

ARBITRATION

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Consumer Lawsuits: Practical Defense Tips

Neighborhood financial services providers have become prime targets of plaintiffs' lawyers across the country. Armed with favorable consumer-protection statutes, plaintiffs' lawyers are challenging the industry's business practices by filing class-action lawsuits in which they seek millions of dollars in cash, debt forgiveness and attorney's fees.

Your company, however, is not defenseless. Although lawsuits cannot be prevented, proper corporate structuring and the use of arbitration agreements containing class-waiver clauses are two tools that can help your company limit its exposure to class-action suits.

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Where a company is incorporated and where a company maintains its

principal place of business directly impact where the company can be sued.

With careful planning, a company can structure itself in a way that makes it more difficult for plaintiffs (and those hoping to serve as class representatives) to force the company to defend a nationwide class action in a venue chosen by the plaintiff's counsel.

In 2005, Congress enacted the Class Action Fairness Act to combat the problem of plaintiffs' lawyers being free to select the jurisdiction in which they file a lawsuit. Once certain criteria have been shown, CAFA affords a defendant the right to remove a lawsuit filed in state court to federal court.

Although dependent upon the circumstances, defending against class-action claims in federal court is usually preferable to defending against those same claims in state court, primarily because the federal courts are often better equipped to handle class litigation.

Although your ability to utilize CAFA will depend on the specific facts of the case, where your company is incorporated and where your company chooses to maintain its principal place of business will directly impact its ability to invoke CAFA. That is

because the threshold question of CAFA jurisdiction compares the citizenship of the plaintiff(s) with the citizenship of the defendant(s).

CAFA can only be invoked in lawsuits where a substantial majority of the plaintiffs of the proposed class and the defendants are "citizens" of different states.

By structuring your company so that its citizenship is different than the citizenship of your typical customer (this is commonly referred to as "diversity"), you will increase the likelihood of satisfying the threshold element of CAFA.

As a general example to illustrate this point, if you intend to operate stores in Missouri, your company could incorporate under the laws of Delaware and maintain its principal place of business in Kansas. Your company would then be a citizen of Delaware and a citizen of Kansas for purposes of CAFA.

Since your stores will primarily service individuals who reside in Missouri, the substantial majority of your customers should be citizens of Missouri.

If a customer brings a class-action suit against your company in Missouri, your company should then

Continued on page 32

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DEFENSE TIPS *from page 30*

be in a better position to invoke CAFA jurisdiction and remove the lawsuit to federal court, since the substantial majority of the plaintiffs and your company would be considered citizens of a different state.

While the availability of CAFA jurisdiction in any specific case will depend on numerous factors, and not just your company's citizenship, structuring your company such that it is diverse from your typical customer will greatly increase your company's chances of invoking CAFA jurisdiction if your company is forced to defend against a class-action lawsuit filed in state court.

You should consult your lawyer for legal advice relating to the specific circumstances involved with your company.

Include a Class-Waiver Clause

Arbitration is a contractual agreement between two parties whereby they agree to waive their right to litigate certain disputes in the courts and instead agree to allow a third party (the arbitrator) to decide their claims.

Although arbitration can be preferable to litigation for several reasons, the primary advantage of arbitration is that the parties may be able to set the rules by which they agree to arbitrate.

For example, the parties can decide (1) who will serve as the arbitrator; (2) the number of arbitrators on the panel who will hear the case; (3) the location of the arbitration; (4) what law shall govern the arbitration; (5) who shall bear the costs of arbitration ... and the list goes on and on.


Submitting any potential disputes to individual arbitration — as opposed to allowing class arbitration — is one such rule that can be incorporated into an arbitration agreement that will also help protect your company from exposure to class action cases.

A class-waiver provision basically prevents either party from serving as

a class representative or from joining a class-action lawsuit filed against the opposing party. Instead, both parties agree to only bring their claims on an individual basis.

Requiring customers to pursue individual claims is advantageous, as a practical matter, because individual claims are less expensive to defend and they greatly reduce your overall exposure.

The United States Supreme Court recently held in *AT&T Mobility LLC v. Concepcion* that such class-waiver provisions are enforceable when incorporated into an otherwise valid arbitration agreement.



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Specifically, the court held that the Federal Arbitration Act prohibits states from conditioning the enforcement of arbitration agreements on the availability of class action procedures. Creating a valid and enforceable arbitration agreement is therefore critical to utilizing the benefits provided by class-waiver provisions.

Some courts are undoubtedly reluctant to enforce arbitration agreements because most of those arbitration agreements are found in form contracts, e.g., form loan agreements.

Enforceable Agreement

Although you should consult your lawyer for advice relating to the circumstances involved with your company, there are several principles that may help you create a valid and enforceable arbitration agreement.

- Introduce the arbitration agreement with conspicuous language expressly stating that the loan agreement contains a contract to arbitrate. Utilize all caps and bold font to introduce the various headings of the arbitration agreement, and use the same size font as the font used in the other portions of the agreement. Following these practices makes it difficult for your customers to later argue that the arbitration agreement was buried in the fine print of the loan agreement.

- Provide a mechanism by which your customers can choose to opt out of the arbitration agreement contained in their loan agreements. Regardless of the mechanism you create, clearly explain the opt-out process in the arbitration agreement and give your customers a reasonable time to make their decision. (60 days is usually considered reasonable). These opt-out provisions make it difficult for your customers to later argue that they were forced into or under duress when they contracted to arbitrate.

- Agree to advance the costs associated with arbitration, e.g., filing costs, arbitrator fees, etc., until the case is resolved. These provisions make it difficult for your customer to later claim that the expense of arbitration serves as a barrier to them pursuing their merit-based claims.

- Allow the customer to recover in arbitration any remedy that would otherwise be available in court. For example, your arbitration agreement should expressly state that the customer can recover attorney's fees, statutory damages and punitive damages in arbitration if those remedies would be otherwise available in a court of law. These provisions make it difficult for your customer to later contend that the purpose of the arbitration agreement is to essentially immunize your company from liability.

- Carve out an exception to the arbitration agreement so that your customers are permitted to file suit against your company in small claims court. Small claims court serve as an

effective means of quickly resolving disputes concerning relatively small amounts of damages. Allowing customers to utilize these tribunals makes it difficult for them to later allege that the real purpose of the arbitration agreement is to delay resolution of the dispute, making it futile to file their claims.

Vital Provisions

The foregoing are examples of provisions that may increase the probability of a court enforcing an arbitration provision included in your loan agreement.

Incorporating a class-waiver provision into an otherwise valid and enforceable arbitration agreement should help shield your company from potential exposure to class litigation. Your lawyer can help you analyze this issue and draft such a provision for your loan agreement.

Although your company cannot prevent lawsuits, by consulting your lawyer to obtain legal advice regarding these issues, you can take steps to limit the exposure your company may face from class-action lawsuits.

Proper corporate structuring and the use of class-waiver clauses in enforceable arbitration agreements are two possible methods that can assist in your defense.

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