner that ensured few, if any, would read it; that they were forced to use Insight's services because it was the only local broadband cable Internet provider; that they could not effectively pursue their claims on an individual basis; and that, because of the small amounts involved, individual customers would be unable to retain counsel willing to take the case.

On September 6, 2006, the trial court entered an order granting Insight's motion to compel arbitration, dismissing the class action with prejudice, and allowing individual customers to pursue their claims in small claims court as provided under the Service Agreement's arbitration clause. The Court of Appeals affirmed the circuit court's decision. We granted discretionary review.

II. KENTUCKY LAW APPLIES TO REVIEW OF THE ARBITRATION CLAUSE

Among the provisions contained in the Dispute Resolution section of the Service Agreement is a choice of law clause which provides that "New York Law, (excluding its choice of law rules) will apply to the construction, interpretation, and enforcement of" the Service Agreement. Citing to *Breeding v. Massachusetts Indem. and Life Ins. Co.*, 633 S.W.2d 717 (Ky. 1982), the circuit court declined to apply the Service Agreement's choice of law provision, and instead applied Kentucky law in determining whether the arbitration agreement was enforceable.[1] Because a threshold question is the choice of law to be applied in our review, and this issue is an issue raised by Insight in its cross-petition, we first address the enforceability of the Service Agreement's choice of law provision.

Breeding, relied upon by the circuit court, addressed the issue as follows:

> The traditional choice of law rules in the field of contracts dictated that matters bearing upon the execution, interpretation and validity of a contract were determinable by the internal law of the place where the contract was made. *Babcock v. Jackson,* 12 N.Y.2d 473, 240 N.Y.S.2d 743, 191 N.E.2d 279 (1963).
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> However, such a mechanical approach is no longer favored. This court in *Lewis v. Family Group,* Ky., 555 S.W.2d 579 (1977) abrogated the traditional rule of *lex loci contractus* stating:
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> > Traditionally the rule has been that the validity of a contract is to be determined by the laws of the state in which it was made . . . . The modern test is which state has the most significant relationship to the transaction and the parties.

[1] Despite a choice of law provision calling for application of New York law, the circuit court held that Kentucky law applied. Without discussion, the Court of Appeals decision applied Kentucky law and thus, by implication, affirmed the circuit court upon this issue.

> Restatement Second of Conflicts, Sec. 188 (1971).[2] *Lewis, supra*, pp. 581-582.
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> Increasingly, states have adopted the grouping of contacts doctrine. Justice, fairness and the best practical result may best be achieved by giving controlling effect to the law of the jurisdiction which, because of its relationship or contact with the occurrence or the parties, has the greatest concern with the specific issue raised in the litigation. *Babcock v. Jackson*, 240 N.Y.S.2d 743, at 749, 191 N.E.2d 279, at 283, *supra*.
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> The merit of the doctrine followed in *Babcock, supra*, is that it gives to the forum having the most interest in the problem paramount control over the legal issues arising out of a particular factual context.

Id. at 719; *see also Harris Corp. v. Comair, Inc.*, 712 F.2d 1069, 1071 (6th Cir. 1983) and *Wallace Hardware Co., Inc. v. Abrams*, 223 F.3d 382 (6th Cir. 2000). The *Breeding* decision held that Kentucky law should apply because Kentucky had the greater interest in, and the most significant relationship to, the transaction and the parties.

Upon application of *Breeding*, we agree with the circuit court's conclusion that Kentucky law governs our evaluation of the Service Agreement. Appellants, the other members of the putative class, the Internet equipment, the Internet service provided, and the relevant operating area are all located in Kentucky. The customers executed the agreements in Kentucky, and Kentucky

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[2] Section 188 provides, in relevant part: "(1) The rights and duties of the parties with respect to an issue in contract are determined by the local law of the state which, with respect to that issue, has the most significant relationship to the transaction and the parties . . . . (2) In the absence of an effective choice of law by the parties (see § 187), the contacts to be taken into account . . . to determine the law applicable to an issue include: (a)the place of contracting, (b)the place of negotiation of the contract, (c)the place of performance, (d) the location of the subject matter of the contract, and (e) the domicile, residence, nationality, place of incorporation and place of business of the parties . . . ."

has a substantial interest in the protection of its residents in the area of commercial transactions. Moreover, one of the principal claims arises under the Kentucky Consumer Protection Act. New York, on the other hand, has no discernible connection or interest at all in the subject matter of this litigation. Thus, there can be no doubt that Kentucky has "the greater interest and the most significant relationship to the transaction and the parties."

We accordingly base our review of the Service Agreement on relevant Kentucky law. We further note, however, that the parties do not dispute that the Federal Arbitration Act (FAA) is applicable to the arbitration clause, and we accordingly apply its provisions as appropriate.

III. THE SERVICE AGREEMENT'S COMPREHENSIVE BAN ON CLASS ACTION LITIGATION IS UNENFORCEABLE

The principal issue in this appeal is whether the Service Agreement's ban on class action litigation is enforceable against Appellants and the putative class they would represent. Appellants contend[3] that prohibitions on class action litigation in consumer adhesion contracts should be held to be unenforceable *per se* upon the grounds that they are exculpatory, result in unjust enrichment to the company, and are, accordingly, unconscionable and void as against public policy. The issue is one of first impression in this jurisdiction.

[3] The Attorney General of Kentucky, AARP, and the Kentucky Justice Association filed amicus curie briefs supporting Appellants on this issue. The Pacific Legal Foundation filed a brief in support of upholding the class action ban provision.

As explained below, while we do not go so far as to broadly declare prohibitions on class action litigation in consumer adhesion contracts unenforceable in all circumstances, we hold that the ban is unenforceable under the individualized facts of this case.

Provision 5(e) of the Service Agreement provides as follows:

> **No Class Action or Consolidated Proceedings.** NO DISPUTE MAY BE JOINED WITH ANOTHER LAWSUIT, OR IN AN ARBITRATION WITH A DISPUTE OF ANY OTHER PERSON. All parties to the arbitration must be individually named. THERE SHALL BE NO RIGHT OR AUTHORITY FOR ANY CLAIMS TO BE ARBITRATED ON A CLASS ACTION OR CONSOLIDATED BASIS OR ON BASES INVOLVING CLAIMS BROUGHT IN A PURPORTED REPRESENTATIVE CAPACITY ON OF THE GENERAL PUBLIC (SUCH AS A PRIVATE ATTORNEY GENERAL), OTHER SUBSCRIBERS, OR OTHER PERSONS SIMILARLY SITUATED. Customer understands and acknowledges that by consenting to submit claims to arbitration pursuant to this Agreement, Customer may be forfeiting his or her right to share in any class action awards. This Section will not apply to any individual claims filed by Customer in a lawsuit prior to the effective date of this Agreement, nor to the claims of a class certified prior to the effective date of this Agreement. This Section will apply to all other claims, including class claims where a class has not yet been certified, even if the facts and circumstances upon which the claims are based occurred or existed before the effective date of this Agreement.

Thus, the ban on class actions in this provision is comprehensive and absolute, prohibiting the joining of lawsuits in all situations and in all forums. Appellants contend that the Service Agreement's prohibition on class action litigation effectively shields Insight from liability for conduct resulting in many small claims by removing the only viable and economically effective remedy to redress such claims. They argue that because it is not economically practical

for an individual customer to independently litigate his or her small claim, the class action prohibition serves to exculpate Insight from liability for such claims and, correspondingly, it unjustly enriches the company because there will never be an adjudication requiring it to repay the many small claims.

The potential that an absolute ban on class action litigation may produce an improper exculpatory result is demonstrated by way of a simple example. Suppose XYZ Company inadvertently or intentionally overbilled each of its one million customers by one dollar during a particular month. As a result, it gained possession of one million dollars to which it is not entitled, and which instead belongs to its customer base. Suppose, in addition, that the company acted unethically (or incorrectly believed it had a valid defense) and refused to return the overcharges. Economic realities dictate that none[4] of the one million overbilled customers would bring an individual claim seeking the recovery of his dollar. The time, effort, and expense involved to recover a dollar simply would not be worthwhile. Thus, while the economic loss to each individual customer would be negligible, the lack of an economically viable means to bring the company into court would effectively exculpate the company from liability, allowing it to reap unjustly a substantial economic windfall. We agree with the Appellants that the only economically viable means for customers to bring a

[4] Or a negligible few who are motivated by something other than economic concerns.

company into court, as plaintiffs, under these circumstances is by class action litigation.[5]

The practical effect of a *de minimis* claim situation has been explained in other cases addressing class action litigation. "Economic reality dictates that [litigation involving many small claims] proceed as a class action or not at all." *Eisen v. Carlisle & Jacquelin*, 417 U.S. 156, 161 (1974) ("A critical fact in this litigation is that petitioner's individual stake in the damages award he seeks is only $70. No competent attorney would undertake this complex antitrust action to recover so inconsequential an amount."). "The policy at the very core of the class action mechanism is to overcome the problem that small recoveries do not provide the incentive for any individual to bring a solo action prosecuting his or her rights. A class action solves this problem by aggregating the relatively paltry potential recoveries into something worth someone's (usually an attorney's) labor." *Amchem Products, Inc. v. Windsor*, 521 U.S. 591, 617 (1997) (quoting *Mace v. Van Ru Credit Corp.*, 109 F.3d 338, 344 (7th Cir. 1997)); *Carnegie v. Household Intern., Inc.*, 376 F.3d 656, 661 (7th Cir. 2004) (Posner, J.) ("The *realistic* alternative to a class action is not 17 million

[5] We acknowledge that customers could pursue a remedy through the Attorney General, who is vested with authority under the Kentucky Consumer Protection Act to pursue litigation against companies who would improperly overcharge its customers. However, as noted by the Attorney General, "with the limited resources of the Commonwealth the Attorney General is simply unable to pursue each and every violator and must limit its case selection to those matters involving the greatest public interest." Brief of the Attorney General of Kentucky, pg. 4. Accordingly, the theoretical availability of this remedy does not alter our conclusions.

individual suits, but zero individual suits, as only a lunatic or a fanatic sues for $30.")

As explained in *Vasquez v. Superior Court*, 484 P.2d 964, 968 (Cal. 1971), "[f]requently numerous consumers are exposed to the same dubious practice by the same seller so that proof of the prevalence of the practice as to one consumer would provide proof for all. Individual actions by each of the defrauded consumers are often impracticable because the amount of individual recovery would be insufficient to justify bringing a separate action; thus an unscrupulous seller retains the benefits of its wrongful conduct." "A class action by consumers produces several salutary by-products, including a therapeutic effect upon those sellers who indulge in fraudulent practices, aid to legitimate business enterprises by curtailing illegitimate competition, and avoidance to the judicial process of the burden of multiple litigation involving identical claims. The benefit to the parties and the courts would, in many circumstances, be substantial." *Id.*

Moreover, proceeding by class action "both eliminates the possibility of repetitious litigation and provides small claimants with a method of obtaining redress for claims which would otherwise be too small to warrant individual litigation. Denial of a class action in cases where it is appropriate may have the effect of allowing an unscrupulous wrongdoer to 'retain[ ] the benefits of its wrongful conduct.'" *Keating v. Superior Court*, 645 P.2d 1192, 1206-1207 (Cal. 1982) (overruled on other grounds in *Southland Corp. v. Keating*, 465 U.S. 1

(1984)) (citations omitted). "Controversies involving widely used contracts of adhesion present ideal cases for class adjudication; the contracts are uniform, the same principles of interpretation apply to each contract, and all members of the class will share a common interest in the interpretation of an agreement to which each is a party." *Id.* at 1207 (citations and footnote omitted).

Because a class action under CR 23 is often the only economically viable legal procedure to redress a large number of *de minimis* claims, a clause prohibiting customers from proceeding under the rule is, as claimed by the Appellants, an exculpatory provision which may effectively shield a company from liability for unlawful activity.

"The general rule is that persons may not contract against the effect of their own negligence and that agreements which attempt to do so are invalid." *Meiman v. Rehabilitation Center, Inc.*, 444 S.W.2d 78, 80 (Ky. 1969) (citation omitted).[6] While there are exceptions to this general rule,[7] "in no event can such an exculpatory agreement be upheld where either '(1) the interest of the public requires the performance of such duties, or (2) because the parties do not stand upon a footing of equality, the weaker party is compelled to submit to the stipulation.'" *Id.* Here, Insight's customers were "weaker" parties required to submit to the exculpatory clause, and, accordingly, the rule that such

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[6] While *Meiman* involved an exculpatory clause in the context of a medical procedure, it stands to reason that the same principle is applicable where no physical injury is involved. And, moreover, it follows that the same principle would apply with equal force to intentional conduct.

[7] *See*, e.g., *Cobb v. Gulf Refining Co.*, 284 Ky. 523, 145 S.W.2d 96 (1940) (A landlord may exempt himself from liability to tenant for negligence).

provisions may not be enforced is applicable. For that reason, we hold the absolute ban upon class action litigation is unenforceable in this case, and in like cases, as exculpatory, substantively unconscionable, and contrary to public policy.[8]

Despite the practical realities described above arising out of class action prohibitions in *de minimis* claim cases, Insight contends that the weight of authority supports the enforcement of arbitration provisions prohibiting customers from joining together in a class action lawsuit. In support of its position Insight cites us to *Jenkins v. First American Cash Advance of Georgia, LLC*, 400 F.3d 868 (11th Cir. 2005) (upholding class action ban in payday loan contract); *Randolph v. Green Tree Fin. Corp.-Alabama*, 244 F.3d 814, 819 (11th Cir. 2001) (holding "a contractual provision to arbitrate [Truth in Lending Act] claims is enforceable even if it precludes a plaintiff from utilizing class action procedures in vindicating statutory rights under TILA"); *Snowden v. CheckPoint Check Cashing*, 290 F.3d 631, 638 (4th Cir. 2002) (rejecting the borrower's argument "that the Arbitration Agreement is unenforceable as unconscionable because without the class action vehicle, she will be unable to maintain her

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[8] Here, we note that in this declaration of public policy, the usual deference to legislative prerogative is not involved. The class action is a creation of the courts, not the legislatures; hence its foundation in this country is in the court-established civil rules, rather than the statutes. As was the case in England, class actions in the United States are an outgrowth of the compulsory joinder rule that prevailed in courts of equity. *Shaw v. Toshiba America Information Systems, Inc.*, 91 F.Supp.2d 942, 946-951 (E.D.Tex. 2000) (recounting history of class action litigation). *See also Hansberry v. Lee*, 311 U.S. 32, 41 (1940) ("The class suit was an invention of equity to enable it to proceed to a decree in suits where the number of those interested in the subject of the litigation is so great that their joinder as parties in conformity to the usual rules of procedure is impracticable.") As such, courts enjoy wider latitude in determining public policy and fashioning remedies in this type of litigation.

legal representation given the small amount of her individual damages"); *Johnson v. West Suburban Bank*, 225 F.3d 366, 369 (3d Cir. 2000) (holding arbitration "clauses are effective even though they may render class actions to pursue statutory claims under the [Truth in Lending Act] or the [Electronic Funds Transfer Act] unavailable"); and *Livingston v. Assocs. Fin., Inc.*, 339 F.3d 553, 559 (7th Cir. 2003) ("The Arbitration Agreement at issue here explicitly precludes the [borrowers] from bringing class claims or pursuing 'class action arbitration,' so we are therefore 'obliged to enforce the type of arbitration to which these parties agreed, which does not include arbitration on a class basis.'").

For the reasons already discussed, however, we are not persuaded by these authorities, and instead join those jurisdictions holding under similar circumstances that class action bans are unenforceable. *See, e.g.*, *Homa v. American Express Co.*, 558 F.3d 225 (3rd Cir. 2009) (holding class-arbitration waiver within parties' credit card agreement was unconscionable under New Jersey law); *Lowden v. T-Mobile USA, Inc.*, 512 F.3d 1213 (9th Cir. 2008) (litigation and arbitration class action prohibition contained in arbitration provision in cellular phone service contract were substantively unconscionable and unenforceable under Washington law for denying any meaningful remedy); *Kristian v. Comcast Corp.*, 446 F.3d 25 (1st Cir. 2006) (holding under of Massachusetts law that Agreement that prohibited arbitration on class action basis was invalid as preventing cable television subscribers from vindicating

statutory rights in suits against provider; enforcing the prohibition would be essentially shield provider from private consumer antitrust enforcement liability, even in cases where it has violated the law); *Caban v. J.P. Morgan Chase & Co.*, 606 F.Supp.2d 1361 (S.D.Fla. 2009) (class action waiver in the arbitration provision of the credit card agreement was invalid as unconscionable under Florida law); *Fiser v. Dell Computer Corp.*, 188 P.3d 1215 (N.M. 2008) (class action ban was substantively unconscionable); *Muhammad v. County Bank of Rehoboth Beach, Delaware*, 912 A.2d 88 (N.J. 2006) (class-arbitration waiver contained in arbitration agreement was unconscionable due to public interest at stake); *Scott v. Cingular Wireless*, 161 P.3d 1000 (Wash. 2007) (class action waiver in arbitration clause of standard subscriber contract for cellular telephone service, which waiver prohibited class action litigation and class action arbitration, violated Washington State public policy and therefore was substantively unconscionable); *Kinkel v. Cingular Wireless, LLC*, 857 N.E.2d 250 (Ill. 2006) (class action waiver was substantively unconscionable); *Discover Bank v. Superior Court*, 113 P.3d 1100 (Cal. 2005) (waiver of class arbitration in a consumer contract of adhesion is unconscionable under California law and should not be enforced, when it occurs in a setting in which disputes between the contracting parties predictably involve small amounts of damages, and when it is alleged that the party with the superior bargaining power has carried out a scheme to deliberately cheat large numbers of consumers out of individually small sums

of money); *State ex rel. Dunlap v. Berger*, 567 S.E.2d 265 (W.Va. 2002) (language in retailer's purchase and financing agreement document that prohibited punitive damages and class action relief was unconscionable and unenforceable); *Leonard v. Terminix Intern. Co., L.P.*, 854 So.2d 529 (Ala. 2002) (arbitration clause which precluded class-action treatment of a dispute was unconscionable and unenforceable).

Nor are we persuaded by Insight's argument in its cross-petition that the incorporation of the American Arbitration Association's rules and procedures or its provision allowing for litigation in small claims court frees the class action ban of its unconscionable character. Even with a remedy in small claims court and fair, reasonable arbitration rules, a rational customer acting in his own economic interests will not often be able to bring either a small claims court action or proceed to arbitration to collect such a *de minimis* claim. Consequently, the clause remains exculpatory, and thus substantively unconscionable when attached to consumer adhesion contracts coupled with *de minimis* claims. We note also that the class action promotes judicial economy and preserves judicial resources. If a substantial number of aggrieved claimants against Insight opted to proceed in small claims court, the ability of the court to efficiently process their claims and others could become seriously strained.

IV. THE GENERAL ARBITRATION CLAUSE IS SEVERABLE FROM THE CLASS ACTION PROVISION AND IS ENFORCEABLE AGAINST THE CLASS UPON REMAND

Having determined that the Service Agreement's class action ban is unenforceable, the question then becomes whether the general arbitration clause survives and thus compels arbitration in the class action litigation. Appellants' position is that the arbitration clause is unenforceable in totality as an unconscionable adhesion contract term. For the reasons explained below, we conclude that the general arbitration provisions are severable from the class action prohibition provision,[9] and remain enforceable in any litigation or adjudicative processes that may occur upon remand.

A. The Arbitration Clause

Section 5 of the Service Agreement, contains the following general provisions relevant to our review of the enforceability of the arbitration clause:

> **(a) Arbitration for Resolution of Disputes.** IT IS IMPORTANT THAT YOU READ THIS ENTIRE SECTION CAREFULLY. THIS SECTION PROVIDES FOR RESOLUTION OF DISPUTES THROUGH FINAL AND BINDING ARBITRATION BEFORE A NEUTRAL ARBITRATOR INSTEAD OF IN A COURT BY A JUDGE OR JURY OR THROUGH A CLASS ACTION. YOU continue to have CERTAIN RIGHTS TO OBTAIN RELIEF FROM a federal or state REGULATORY agency.
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> **(b) BINDING ARBITRATION.** The arbitration process established by this section is governed by the Federal Arbitration Act ("FAA"), 9 U.S.C. §§ 1-16. The FAA, not state law, shall govern the arbitrability of all disputes between Insight regarding this Agreement and the Service. You have the right to take any dispute that qualifies to small claims court rather than arbitration. However, all other disputes arising out of or related to this Agreement (whether based in contract, tort, statute, fraud, misrepresentation or any other legal or equitable theory) must be

[9] In Section V of this opinion, we determine the confidentiality provisions of the arbitration clause to be substantively unconscionable. Thus, our discussion in this section, addresses the original arbitration clause stripped of both the class action ban and the confidentiality provisions.

> resolved by final and binding arbitration, unless provided otherwise in this Agreement. This includes any dispute based on any product, service or advertising having a connection with this Agreement and any dispute not finally resolved by a small claims court. The arbitration will be conducted by one arbitrator using the procedures described by this Section. *If any portion of this Dispute Resolution Section is determined to be unenforceable, then the remainder shall be given full force and effect. The provisions of this section shall survive termination, amendment or expiration of this Agreement.*

(emphasis added)

As noted, Section 5 subsection (b) of the Service Agreement provides for severability. As discussed below, we discern nothing improper, unconscionable, or unenforceable about this severability clause, and, accordingly, conclude that the general arbitration clause survives our determination that the class action ban is unenforceable.

B. Kentucky Law Favors Arbitration

We begin by noting that in Kentucky, unlike most jurisdictions, arbitration enjoys the imprimatur of our state Constitution. Section 250 of the Kentucky Constitution provides "It shall be the duty of the General Assembly to enact such laws as shall be necessary and proper to decide differences by arbitrators, the arbitrators to be appointed by the parties who may choose that summary mode of adjustment." Similar provisions were contained in Article VI, Section 10, of Kentucky's Second Constitution adopted in 1799, and in Article 8, Section 10, of Kentucky's Third Constitution adopted in 1850. *See Dutschke v. Jim Russell Realtors, Inc.*, 281 S.W.3d 817, 823 (Ky. App. 2008).

Clearly, it has long been the public policy of Kentucky that arbitration is

a favored method of dispute resolution. "Arbitration has always been favored by the courts." *Poggel v. Louisville Ry. Co.*, 225 Ky. 784, 10 S.W.2d 305, 310 (1928). "Kentucky law favors the enforcement of arbitration agreements." *Medcom Contracting Services, Inc. v. Shepherdsville Christian Church Disciples of Christ*, 290 S.W.3d 681, 685 (Ky. App. 2009) (citing *Kodak Mining Co. v. Carrs Fork Corp.*, 669 S.W.2d 917 (Ky. 1984)); *see also Ally Cat, LLC v. Chauvin*, 274 S.W.3d 451, 458 (Ky. 2009).

Further, our legislature has statutorily recognized a public policy preference favoring arbitration. Subject to exceptions not relevant here, KRS 417.050 provides that "[a] written agreement to submit any existing controversy to arbitration or a provision in written contract to submit to arbitration any controversy thereafter arising between the parties is valid, enforceable and irrevocable, save upon such grounds as exist at law for the revocation of any contract." Similarly, the Federal Arbitration Act, 9 U.S.C.A. § 2 (FAA), which is applicable to arbitration provisions involving interstate commerce,[10] provides that "[a] written provision in any . . . contract evidencing a transaction involving commerce to settle by arbitration a controversy thereafter arising out of such contract or transaction, or the refusal to perform the whole or any part thereof, or an agreement in writing to submit to arbitration an existing controversy arising out of such a contract, transaction,

[10] The parties do not dispute that the FAA is applicable to the arbitration clause under consideration. The contract for Internet service which is the subject matter of the contract clearly involves an interstate (indeed worldwide) service, and, moreover, the arbitration clause itself specifically provides that "[t]he arbitration process established by this section is governed by the [FAA]." Thus, without objection of the parties, we apply FAA provisions as appropriate.

or refusal, shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract."

In light of our clear constitutional and statutory authorities favoring arbitration "[t]he party seeking to enforce an agreement has the burden of establishing its existence, but once prima facie evidence of the agreement has been presented, the burden shifts to the party seeking to avoid the agreement. The party seeking to avoid the arbitration agreement has a heavy burden." *Louisville Peterbilt, Inc. v. Cox*, 132 S.W.3d 850, 857 (Ky. 2004) (citation omitted). As such, we begin our review with a strong presumption that the general arbitration clause is severable from the class action prohibition provision (and confidentiality provisions), and remains in full force and effect upon the continuation of any proceedings following remand.

C. The Arbitration Clause is not Unconscionable

Appellants contend that the general arbitration clause should be held unenforceable upon the grounds that the provision is unconscionable. "A fundamental rule of contract law holds that, absent fraud in the inducement, a written agreement duly executed by the party to be held, who had an opportunity to read it, will be enforced according to its terms." *Conseco Finance Servicing Corp. v. Wilder*, 47 S.W.3d 335, 341 (Ky. App. 2001) (citing *Cline v. Allis-Chalmers Corp.*, 690 S.W.2d 764 (Ky. App. 1985)).

The doctrine of unconscionability has developed as a narrow exception to this fundamental rule. The doctrine is used by the courts to police the

excesses of certain parties who abuse their right to contract freely. It is directed against one-sided, oppressive and unfairly surprising contracts, and not against the consequences *per se* of uneven bargaining power or even a simple old-fashioned bad bargain. *Id.* (citing *Louisville Bear Safety Service, Inc., v. South Central Bell Telephone Company,* 571 S.W.2d 438, 440 (Ky. App. 1978)). An unconscionable contract is "one which no man in his senses, not under delusion, would make, on the one hand, and which no fair and honest man would accept, on the other." *Id.* at 342 ((quoting Black's Law Dictionary, 1694 (4th ed. 1976)).

In *Conseco*, the Court of Appeals noted that review of arbitration clauses for unconscionability involves a two step process – first, a review focused on the procedures surrounding the making of the arbitration clause (procedural unconscionability) and second, a review of the substantive content of the arbitration clause (substantive unconscionability). *Id.* at 343 fn 22. In their arguments, the parties have applied this two-step process. In light of *Conseco*, and because the parties have placed much emphasis upon this framework, we likewise review the argument using the procedural/substantive unconscionability structure.[11]

1. Procedural Unconscionability

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[11] The parties raise the issue of whether a finding of unconscionability requires *both* procedural and substantive unconscionability. In our view, for the reasons reflected herein, there need not be both. Substantive unconscionability, alone, is grounds for a determination that an arbitration clause, or an individual provision thereof, is unenforceable. Similarly, the converse is true. If the arbitration clause is written in "legalese" and disguised in the "fine print," the provision may be unenforceable even though not substantively unconscionable.

Procedural, or "unfair surprise," unconscionability "pertains to the process by which an agreement is reached and the form of an agreement, including the use therein of fine print and convoluted or unclear language . . . . [It] involves, for example, 'material, risk-shifting' contractual terms which are not typically expected by the party who is being asked to 'assent' to them and often appear [ ] in the boilerplate of a printed form." *Conseco,* 47 S.W. 3d at 343 fn 22 (citing *Harris v. Green Tree Financial Corp.*, 183 F.3d 173, 181 (3rd Cir. 1999). Factors relevant to the procedural unconscionability inquiry include the bargaining power of the parties, "the conspicuousness and comprehensibility of the contract language, the oppressiveness of the terms, and the presence or absence of a meaningful choice." *Jenkins v. First American Cash Advance of Georgia, LLC.*, 400 F.3d 868, 875-876 (11th Cir. 2005).

Appellants argue that the arbitration clause is procedurally unconscionable because it is contained in a non-negotiable, take it or leave it, adhesion contract. They also argue that the arbitration clause is procedurally unconscionable because it is not readily visible to customers contracting for service via the Internet who must navigate to a separate page in order to see it. "A contract of adhesion is a standardized contract, which, imposed and drafted by the party of superior bargaining strength, relegates to the subscribing party only the opportunity to adhere to the contract or reject it." *Patterson v. ITT Consumer Financial Corp.*, 18 Cal.Rptr.2d 563, 565 (Cal. App. 1993) (citation and internal quotation marks omitted). Adhesion contracts are not *per se*

improper. On the contrary, they are credited with significantly reducing transaction costs in many situations. *See Hill v. Gateway 2000, Inc.*, 105 F.3d 1147 (7th Cir.1997). However, adhesion contracts are subject to abuse. Oppressive terms ancillary to the main bargain can be concealed in fine print and couched in vague or obscure contractual language. "In consumer transactions in particular, courts have been willing to scrutinize such contracts and have refused to enforce egregiously abusive ones." *Conseco*, 47 S.W.3d at 342 fn 20. (citing *Jones v. Bituminous Casualty Corp.*, 821 S.W.2d 798 (Ky. 1991)).

Upon review of the general provisions of the arbitration clause, we cannot conclude that it is procedurally unconscionable. The clause was not concealed or disguised within the form; its provisions are clearly stated such that purchasers of ordinary experience and education are likely to be able to understand it, at least in its general import; and its effect is not such as to alter the principal bargain in an extreme or surprising way. As noted by the trial court "[t]he provision is in clear and concise language. The title is in bold print. The method of referring the reader to a different screen is a common practice in most web sites, and even in many written contracts (usually by reference to an addendum)." In summary, we do not find the arbitration clause to be procedurally unconscionable.

2. Substantive Unconscionability

Substantive unconscionability "refers to contractual terms that are

unreasonably or grossly favorable to one side and to which the disfavored party does not assent." *Conseco,* 47 S.W.3d at 343 fn 22 (citation omitted). As for substantive unconscionability, courts consider "the commercial reasonableness of the contract terms, the purpose and effect of the terms, the allocation of the risks between the parties, and similar public policy concerns." *Jenkins*, 400 F.3d at 876.

Stripped of the class action ban and the confidentiality provision, the arbitration clause in this case is a basic arbitration clause permitting either side to compel arbitration. It has no unique characteristics to distinguish it from any other standard arbitration clause. Indeed, for the *de minimis* individual claims of this case, the customer is deprived of no right at all by the arbitration clause. With or without the arbitration clause, he is free to take his cause of action to small claims court, which would be the normal forum in Kentucky's court system for the individual's claim to be filed in any event. In summary, the general arbitration clause is not substantively unconscionable.

D. Conclusion

As noted above, our state Constitution and statutes favor the enforceability of arbitration agreements. Moreover, the purpose of the FAA "was to reverse the longstanding judicial hostility to arbitration agreements that had existed at English common law and had been adopted by American courts, and to place arbitration agreements upon the same footing as other contracts." *Gilmer v. Interstate/Johnson Lane Corp.*, 500 U.S. 20, 24 (1991).

The FAA's provisions "manifest a 'liberal federal policy favoring arbitration agreements.'" *Id.* at 25 (quoting *Moses H. Cone Mem'l Hosp. v. Mercury Constr. Corp.*, 460 U.S. 1, 24, (1983)). The Supreme Court has "rejected generalized attacks on arbitration that rest on 'suspicion of arbitration as a method of weakening the protections afforded in the substantive law to would-be complainants.'" *Green Tree Fin. Corp. v. Randolph*, 531 U.S. 79, 89-90 (2000) (quoting *Rodriguez de Quijas v. Shearson/Am. Express, Inc.*, 490 U.S. 477, 481, (1989)); *Jenkins*, 400 F.3d at 874. In light of such long-standing public policy, we see no basis to disturb this contractual term. Accordingly, upon remand, upon satisfaction of the relevant procedural requirements contained in the arbitration agreement, class action litigation may proceed in an arbitration forum.

V. THE CONFIDENTIALITY PROVISION IS UNENFORCEABLE

Finally, as has been referred to on several occasions, the Appellants contend that the confidentiality provision contained in the arbitration agreement should be deemed unenforceable because it gives the company "an unyielding advantage over individual customers." As a repeat participant in the arbitration proceedings, the company is able to gather a body of information relating to precedent and rulings arising from within the dispute resolution process, to which customers involved in separate proceedings would have no access.

Subsection (g) of the Dispute Resolution provisions, titled Arbitration

Information and Filing Procedures, provides, in relevant part, that "[n]either you nor Insight may disclose the existence, content or results of any arbitration or award, except as may be required by law, to confirm and enforce an award, or to the party's attorneys and/or accountants." Although facially neutral, confidentiality provisions usually favor companies over individuals. *Ting v. AT&T*, 319 F.3d 1126, 1151 (9th Cir. 2003). It is generally recognized that because companies continually arbitrate the same claims, the arbitration process tends to favor the company. *Cole v. Burns Intern. Sec. Services*, 105 F.3d 1465, 1476 (D.C. Cir. 1997). In *Cole*, the D.C. Circuit held that because of plaintiffs' lawyers and arbitration appointing agencies like the AAA, who can scrutinize arbitration awards and accumulate a body of knowledge on a particular company, there was little likelihood of any harm occurring from the "repeat player" effect. *Id.* at 1486.

In *Ting*, however, the Ninth Circuit concluded that if a "company succeeds in imposing a gag order, plaintiffs are unable to mitigate the advantages inherent in being a repeat player." *Ting*, 319 F.3d at 1152. *Ting* concluded that such confidentiality clauses were unenforceable because it permitted the company to "place[] itself in a far superior legal posture by ensuring that none of its potential opponents have access to precedent while, at the same time, [the company] accumulates a wealth of knowledge on how to negotiate the terms of its own unilaterally crafted contract[,]" and because "the unavailability of arbitral decisions may prevent potential plaintiffs from

obtaining the information needed to build a case of intentional misconduct or unlawful discrimination[.]" *Id.*

Further, "the secrecy provisions of the arbitration agreements both affect the outcomes of individual arbitrations and clearly favor Defendants. They do so by reinforcing the advantages Defendants already possess as repeat participants in the arbitration process." *Acorn v. Household Intern., Inc.*, 211 F.Supp.2d 1160, 1173 (N.D. Cal. 2002). "[S]everal studies have found and several courts have held that a party's repeated appearance (before the same group of arbitrators conveys distinct advantages over the [one-time participant]." *Mercuro v. Superior Court*, 116 Cal.Rptr.2d 671, 678 (Cal. App. 2002). *See also Sprague v. Household Intern.*, 473 F.Supp.2d 966, 975 (W.D.Mo. 2005) (company has not explained why confidentiality agreements provide any real benefit, much less a comparable benefit, to the consumer and, as repeat players, the company is the obvious beneficiary of any attempt to obscure the process); *Luna v. Household Finance Corp. III*, 236 F.Supp.2d 1166, 1180 (W.D.Wash. 2002) ("The advantages repeat participants possess over "one time" participants in arbitration proceedings are widely recognized in legal literature and by federal courts."); *Armendariz v. Foundation Health Psychcare Services, Inc.*, 6 P.3d 669, 690 (Cal. 2000) (size of employee award in arbitration is lower when employer is a repeat participant); Bingham, "Employment Arbitration: The Repeat Player Effect," 1 Emp. Rts. & Employment Poly. J. 189, 213 (1997) (potential reasons for the repeat player

advantage in arbitrations include: "unequal information in arbitrator selection," "unequal representation at the hearing," a repeat participant's ability to screen out and settle meritorious cases, and the arbitrator's incentive to satisfy repeat customers). Consequently, although facially neutral, the confidentiality provision of the arbitration agreement, in effect, favors Insight.

Insight directs us to *Iberia Credit Bureau, Inc. v. Cingular Wireless, LLC*, 379 F.3d 159, 175 (5th Cir. 2004) (while the confidentiality requirement is probably more favorable to the cellular provider than to its customer, the plaintiffs have not persuaded us that the requirement is so offensive as to be invalid.); *Parilla v. IAP Worldwide Services, VI, Inc.*, 368 F.3d 269, 280 (3rd Cir. 2004) (each side has the same rights and restraints under those provisions and there is nothing inherent in confidentiality itself that favors or burdens one party vis-a-vis the other in the dispute resolution process.); and *Monroe v. Citigroup, Inc.*, 2003 U.S. Dist. LEXIS 26316 (N.D.Fla. Aug. 5, 2003). Nevertheless, Insight has failed to identify any practical social utility to the provision. In light of the substantial potential adverse consequences of the confidentiality provisions and the absence of countervailing benefits, we join those jurisdictions that hold that such provisions are unenforceable.

VI. CONCLUSION

For the foregoing reasons the decision of the Court of Appeals is reversed, and this matter is remanded to the Jefferson Circuit Court for such further proceedings as are consistent with this opinion.

Minton, C.J., Abramson, Cunningham, Noble, and Scott, JJ., concur. Schroder, J., concurs in part and dissents in part by separate opinion.

SCHRODER, J., CONCURRING IN PART AND DISSENTING IN PART: I concur with the well-reasoned opinion of the majority on all of the issues except as to the enforceability of the general arbitration clause. While I recognize the federal and state authorities favoring arbitration, I believe that Insight's arbitration agreement is so procedurally unconscionable that the arbitration clause itself should be held invalid.

The majority accurately sets out the factors relevant to the procedural unconscionability inquiry – "the conspicuousness of the terms and comprehensibility of the contract language, the oppressiveness of the terms, and the presence or absence of a meaningful choice." *Jenkins v. First American Cash Advance of Georgia, LLC,* 400 F.3d 868, 875-76 (11th Cir. 2005). However, the Court's opinion does not address the last factor – whether the Appellants had a meaningful choice - which I see as critical to the analysis of unconscionability in this case.

The record established that Insight was the only provider of high-speed broadband cable internet services in Louisville at the time Appellants entered into the service agreements. Although there may have been other options to obtain internet access, the record indicates the service agreements for these companies had similar binding arbitration clauses or they did not provide high-speed broadband cable service. In the digital age in which we now live, internet

access is becoming more and more of a necessity for personal communication, as well as for business and commerce purposes. The service agreement in this case was a "take or leave it" adhesion contract that customers, who had no bargaining power, were forced to submit to if they wanted high speed cable internet access. Unlike the Appellees in *Conseco Finance Servicing Corp. v. Wilder*, who did not allege that there was not another reasonably available source for mobile home financing, Appellants in the present case have shown they had no meaningful choice in obtaining the high speed internet service they sought. 47 S.W.3d 335, 343, n.24 (Ky. App. 2001).

The fact that the arbitration portion of the service agreement was not in the portion of the agreement asking for the customer's assent was further proof of its procedural unconscionability. Customers had to navigate to a separate page to see that portion of the agreement. While the majority notes that this is a common practice, it certainly cannot be characterized as conspicuous.

For the above reasons, I would allow the class action suit in the Jefferson Circuit Court to go forward.

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