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SUPREME COURT OF THE STATE OF WASHINGTON

DOUG SCOTT, LOREN TABASINKE, SANDRA TABASINSKE, PATRICK OISHI, JANET OISHI, et al.,

Petitioners,

v.

CINGULAR WIRELESS,

Respondent.

PETITIONERS' STATEMENT OF ADDITIONAL AUTHORITIES

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STATEMENT OF ADDITIONAL AUTHORITIES

Pursuant to RAP 10.8, Petitioners submit this statement of additional authorities to provide the Court with two recent decisions.

In *Coady v. Cross Country Bank.*, Slip Copy, No. 2005AP2770, 2007 WL 188993 (Wis. App. Jan. 25, 2007), the Wisconsin Court of Appeals held under Wisconsin law that the arbitration clause in the Cross Country Bank credit card agreements, which requires cardholders to waive any rights to proceed on a class-wide basis if arbitration is elected "is both procedurally and substantively unconscionable." 2007 WL 188993 at *6, ¶27.

First, the *Coady* court held that Cross Country Bank credit card agreement's arbitration clause is procedurally unconscionable under Wisconsin law. 2007 WL 188993 at *6–9, ¶¶ 28-41. That holding is relevant to Petitioners' argument that Cingular's arbitration clause is procedurally unconscionable under Washington law. Opening Br. at 43–50; Mot. for Disc. Rev. at 11–13.

Second, the *Coady* court held that Country Bank credit card agreement's arbitration clause is substantively unconscionable under Wisconsin law. 2007 WL 188993 at *9–11, ¶¶ 42-50. That holding is relevant to Petitioners' argument that the class action ban in Cingular's arbitration clause is substantively unconscionable under Washington law. Opening Br. at 11–29; Reply Br. at 4–8; Mot. for Disc. Rev. at 6–10; Reply in Support of Disc. Rev. at 6–9; Supp. Br. at 8–13.

In *Vasquez-Lopez v. Beneficial Oregon, Inc., -- P.3rd ---, 2007 WL 294116 (Or. App Jan. 31, 2007*, the Oregon Court of Appeals held that the arbitration rider to a consumer mortgage, which contained a ban on class actions, a cost-sharing provision, and a confidentiality clause, "was unconscionable, based on the oppressive circumstances of its formation, as well as its ban on class actions and its costsharing [sic] provisions." 2007 WL 294116 at *17.

The Oregon Court of Appeals found the ban on class actions, the cost sharing provision and confidentiality clause to be one-sided at the inception of the contract, stating that "the fact that plaintiffs have not filed a class action is irrelevant; the unconscionability of a contract is gauged as of the time it is formed. [Cite omitted]. In short, the class action ban is unilateral in effect . . . ." 2007 WL 294116 at *9. The court's decision is relevant to Petitioners' argument that the class action ban in Cingular's consumer contract is substantively unconscionable because it is one-sided. Appellants' Opening Br. (Ct. App.) at 11–19.

Respectfully submitted this 9th day of February, 2007.

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Coady v. Cross County BankWis.App.,2007.Only the Westlaw citation is currently available.
NOTICE: FINAL PUBLICATION DECISION PENDING. SEE W.S.A. 809.23.

Court of Appeals of Wisconsin.

Angeline COADY, Sharon Johnson, Janice Kask, Sue Lubnow, Patrick Peterson, Lori Peterson, Robert Peterson, Richard Steeves, Stacia Stokes and Richard Kask on behalf of himself and all others similarly situated, Plaintiffs-Respondents,

v.

CROSS COUNTRY BANK, Inc. and Applied Card Systems, Inc., Defendants-Appellants.

No. 2005AP2770.

Jan. 25, 2007.

APPEAL from an order of the circuit court for Dane County: Robert A. DeChambeau, Judge. Affirmed and cause remanded.

Before LUNDSTEN, P.J., DYKMAN and HIGGINBOTHAM, JJ.

¶ 1 LUNDSTEN, P.J.

Cross Country Bank and Applied Card Systems (collectively, "Cross Country") appeal the circuit court's order denying their motion to compel arbitration and stay court proceedings.[FN1] The plaintiffs, individuals who hold credit cards through Cross Country, sued Cross Country and sought to proceed as a class, alleging that Cross Country engaged in illegal debt collection practices in violation of the Wisconsin Consumer Act. Cross Country argues that the circuit court erred in concluding that the arbitration clause in its credit card agreement with the plaintiffs is unconscionable. We agree with the circuit court that the arbitration clause is unconscionable, and therefore affirm the court's order.

FN1. Cross Country filed a petition for leave to appeal from this non-final order.

Background

¶ 2 Each of the plaintiffs received a credit card and credit card agreement from Cross Country after responding to a direct mail or other solicitation from Cross Country.[FN2] Cross Country subsequently "charged off" all of the plaintiffs' accounts except for one plaintiff, who has two active accounts. The unpaid balances that were "charged off" ranged from approximately $690 to $3800.

FN2. One of the plaintiffs is the wife of a Cross Country credit cardholder and averred that she is not a party to the credit card account or agreement. Because the parties do not make separate arguments with respect to this plaintiff, we will not distinguish her from the other plaintiffs in the remainder of this opinion.

Also, it appears that there are three different versions of the credit card agreement, each of which applies to one or more of the plaintiffs. The parties have not suggested that there are any relevant differences among the versions for purposes of this appeal and, therefore, we make no distinction among the versions.

¶ 3 The credit card agreement that Cross Country provided to the plaintiffs contains a choice of law clause, which reads:

Governing Law. This Agreement and your Account will be governed by, and interpreted under Federal law and the laws of the State of Delaware without reference to principles of conflict of laws. ***The legality, enforceability and interpretation of this Agreement and the amounts contracted for, charged and received under this Agreement will be governed by such laws. This Agreement is entered into between you and us in Delaware. We make decisions about granting credit to you from and extend credit to you under this Agreement in Delaware. Federal and Delaware law will also apply to any controversy, Claim or dispute arising from or relating in any way to the subject matter of this Agreement and/or your Account, including, without limitation, statutory, equitable or tort claims.***

¶ 4 The credit card agreement also contains a lengthy arbitration clause, which includes provisions requiring that all disputes be arbitrated if either party elects arbitration and that cardholders waive any rights to proceed on a class-wide basis if arbitration is elected. Specifically, the arbitration clause reads:

If you or we elect to arbitrate a Claim, you will not have the right to pursue that Claim in court or have a jury decide the Claim....
If you or we elect to arbitrate a Claim: (1) neither you nor anyone else on your behalf can pursue that Claim in court or in an arbitration proceeding on a class-wide or representative basis; and (2) Claims brought by or against one account holder (or joint account holders) may not be brought together with Claims brought by or against any other account holder.

The arbitration clause contains an additional choice of law provision, which reads:**Governing Law.** This Agreement involves interstate commerce and this Arbitration Provision is governed by the Federal Arbitration Act ("FAA"), 9 U.S.C. § § 1 et seq. The arbitrator must follow: (1) the FAA; (2) the substantive law, consistent with the FAA, related to any Claim....

¶ 5 The plaintiffs sued Cross Country, alleging that Cross Country had engaged in illegal debt collection practices, including harassing phone calls that involved abusive, derogatory, or obscene language and, in some instances, threats. The plaintiffs claimed that Cross Country's debt collection practices violated the Wisconsin Consumer Act, and they sought damages, including double damages under the Act for their finance charges.[FN3]

FN3. The Wisconsin Consumer Act contains the following provisions:
427.104. Prohibited practices. (1) In attempting to collect an alleged debt arising from a consumer credit transaction or other consumer transaction, including a transaction primarily for an agricultural purpose, where there is an agreement to defer payment, a debt collector may not:
....
(b) Threaten criminal prosecution;
....
(d) Initiate or threaten to initiate communication with the customer's employer prior to obtaining final judgment against the customer, except as permitted by statute including specifically s. 422.404 ...;
(e) Disclose or threaten to disclose to a person other than the customer or the customer's spouse information affecting the customer's reputation ...;
....
(g) Communicate with the customer or a person related to the customer with such frequency or at such unusual hours or in such a manner as can reasonably be expected to threaten or harass the customer;
(h) Engage in other conduct which can reasonably be expected to threaten or harass the customer or a person related to the customer;
(i) Use obscene or threatening language in communicating with the customer or a person related to the customer;
(j) Claim, or attempt or threaten to enforce a right with knowledge or reason to know that the right does not exist;
....
(L) Threaten action against the customer unless like action is taken in regular course or is intended with respect to the particular debt....
All references to the Wisconsin Statutes are to the 2003-04 version unless otherwise noted.

¶ 6 Cross Country moved to compel arbitration and stay all proceedings, asserting that the plaintiffs' claims fell within the scope of the arbitration clause in the credit card agreement. The plaintiffs contended that Cross Country's arbitration clause violated the Wisconsin Consumer Act, that the clause was unconscionable, and that the clause was illusory. In addition, the plaintiffs filed an amended complaint, seeking class certification and adding claims that Cross Country's choice of law and arbitration clauses violated the Act. The plaintiffs sought declaratory relief and to permanently enjoin Cross Country from conducting business operations in Wisconsin in violation of the Act and from including terms in its credit card agreements in violation of the Act.

¶ 7 The circuit court concluded that Cross Country's arbitration clause was unconscionable, struck the clause from the parties' credit card agreements, and denied Cross Country's motion. We reference additional facts as needed in the discussion section of this opinion.

Discussion

A. Whether Wisconsin Or Delaware Law Applies

¶ 8 The central issue in this case is whether the arbitration clause in Cross Country's credit card agreement is unconscionable and, therefore, unenforceable. However, this unconscionability issue presents a preliminary inquiry into the applicable law because Cross Country asserts that the circuit court erred by applying Wisconsin law. Cross Country argues that the credit card agreement's choice of law clause requires that Delaware law be applied to the question of whether the arbitration clause is unconscionable. Cross Country further argues that, under Delaware law, there can be no real dispute that its arbitration clause is not unconscionable and is, therefore, enforceable.

¶ 9 This preliminary choice of law inquiry presents a question of law for our *de novo* review. *Drinkwater v. American Family Mut. Ins. Co.*, 2006 WI 56, ¶ 14, 290 Wis.2d 642, 714 N.W.2d 568. For the reasons that follow, we conclude that Wisconsin law applies.

¶ 10 Cross Country frames its choice of law argument under *Bush v. National School Studios, Inc.*, 139 Wis.2d 635, 407 N.W.2d 883 (1987). In *Bush*, the supreme court held that parties are generally free to contract for choice of law, although not "at the expense of important public policies of a state whose law would be applicable if the parties['] choice of law provision were disregarded." *Id.* at 642; *see also General Med. Corp. v. Kobs*, 179 Wis.2d 422, 428, 507 N.W.2d 381 (Ct.App.1993) ("[P]arties cannot, by contract, override fundamental policies of the state whose law would be applicable absent the choice of law provision.").

¶ 11 Among the laws "likely to embody an important state public policy" are those that "are designed to protect a weaker party against the unfair exercise of superior bargaining power by another party." *Bush*, 139 Wis.2d at 643. The court in *Bush* disregarded a choice of law clause specifying the application of Minnesota law in order to give effect to the important public policy embodied in the Wisconsin Fair Dealership Law. *Id.* at 644-45. The court's conclusion rested largely on two facts. First, the legislature enacted the Fair Dealership Law " '[t]o protect dealers against unfair treatment by grantors, who inherently have superior economic power and superior bargaining power in the negotiation of dealerships.' " *Id.* at 644 (quoting Wis. Stat. § 135.025(2)(b)). Second, the Fair Dealership Law expressly states that it cannot " 'be varied by contract or agreement' " and that any such contract or agreement attempting to do so is " 'void and unenforceable to that extent.' " *Bush*, 139 Wis.2d at 644-45 (quoting § 135.025(3)).

¶ 12 We conclude that the Wisconsin Consumer Act embodies an important state public policy under the logic of *Bush*. The Act is analogous to the Wisconsin Fair Dealership Law in key respects. Like the Fair Dealership Law, the Act is plainly designed to protect a weaker party against the unfair exercise of superior bargaining power by another party. The legislature has expressly stated that the purposes of the Wisconsin Consumer Act include the protection of "customers against unfair, deceptive, false, misleading and unconscionable practices by merchants" and the encouragement of "the development of fair and economically sound consumer practices in consumer transactions." Wis. Stat. § 421 .102(2)(b) and (c). Just as the Wisconsin Fair Dealership Law expressly provides that it cannot be varied by contract or agreement and that an attempt at such variation is unenforceable, *see* Wis. Stat. § 135.025(3), the Wisconsin Consumer Act expressly invalidates choice of law clauses specifying that the law of another state will apply, *see* Wis. Stat. § 421.201(10)(a).[FN4]

FN4. Wisconsin Stat. § 421.201(10)(a) provides, in full:
Except as provided in sub. (9), the following terms of a writing executed by a customer are invalid with respect to consumer transactions, or modifications thereof, to which chs. 421 to 427 apply:
(a) That the law of another state shall apply[.]

¶ 13 Cross Country nonetheless argues that its choice of law clause does not run afoul of the *Bush* rule. Cross Country's argument, so far as we understand it, is divided into two main sub-arguments. Cross Country first argues that the choice of law clause does not run afoul of the *Bush* rule because Delaware law would apply to the question of the arbitration clause's enforceability even absent the choice of law clause in the credit card agreement. Cross Country's second argument is that the choice of law clause does not violate an important Wisconsin public policy because the clause does not prevent the plaintiffs from asserting claims and seeking remedies under the Wisconsin Consumer Act in arbitration. We reject both arguments.

1. Applicable Law Absent The Choice of Law Clause

¶ 14 We begin this discussion by noting that Cross Country does not meaningfully discuss or apply seemingly applicable choice of law standards recently developed by our supreme court. In particular, our supreme court has explained that, when performing a choice of law analysis, courts first presume that the law of the forum applies unless it " 'becomes clear that nonforum contacts are of the greater significance,' " *State Farm Mut. Auto. Ins. Co. v. Gillette*, 2002 WI 31, ¶ 51, 251 Wis.2d 561, 641 N.W.2d 662 (citation omitted), or unless the nonforum state's contacts are " 'so obviously limited and minimal that application of that state's law constitutes officious intermeddling,' " *Beloit Liquidating Trust v. Grade*, 2004 WI 39, ¶ 24, 270 Wis.2d 356, 677 N.W.2d 298 (citation omitted); *see also Drinkwater*, 290 Wis.2d 642, ¶ ¶ 40-42. Courts may then apply five "choice-influencing" factors. *See Drinkw a ter*, 290 Wis.2d 642, ¶ ¶ 40, 45; *Beloit Liquidating*, 270 Wis.2d 356, ¶ 25; *Gillette*, 251 Wis.2d 561, ¶ 53. The five "choice-influencing" factors are: (1) predictability of results; (2) maintenance of interstate and international order; (3) simplification of the judicial task; (4) advancement of the forum's governmental interests; and (5) application of the better rule of law. *Gillette*, 251 Wis.2d 561, ¶ 53. Cross Country does not attempt to apply these five factors.

¶ 15 Cross Country does argue that Delaware is the state with the "most significant relationship" to the parties' dispute. In this regard, Cross Country relies on two factual assertions. The first is Cross Country's assertion that it extends credit to the plaintiffs "in Delaware." But this assertion is based on faulty logic. Cross Country relies on language in the choice of law clause stating that Cross Country "extend[s] credit to [its customers] under this Agreement *in Delaware* " (emphasis added). Obviously, however, language in the choice of law clause is of no value in assessing what would happen in the absence of the clause.

¶ 16 Cross Country's second factual assertion is that it is a Delaware bank chartered in and organized under the laws of Delaware with its sole place of business in Delaware. This may be true, but there is no apparent reason why this fact shows that Delaware has the "most significant relationship" with the parties' dispute. After all, Cross Country solicited plaintiffs in Wisconsin, it supplies a service used in Wisconsin, and the plaintiffs are Wisconsin residents who brought suit in a Wisconsin forum.

¶ 17 In sum, Cross Country does not persuade us that Delaware law would apply even absent the choice of law clause in the parties' credit card agreement. FN5

FN5. Cross Country also makes a one-paragraph argument that federal banking law "supports the primacy" of Delaware law in this case. This argument is insufficiently developed, however, so we decline to address it. *See State v. Pettit*, 171 Wis.2d 627, 646-47, 492 N.W.2d 633 (Ct.App.1992) (court may decline to address issues on appeal that are inadequately briefed).

2. Wisconsin Public Policy

¶ 18 Cross Country's second argument is that the choice of law clause does not violate an important Wisconsin public policy because the clause does not prevent the plaintiffs from asserting claims and seeking remedies under the Wisconsin Consumer Act in arbitration. We disagree. As explained below, the choice of law clause precludes the plaintiffs from asserting *any* claims or remedies under Wisconsin law, including those available under the Act, whether in litigation or arbitration.

¶ 19 Cross Country maintains that the choice of law clause pertains only to the legality, enforceability, and interpretation of the parties' agreement and that, under the agreement, the plaintiffs are free to pursue Wisconsin Consumer Act claims and remedies in arbitration. Cross Country focuses on the following language in the clause:

Governing Law. This Agreement and your Account will be governed by, and interpreted under Federal law and the laws of the State of Delaware without reference to principles of conflict of laws. *The legality, enforceability and interpretation of this Agreement* and the amounts contracted for, charged and received under this Agreement *will be governed by such laws.*

(Original emphasis omitted; emphasis added.) Cross Country then points to the additional choice of law provision contained in the credit card agreement's arbitration clause. That choice of law provision reads:**Governing Law.** This Agreement involves interstate commerce and this Arbitration Provision is governed by the Federal Arbitration Act ("FAA"), 9 U.S.C. § § 1 et seq. The arbitrator must follow: (1) the FAA; (2) *the substantive law, consistent with the FAA, related to any Claim ....*

(Emphasis added.)

¶ 20 Cross Country reads the choice of law clause and the additional choice of law provision in the arbitration clause together, to mean that (1) the choice of law clause must control only the legality, enforceability, and interpretation of the credit card agreement's provisions, and (2) the arbitration clause, via the additional choice of law provision, allows the plaintiffs to assert claims and pursue remedies under the Wisconsin Consumer Act, albeit in arbitration. Close examination reveals, however, that the choice of law clause does not permit the assertion of claims and remedies under the Wisconsin Consumer Act.

¶ 21 Cross Country's reading of the choice of law clause takes language in the clause out of context. The clause, in full, reads:

Governing Law. This Agreement and your Account will be governed by, and interpreted under Federal law and the laws of the State of Delaware without reference to principles of conflict of laws. The legality, enforceability and interpretation of this Agreement and the amounts contracted for, charged and received under this Agreement will be governed by such laws. This Agreement is entered into between you and us in Delaware. We make decisions about granting credit to you from and extend credit to you under this Agreement in Delaware. *Federal and Delaware law will also apply to any controversy, Claim or dispute arising from or relating in any way to the subject matter of this Agreement and/or your Account, including, without limitation, statutory, equitable or tort claims.*

(Original emphasis omitted; emphasis added.) Cross Country does not explain to our satisfaction how the emphasized language can be squared with its assertion that the choice of law clause pertains only to the legality, enforceability, and interpretation of the parties' agreement.

¶ 22 Without further assistance from Cross Country, the only reasonable construction of the choice of law clause that we have identified is that it works in tandem with the arbitration clause's additional choice of law provision to make Delaware law and federal law the applicable "substantive law ... related to any Claim." Indeed, the arbitration clause effectively incorporates the choice of law clause through its use of the term "Claim;" which appears in both clauses. The choice of law clause states that "Federal and Delaware law will ... apply to any controversy, Claim or dispute ." And the arbitration clause's additional choice of law provision states that the arbitrator will follow "the substantive law, consistent with the FAA, related to any Claim." "Claim," in turn, is defined broadly as

any dispute between you and us that arises as a result of or has anything at all to do with: (1) your Account; ... (3) this Agreement; ... or (5) your relationship with us.... It includes disputes relating to constitutional provisions; statutes; ordinances; regulations; court decisions; compliance with the Agreement; and wrongful acts of every type (whether intentional; fraudulent; reckless; or just negligent). It includes requests for money, for orders requiring you or us to take certain actions ... and for any other kind of relief.

¶ 23 In short, Cross Country has provided that (1) all "Claims" will be governed by the "substantive law ... related to any Claim"; (2) defined a "Claim" in a broad fashion to include "any dispute ... that arises as a result of or has anything at all to do with" a plaintiff's account, the credit card agreement, or a plaintiff's relationship with Cross Country; and (3) Delaware law will apply to any "Claim." Cross Country's reading of the choice of law clause as limited to the legality, enforceability, or interpretation of the agreement is unreasonable.

¶ 24 Therefore, we reject Cross Country's argument that the choice of law clause does not violate an important state public policy. The clause violates an important state public policy as embodied in the Wisconsin Consumer Act because it bars the plaintiffs from asserting any claims or seeking any remedies under the Act, *even in an arbitration.* We will, therefore, disregard the choice of law clause and apply Wisconsin law to the question of whether the arbitration clause in the credit card agreement is unconscionable.

B. Whether Cross Country's Arbitration Clause Is Unconscionable

¶ 25 Cross Country argues in the alternative that, even if Wisconsin law is applied, the circuit court still erred in concluding that the arbitration clause was unconscionable. This challenge to the circuit court's decision presents a mixed question of law and fact. *Wisconsin Auto Title Loans, Inc. v. Jones,* 2006 WI 53, ¶ 25, 290 Wis.2d 514, 714 N.W.2d 155. We will not set aside a circuit court's findings of fact unless clearly erroneous. *Id.* Whether the facts found by the circuit court render a contract provision unconscionable is a question of law for our *de novo* review. *Id.* The party seeking to invalidate a contract provision as unconscionable has the burden of proving facts that justify a legal conclusion that the provision is invalid. *Id*., ¶ 30.

¶ 26 Our unconscionability determination is guided by the following principles:

Unconscionability is an amorphous concept that evades precise definition. Indeed, it has been said that "[i]t is not possible to define unconscionability. It is not a concept but a determination to be made in light of a variety of factors not unifiable into a formula."

We have made several attempts at delineating what is meant by unconscionability. The underlying principle that has evolved in such attempts is that "[t]he principle is one of prevention of oppression or unfair surprise and not of disturbance of allocation of risks because of superior bargaining power." Unconscionability has often been described as the absence of meaningful choice on the part of one of the parties, together with contract terms that are unreasonably favorable to the other party.

A determination of unconscionability requires a mixture of both procedural and substantive unconscionability that is analyzed on a case-by-case basis. The more substantive unconscionability present, the less procedural unconscionability is required, and vice versa. A court will weigh all the elements of unconscionability and may conclude unconscionability exists because of the combined quantum of procedural and substantive unconscionability. "To tip the scales in favor of unconscionability requires a certain quantum of procedural plus a certain quantum of substantive unconscionability."

Determining whether procedural unconscionability exists requires examining factors that bear upon the formation of the contract, that is, whether there was a "real and voluntary meeting of the minds" of the contracting parties. The factors to be considered include, but are not limited to, age, education, intelligence, business acumen and experience, relative bargaining power, who drafted the contract, whether the terms were explained to the weaker party, whether alterations in the printed terms would have been permitted by the drafting party, and whether there were alternative providers of the subject matter of the contract.

Substantive unconscionability addresses the fairness and reasonableness of the contract provision subject to challenge. Wisconsin courts determine whether a contract provision is substantively unconscionable on a case-by-case basis.

No single, precise definition of substantive unconscionability can be articulated. Substantive unconscionability refers to whether the terms of a contract are unreasonably favorable to the more powerful party. The analysis of substantive unconscionability requires looking at the contract terms and determining whether the terms are "commercially reasonable," that is, whether the terms lie outside the limits of what is reasonable or acceptable. The issue of unconscionability is considered "in the light of the general commercial background and the commercial needs."

Id., ¶¶ 31-36 (footnotes omitted).

¶ 27 We conclude, as did the circuit court, that the arbitration clause is both procedurally and substantively unconscionable.

1. Procedural Unconscionability

¶ 28 We begin by examining the circuit court's decision and the evidence in light of the factors relevant to procedural unconscionability under *Wisconsin Auto Title*, a case in which the supreme court concluded that an arbitration clause was unconscionable. *See id.*, ¶ 4.

¶ 29 Each of the plaintiffs is over the age of eighteen, and most but not all of them have a high school education.[FN6] Nothing in the record suggests that any of the plaintiffs have any particular business acumen or experience. At least half of the plaintiffs are unemployed, including four plaintiffs who are not working because of a disability. Of those that are employed, their occupations include bus driver and substitute teacher, foundry worker, billing specialist, and administrative secretary.

FN6. Two of the plaintiffs have college degrees. At least one of the plaintiffs did not finish high school.

¶ 30 The circuit court found that all of the plaintiffs qualified as either "low-income or nearly so" and, as such, were unlikely to turn down one of their few sources of credit based on the inclusion of an arbitration clause, regardless of whether they were aware of the clause. The court further found that not being able to obtain a credit card could have a debilitating impact on the individual plaintiffs.

¶ 31 In addition, the circuit court found that the relative bargaining power between the plaintiffs and Cross Country was grossly disproportionate. The court noted that Cross Country may have as many as

33,000 credit card customers in Wisconsin and that Cross Country did not deny that it is a multimillion dollar national company that has earned over half a billion dollars in the previous eight years by marketing credit cards to people with low or poor credit.

¶ 32 It is clear from the form nature of the credit card agreement that Cross Country, not the plaintiffs, drafted the agreement including the arbitration clause. In addition, the plaintiffs averred that no one from Cross Country reviewed any of the terms of the agreement with them, and that no one from Cross Country read or explained the terms of the agreement to them.[FN7] The record does not reflect whether there were other credit card companies willing to extend credit to the plaintiffs.

> FN7. Citing law from other jurisdictions, Cross Country argues that it owed no duty to the plaintiffs to explain the arbitration clause. This argument is unpersuasive because it ignores Wisconsin law stating that one factor relevant to procedural unconscionability is whether the terms of a contract were explained to the weaker party. *See Wisconsin Auto Title Loans, Inc. v. Jones,* 2006 WI 53, ¶ 34, 290 Wis.2d 514, 714 N.W.2d 155.

¶ 33 Other facts that are present here, and that support a determination of procedural unconscionability under the relevant case law, are that the credit card agreement, including the arbitration clause, was in small print, *see Leasefirst v. Hartford Rexall Drugs, Inc.,* 168 Wis.2d 83, 90, 483 N.W.2d 585 (Ct.App.1992); that the plaintiffs did not read or were not aware of the arbitration clause in the credit card agreement, *see id.;* and that the credit card accounts were opened in response to a solicitation from Cross Country, *see First Federal Financial Service, Inc. v. Derrington's Chevron, Inc.,* 230 Wis.2d 553, 561, 602 N.W.2d 144 (Ct.App.1999).

¶ 34 Also weighing in favor of procedural unconscionability is the fact that Cross Country did not provide the credit card agreements to the plaintiffs at the time they signed up for Cross Country's credit card. Rather, Cross Country provided the agreements after the fact, along with the plaintiffs' credit cards.

¶ 35 Cross Country admitted that it requires customers to accept the terms of the credit card agreement, that usage of the credit card represents acceptance of the agreement, and that "[u]sually the terms of the agreement include an arbitration clause ." These facts, along with the form nature of the credit card agreement, support the circuit court's additional finding that the plaintiffs were presented with the arbitration clause in the credit card agreement on a take-it-or-leave-it basis. *See Wisconsin Auto Title,* 290 Wis.2d 514, ¶ 34. Cross Country's arbitration clause is therefore an adhesion contract, *see id.,* ¶ 52, a fact that, while not dispositive, weighs in favor of procedural unconscionability.[FN8] *See id.,* ¶ 53 (although "[o]rdinarily" valid, adhesion contracts are "suspect because they may indicate the inequality of bargaining power between the parties to the contract").

> FN8. One definition of an "adhesion contract" is a "standard-form contract prepared by one party, to be signed by the party in a weaker position, usu[ally] a consumer, who adheres to the contract with little choice about the terms." Black's Law Dictionary 342 (8th ed.2004).

¶ 36 Cross Country does not assert that the circuit court's factual findings are clearly erroneous. Instead, Cross Country argues more generally that the circuit court "did not make explicit findings of fact but merely noted plaintiffs' allegations." We disagree. The circuit court made a number of findings of fact. Those findings are supported by the record, including plaintiffs' affidavits, Cross Country's responses to plaintiffs' discovery requests, and allegations not disputed by Cross Country either in the circuit court or on appeal.

¶ 37 Cross Country nonetheless argues that the record is devoid of evidence that the plaintiffs lacked a "meaningful choice." It bases this argument on the assertion that the credit card industry is highly competitive and that the plaintiffs failed to establish that they could not obtain a credit card from a company that did not include an arbitration clause in its credit card agreement.

¶ 38 Regardless whether the credit card industry is highly competitive in a manner that is relevant here, we agree with Cross Country that the record does not disclose precisely what other credit options, if any, were available to the plaintiffs. Still, this is far from a dispositive factor in our decision, as *Wisconsin Auto Title* demonstrates. In *Wisconsin Auto Title,* which involved a short-term, high-interest loan secured by the borrower's vehicle, there was no apparent evidence of the borrower's other credit options. *See id.*, ¶ ¶ 11-16, 50-51. So far as we know, and so far as the supreme court in *Wisconsin Auto Title* knew, there was significant competition for the business of borrowers of such loans, and the borrower could have obtained a loan on more favorable terms. The supreme court nonetheless concluded, based on the borrower's indigency, need for money, and the unfavorable terms of the loan actually obtained, that the borrower "apparently lacked a meaningful, alternative means to obtain a more favorable loan." *Id.*, ¶ ¶ 51, 57. Similarly here, the circuit court could reasonably infer from the facts that the plaintiffs lacked a meaningful, alternative means to obtain needed credit on a more favorable basis.

¶ 39 Thus, we are not persuaded by Cross Country's argument that the plaintiffs had to do more to establish that they lacked a "meaningful choice," as that phrase is used in the law of unconscionability. Rather, " 'gross inequality of bargaining power, together with terms unreasonably favorable to the stronger party, may ... *show that the weaker party had no meaningful choice.*' " *Id.*, ¶ 49 n. 42 (quoting 2 Restatement (Second) of Contracts § 208 cmt. d (1979) (emphasis added)).[FN9] Parties asserting unconscionability are not necessarily required to demonstrate to a factual certainty that they could not have obtained the desired product or service elsewhere under more favorable terms. *See, e.g., Leasefirst*, 168 Wis.2d at 90 (forum-selection clause was procedurally unconscionable because the clause was not explained or mentioned by a salesperson, the clause was in small print, the plaintiff did not read the clause, and the salesperson did not disclose all of the parties involved in the transaction and their relationships). We think this is particularly true where, as here, the plaintiffs were solicited by the defendant. *See First Fed. Fin. Serv.*, 230 Wis.2d at 561 ("True, James did not shop around for his security system. That is because he was actively solicited by Western Security.").[FN10]

FN9. For the reasons we discuss in the section of this opinion addressing substantive unconscionability, we conclude that the arbitration clause was unreasonably favorable to Cross Country. *See infra*, ¶ ¶ 42-50.

FN10. We recognize that the plaintiffs carry the burden to show unconscionability. *See Wisconsin Auto Title*, 290 Wis.2d 514, ¶ 30. The point of our discussion above is that the plaintiffs have met that burden under the applicable standards with the facts they have presented. Cross Country has not rebutted the plaintiffs' case by, for example, showing that the plaintiffs could have found credit card companies willing to offer them a credit card without a similar arbitration clause.

We further observe that, under Cross Country's view, individual plaintiffs, in order to prove they lacked a "meaningful choice," would apparently be required to ascertain and proffer the terms of every credit card reasonably available to them. Without further information, we are unable to determine whether this is a reasonable requirement. We wonder whether it is possible for a plaintiff to prove he or she has exhausted all of the reasonable alternatives and that none of them offered comparable credit without a similar arbitration requirement. However, because we conclude that the plaintiffs here did not need to make such a showing, we address the question no further.

¶ 40 Cross Country also argues that, unlike in *Wisconsin Auto Title*, there was no finding here that the plaintiffs are indigent. *See Wisconsin Auto Title*, 290 Wis.2d 514, ¶ 50. Although *Wisconsin Auto Title* indicates that indigency is an important procedural unconscionability factor in the context of consumer credit transactions, nothing in the decision makes indigency a prerequisite. On the contrary, the *Wisconsin Auto Title* decision supports the circuit court's determination here. The *Wisconsin Auto Title* court considered the plaintiff's financial circumstances even though "the specifics of the [plaintiff]'s financial situation [were] not in the record." *Id.* Similarly here, although the record contains limited facts as to the "specifics" of the plaintiffs' financial situations, those facts support both the factual inference that the plaintiffs' circumstances leave them with comparatively few credit options and the legal conclusion that Cross Country's arbitration clause is procedurally unconscionable. *See ACORN v. Household Int'l, Inc.*, 211 F.Supp.2d 1160, 1169 (N.D.Cal.2002) ("Defendants market their services to customers 'who have limited credit histories, modest income, high debt to income ratios, or have experienced credit problems....' These consumers are unlikely to refuse one of their few sources of credit because of the inclusion of an arbitration clause." (citation omitted)).

¶ 41 Based on all of the circumstances, we conclude that a sufficient "quantum" of procedural unconscionability is present.[FN11]

FN11. Cross Country contends that the circuit court's determination on procedural unconscionability conflicts with *Buckeye Check Cashing, Inc. v. Cardegna,* 126 S.Ct. 1204 (2006), and *Prima Paint Corp. v. Flood & Conklin Manufacturing Co.,* 388 U.S. 395 (1967). Cross Country's argument in this respect seems to be that *Buckeye* and *Prima Paint* preclude courts, as opposed to an arbitrator, from considering circumstances relevant to the validity of a contract as a whole when addressing the validity of an arbitration clause. If that is Cross Country's argument, we disagree.
Under *Buckeye* and *Prima Paint,* "unless the challenge is to the arbitration clause itself, the issue of the contract's validity is considered by the arbitrator in the first instance." *Buckeye,* 126 S.Ct. at 1209 (citing *Prima Paint*). Here, the challenge is to the arbitration clause itself and therefore presents a question that a *court* may decide in the first instance. In *Wisconsin Auto Title,* our supreme court explained that "[t]he United States Supreme Court has made it clear that although challenges to the validity of a contract as a whole must be made in arbitration if the contract so provides, challenges to an arbitration provision in a contract may be raised in a court proceeding." *Wisconsin Auto Title,* 290 Wis.2d 514, ¶ 6 (citing *Buckeye,* 126 S.Ct. at 1208-09 (in turn citing *Prima Paint,* 388 U.S. at 402-04)).
Of course, when deciding whether an arbitration clause is procedurally unconscionable, a court may need to consider facts that could also be relevant to the validity of the contract as a whole. Doing so does not run afoul of *Buckeye* and *Prima Paint.* If common sense does not already make this apparent, our supreme court's decision in *Wisconsin Auto Title* does. The court in *Wisconsin Auto Title,* in deciding that an arbitration clause was procedurally unconscionable, considered numerous facts that also could have been relevant to the validity of the contract as a whole. *See Wisconsin Auto Title,* 290 Wis.2d 514, ¶¶ 42-58.

2. Substantive Unconscionability

¶ 42 Substantive unconscionability focuses on the "one-sidedness, unfairness, unreasonableness, harshness, overreaching, or oppressiveness of the provision at issue." *Wisconsin Auto Title,* 290 Wis.2d 514, ¶ 59. "In many of the cases in which a contract provision has been held to be substantively unconscionable, a creditor has unduly restricted a debtor's remedies or unduly expanded its own remedial rights." *Id .,* ¶ 60.

¶ 43 The circuit court here concluded that the arbitration clause was substantively unconscionable because it prevents the plaintiffs from obtaining any of the relief they seek for abusive debt collection practices under the Wisconsin Consumer Act and because it unfairly prohibits class-wide relief. We agree that these features render the arbitration clause substantively unconscionable.

¶ 44 Cross Country does not frame its argument in terms of whether its arbitration clause is "commercially reasonable." *See id.,* ¶ 36. Rather, Cross Country argues that the arbitration clause is not substantively unconscionable because the plaintiffs retain their "substantive" rights under the Wisconsin Consumer Act, although they must assert those rights through arbitration. We have already rejected this argument in the context of the choice of law section of this opinion. As in that context, Cross Country again argues that Delaware law applies only to the legality, enforceability, and interpretation of the credit card agreement. However, as we have explained, the arbitration clause incorporates the choice of law clause and, in doing so, makes Delaware law the state law that applies to all "Claims," a term broadly defined under the arbitration clause to preclude claims under the Wisconsin Consumer Act. *See supra,* ¶¶ 18-24.

¶ 45 Thus, the arbitration clause, if enforced, strips the plaintiffs' right to assert claims and seek remedies under the Wisconsin Consumer Act, regardless whether they proceed individually or on a class basis, and regardless whether they proceed in litigation or in arbitration. The arbitration clause therefore constitutes a significant waiver of substantive rights that unduly restricts the plaintiffs' remedies. *See Kett v. Community Credit Plan, Inc.,* 228 Wis.2d 1, 18 n. 15, 596 N.W.2d 786 (1999) (suggesting that the Act may be among the strongest consumer protection laws in the nation). Moreover, it does not seem plausible that the extent of the waiver would be apparent to the average credit card holder.[FN12]

FN12. We recognize that the arbitration clause informs cardholders that: "[Y]**our ability to obtain information from us and to appeal is more limited in an arbitration than in a lawsuit. Other rights that you would have if you went to court may also not be available in arbitration.**" In addition, the first page of the credit card agreement prominently states: "**THIS AGREEMENT CONTAINS AN ARBITRATION PROVISION THAT MAY SUBSTANTIALLY LIMIT OR AFFECT YOUR RIGHTS.**" These warnings, however, do not make clear to cardholders that they are waiving significant substantive rights under the Wisconsin Consumer Act, *regardless whether a dispute proceeds in arbitration or litigation.*

¶ 46 Cross Country's arbitration clause also prohibits the plaintiffs from proceeding on a class-wide or representative basis, and from otherwise joining claims brought by other cardholders, regardless whether the plaintiffs proceed in litigation or arbitration.[FN13] This aspect of the arbitration clause also contributes to its unconscionability.

FN13. Thus, our decision does not address the situation where an arbitration clause prohibits class-wide litigation but expressly permits class-wide arbitration.

¶ 47 First, although Wisconsin courts have not addressed the question of whether an arbitration clause may be unconscionable based in whole or in part on the fact that the clause prohibits class actions, it is significant that our supreme court has concluded that even a limitation on one type of class action *relief* contributed to an arbitration clause's substantive unconscionability. *See Wisconsin Auto Title,* 290 Wis.2d 514, ¶ 73.

¶ 48 Second, we acknowledge that a majority of state and federal courts have enforced class action waivers and found them *not* unconscionable. We are, however, persuaded by what appears to be a growing minority of courts that a waiver of class-wide relief is a significant factor (and in at least one instance a determinative factor) in invalidating an arbitration provision as unconscionable.[FN14] These courts have recognized that the availability of class-wide relief is often the only means of vindicating consumer rights. *See, e.g., Discover Bank v. Superior Court,* 113 P.3d 1100, 1109 (Cal.2005) ("[C]lass actions and arbitrations are, particularly in the consumer context, often inextricably linked to the vindication of substantive rights."); *State ex rel. Dunlap v. Berger,* 567 S.E.2d 265, 278 (W.Va.2002) ("In many cases, the availability of class action relief is a *sine qua non* to permit the adequate vindication of consumer rights."). This is particularly so when the damages involved are comparatively small for each individual consumer. *See Discover Bank,* 113 P.3d at 1108, 1110; *Muhammad v. County Bank,* 912 A.2d 88, 97-98 (N.J.2006). Moreover, without the availability of a class-wide mechanism, many consumers may never realize that they have been wronged because they may not know that the defendant's conduct is illegal. *See Muhammad,* 912 A.2d at 100. [FN15] In addition, the prospect of class-wide relief "ordinarily has some deterrent effect on a manufacturer or service provider," *Powertel, Inc. v. Bexley,* 743 So.2d 570, 576 (Fla.Dist.Ct.App.1999), but any such effect is eviscerated by arbitration clauses like Cross Country's.

FN14. *See Leonard v. Terminix Int'l Co., L.P.,* 854 So.2d 529, 534, 538 (Ala.2002) (arbitration clause unconscionable where it deprived plaintiffs of a meaningful remedy by limiting certain damages and precluding eligibility for class action treatment); *Powertel, Inc. v. Bexley,* 743 So.2d 570, 574, 576-77 (Fla.Dist.Ct.App.1999) (arbitration clause unconscionable where it limited damages, removed defendant's exposure to class-wide remedies, and forced the plaintiff to waive statutory remedies, including state consumer act remedies), *review denied,* 763 So.2d 1044 (Fla.2000); *Muhammad v. County Bank,* 912 A.2d 88, 91, 101 (N.J.2006) (it was unconscionable for defendants to deprive plaintiff of the class-action mechanism, whether in litigation or arbitration, because the public interest at stake in plaintiff's and fellow consumers' ability to effectively pursue their statutory rights under state's consumer protection act overrides the defendants' right to enforce a bar on class arbitration); *see also Discover Bank v. Superior Court,* 113 P.3d 1100, 1103, 1110 (Cal.2005) (class action waivers, whether for litigation or arbitration, are unconscionable under "some circumstances," including when dispute involves small amounts of damages and plaintiffs allege that defendant has carried out a scheme to cheat large numbers of consumers out of individually small sums of money); *Kinkel v. Cingular Wireless LLC,* 857 N.E.2d 250, 254-56, 274-75 (Ill.2006) (class action waiver in arbitration clause unconscionable where it requires customer to arbitrate all claims, but does not reveal the cost, and contains a liquidated damages clause such that the plaintiff's only reasonable means of obtaining a complete remedy is as the representative or member of a class); *State ex rel. Dunlap v. Berger,* 567 S.E.2d 265, 270-71, 280 (W.Va.2002) (prohibitions on punitive damages and class action relief in arbitration agreement rendered application of agreement unconscionable).

FN15. Cross Country relies on the fact that the arbitration clause provides that the plaintiffs are free to bring a small claims action. We are not convinced that this provision is significant. Cross Country assumes that attorneys are willing to take small claims cases for plaintiffs on an individual basis or that plaintiffs are able to effectively represent themselves in small claims court against multimillion dollar national corporations such as Cross Country. Moreover, the allowance for a small claims action does nothing to change the arbitration clause's dictate that Delaware law be applied to all "Claims," thereby precluding the plaintiffs from asserting any claims or remedies under the Wisconsin Consumer Act. Therefore, the availability of a small claims action does not change our analysis.

¶ 49 We leave it to the circuit court on remand to determine whether this case ultimately is appropriate for class certification. Suffice it to say for our purposes here that the principles behind class-wide mechanisms of relief, whether in litigation or arbitration, all appear to have some relevance in the context of this case so far as we can discern from the limited record presently before us.

¶ 50 We conclude that by both (1) precluding the plaintiffs from asserting claims or remedies under the Wisconsin Consumer Act and (2) prohibiting all forms of class-wide relief, Cross Country has bound the plaintiffs to an arbitration clause that unduly restricts their remedies and is unreasonably favorable to Cross Country. The clause, therefore, is substantively unconscionable.

C. Cross Country's Preemption Argument

¶ 51 As a final matter, we briefly comment on Cross Country's argument that, to the extent the Wisconsin Consumer Act precludes the plaintiffs' ability to waive class action rights in an arbitration agreement, it is preempted by the Federal Arbitration Act.

¶ 52 The Wisconsin Consumer Act contains class action provisions. *See* Wis. Stat. § 426.110. The Act also generally provides that consumers may not waive "rights or benefits" under the Act. Wis. Stat. § 421.106(1). Cross Country thus interprets the Act to prohibit class action waivers like the one in its credit card agreement.

¶ 53 We need not reach the preemption issue that Cross Country's argument raises because our conclusion that Cross Country's arbitration clause is unconscionable is based on the common law of contracts, not on any prohibition on class action waivers under the Wisconsin Consumer Act. *See Wisconsin Auto Title,* 290 Wis.2d 514, ¶ 79 ("Our contract law on unconscionability does not single out arbitration provisions. We therefore conclude that the Federal Arbitration Act does not preempt our unconscionability analysis." (footnote omitted)).[FN16]

FN16. The Federal Arbitration Act provides that, in transactions "involving commerce," agreements to arbitrate are generally valid and enforceable "save upon such grounds as exist at law or in equity for the revocation of any contract." 9 U.S.C. § 2 (2005).

¶ 54 In any event, it appears that Cross Country's argument is of questionable merit in light of *Wisconsin Auto Title.* There, the supreme court addressed a substantially similar argument and explained that United States Supreme Court precedent "strongly suggests that the Wisconsin Consumer Act would not be preempted were the U.S. Supreme Court to address the issue." *Id.,* ¶ ¶ 83-84 (citing and quoting from *Perry v.. Thomas,* 482 U.S. 483, 492 n. 9 (1987)); *cf. Madison Beauty Supply, Ltd. v.. Helene Curtis, Inc.,* 167 Wis.2d 237, 241-44, 481 N.W.2d 644 (Ct.App.1992) (Federal Arbitration

Act preempted provisions in Wisconsin Fair Dealership Law to the extent that those provisions required that a case be tried in a judicial forum).

Conclusion

¶ 55 In sum, Wisconsin law applies to the question of whether Cross Country's arbitration clause is unconscionable and, applying Wisconsin law, we agree with the circuit court that the clause is procedurally and substantively unconscionable. We therefore affirm the circuit court's order denying Cross Country's motion to compel arbitration and stay court proceedings. Because this is a review of a non-final order, we remand for further proceedings.[FN17]

FN17. We ordered replacement briefing in this case so that the parties could address *Wisconsin Auto Title.* That same order requested that the parties address "whether *Atkins v. Swimwest Family Fitness Center,* 2005 WI 4, 277 Wis.2d 303, 691 N.W.2d 334, is relevant to this appeal and, if so, why." We made that request because of the possible comparison between aspects of procedural unconscionability and the *Atkins* court's reliance, in invalidating an exculpatory clause, on lack of opportunity to bargain. *See Atkins v. Swimwest Family Fitness C tr.,* 2005 WI 4, ¶ ¶ 25-26, 277 Wis.2d 303, 691 N.W.2d 334. In response, Cross Country argues that *Atkins* does not apply because Cross Country's arbitration clause is not an exculpatory clause. The plaintiffs assert that Cross Country's arbitration clause is exculpatory in nature and, therefore, unenforceable under *Atkins.* We do not reach the question of whether Cross Country's clause could be characterized as exculpatory or whether *Atkins* provides support for our conclusion here that the arbitration clause is unconscionable. Our silence should not be construed as an implicit opinion on these topics, one way or the other.

Order affirmed and cause remanded.

Recommended for publication in the official reports.

Wis.App.,2007.
Coady v. Cross County Bank

Slip Copy, 2007 WL 188993 (Wis.App.)

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Vasquez-Lopez v. Beneficial Oregon, Inc.Or.App.,2007.Only the Westlaw citation is currently available.

Court of Appeals of Oregon.
Panfilo VASQUEZ-LOPEZ and Maria C. Dominguez, husband and wife, Plaintiffs-Respondents Cross-Appellants,
v.
BENEFICIAL OREGON, INC., dba Beneficial Mortgage Corp., a foreign company, Defendant-Appellant Cross-Respondent.
021010108, A125270.

Argued and submitted June 20, 2006.
Decided Jan. 31, 2007.

Marilyn E. Litzenberger, Judge.
On appeal, affirmed. On cross-appeal, reversed and remanded with instructions to enter judgment awarding punitive damages in the amount found by jury.

Scott G. Seidman argued the cause for appellant-cross-respondent. With him on the briefs were Terry W. Baker, David S. Aman, and Tonkon Torp LLP.
Phil Goldsmith argued the cause for respondents-cross-appellants. With him on the briefs were Maureen Leonard, Mark E. Griffin, and Hope Del Carlo.
David F. Sugerman and Paul & Sugerman, PC, and Deborah M. Zuckerman, Washington, D.C., filed the brief amicus curiae for AARP Foundation, National Association of Consumer Advocates, Oregon Consumer League, and Oregon Trial Lawyers Association.
Justin M. Baxter and Baxter & Baxter, LLP, filed the brief amicus curiae for United Mexican States.
Hardy Myers, Attorney General, Mary H. Williams, Solicitor General, and Kaye E. McDonald, Assistant Attorney General, filed the brief amicus curiae for State of Oregon.

Before SCHUMAN, Presiding Judge, and LANDAU[FN*] and ORTEGA, Judges.

FN* Landau, J., vice Ceniceros, S. J.

SCHUMAN, P. J.
*1 Plaintiffs, immigrants who neither read nor speak English, brought this action against defendant Beneficial Oregon, Inc., a mortgage company, alleging that defendant engaged in predatory lending practices by fraudulently inducing them to borrow money at extremely disadvantageous interest rates and lying to them about what their monthly payments would cover. Defendant filed a motion to compel arbitration pursuant to an arbitration rider to the loan contract, but the trial court denied the motion on the ground that the arbitration rider was unconscionable. At the subsequent trial, the jury found in favor of plaintiffs and awarded them economic, noneconomic, and punitive damages, as well as attorney fees. The court remitted the punitive damages award, lowering it from $500,000 to $237,592.50.

Defendant appeals, assigning error to four trial court rulings: the denial of defendant's motion to compel arbitration; the grant of a directed verdict against two of defendant's affirmative defenses; the failure to further remit the punitive damages award to $100,000; and the award of enhanced attorney fees.[FN1] Plaintiffs cross-appeal, arguing that the punitive damages award should not have been remitted at all. We hold that the court correctly ruled that the arbitration rider was unconscionable and that defendant's affirmative defenses lacked merit as a matter of law. Regarding punitive damages, we hold that the trial court erred in remitting the jury's award. Finally, we hold that the trial court did not abuse its discretion in its award of enhanced attorney fees. We therefore affirm on appeal and, on cross-appeal, we reverse and remand.

FN1. Defendant concedes that plaintiffs presented sufficient evidence to allow the jury to find that defendant caused plaintiffs to enter into the loan transaction by misrepresenting its terms.

I. FACTS

The following facts are either uncontested or, where contested, consistent with the court's and the jury's conclusions. *Ball v. Gladden,* 250 Or 485, 487, 443 P.2d 621 (1968). Plaintiffs, who are husband and wife, immigrated to the United States from Mexico in the late 1980s. Since that time, both have worked in the same Portland factory, where, at the time of trial, each earned approximately $7.75 per hour. With help from family and friends, plaintiffs purchased a house in 1996. In 1999, after consulting with Ferran, a Spanish-speaking mortgage consultant known in the Latino community and not affiliated with defendant, they were able to refinance their home through Continental Savings Bank at a yearly interest rate of seven percent, which was lower than the interest rate on their original loan. The Continental loan was a prime loan, which reflected plaintiffs' favorable credit rating. Their monthly payment on the Continental loan was $612.08 plus an additional amount to pay mortgage insurance and taxes.

After lending plaintiffs money to finance the purchase of a vacuum cleaner, defendant began sending them advertisements for home loans. In the fall of 2000, because plaintiffs were in need of a new roof for their home, they contacted defendant for an appointment, hoping to obtain between $5,000 and $6,000 in financing. They met with senior account executive Joel Higgins, also a native of Mexico, who explained to plaintiffs in Spanish that they would be wise to obtain a second mortgage large enough to cover both the roof and other outstanding debts, allowing them to make only one payment per month. As a result, plaintiffs received a second mortgage from defendant in the amount of $17,948.44. The annual interest rate on that second mortgage was 23.23 percent.

*2 Shortly thereafter, in January 2001, Higgins advised plaintiffs that they could refinance their first mortgage and consolidate it with their second mortgage. Based on Higgins's representations about the new loan, plaintiffs believed that the interest rate would be lower than the rate they were then paying on their existing mortgages and that, if plaintiffs were to divide their monthly payment into two payments per month, their interest rate would drop even lower and they would pay off the balance of the loan in 17 years, as opposed to the standard 30 years. Higgins also told plaintiffs that their monthly payment would remain the same and that automatic payments for insurance and taxes would continue. Because they understood defendant's refinancing terms to be more favorable than those of their loan through Continental, plaintiffs were "convinced" by Higgins to enter the new loan arrangement. According to plaintiffs, Higgins reviewed with them the documents-all of which were in English-without explanation of the interest rate. The annual interest rate on the loan from defendant was 12.987 percent, and the monthly payment, without any withholding for property taxes or insurance, was $1,212.36.

Defendant's "Loan Repayment and Security Agreement" included an arbitration rider that provided, in part:

"By signing this Arbitration Rider, you agree that either Lender or you may request that any claim, dispute, or controversy (whether based upon contract; tort, intentional or otherwise; constitution; statute; common law; or equity and whether pre-existing, present or future), including initial claims, counter-claims, and third party claims, arising from or relating to this Agreement * * *, including the validity or enforceability of this arbitration clause, any part thereof or the entire Agreement ('Claim'), shall be resolved, upon the election of you or us, by binding arbitration * * *.

"* * * * *

"If you file a Claim, the filing costs shall be paid as follows: (a) Lender agrees to pay for the initial cost of filing the Claim up to the maximum amount $100.00[.] * * * The cost of up to one full day of arbitration hearings will be shared equally between us. Fees for hearings that exceed one day will be paid by the requesting party."

The arbitration rider required that any award resulting from arbitration "shall be kept confidential," and it prohibited class action claims. Like the rest of the "Loan Repayment and Security Agreement," it was written in English. Higgins explained some, but not all, of the terms of the arbitration rider to plaintiffs; he told them that the agreement required them to arbitrate any disputes, but that they "could go to court after going through arbitration."

In January 2002, plaintiffs received a bill from Multnomah County showing that they owed money for their property taxes. Plaintiffs consulted a family member, who translated the bill. They then sought advice from Ferran, the mortgage consultant who had helped plaintiffs with their Continental loan. Ferran explained the terms of the loan from defendant, at which point plaintiffs for the first time understood several of its disadvantageous terms. She recommended that plaintiffs pay the tax bill quickly. To further that objective, she helped plaintiffs find refinancing for their mortgage loan again, this time through Homestreet Bank, with a yearly interest rate of seven percent and an established escrow account for property taxes and insurance.

*3 Thereafter, plaintiffs filed suit against defendant, claiming, among other things, that defendant, through Higgins, told them that the interest rate was at most 7.8 percent when he knew it was actually much higher, and told them that the monthly payment included taxes and insurance when he knew that it did not. Defendant's answer included a number of affirmative defenses, including two that were based on allegations that plaintiffs, by giving defendant inaccurate tax returns, fraudulently induced defendant into making the loan. Defendant filed a motion to compel arbitration pursuant to the arbitration rider, but the trial court denied the motion on the ground that the arbitration agreement was unconscionable and therefore unenforceable.

A jury trial ensued. At the close of the evidence, plaintiffs moved for and were granted a directed verdict against defendant's affirmative defenses. The jury subsequently returned a verdict awarding plaintiffs $26,639.73 in economic damages, $5,000 in noneconomic damages, and $500,000 in punitive damages on their fraud claim, in addition to $28,544 in money damages on their claim under 15 USC sections 1635 to 1640, provisions of the federal Truth in Lending Act (TILA). Defendant then filed a motion for a new trial on the basis of its affirmative defenses and a motion to remit the punitive damages award to $100,000. The court denied the motion for a new trial but partially allowed the motion to remit, reducing the punitive damages in a supplemental judgment to $237,592.50. A second supplemental judgment was thereafter issued awarding plaintiffs $182,107.50 in attorney fees under their TILA claim, to which defendant unsuccessfully objected. This appeal and cross-appeal followed.

II. ENFORCEABILITY OF THE ARBITRATION RIDER

We begin with defendant's argument that the court erred in denying the motion to compel arbitration. The parties agree that plaintiffs' claims fall within the terms of the arbitration agreement; that the Federal Arbitration Act, 9 USC sections 1 to 16(FAA), controls the outcome, *see Southland Corp. v. Keating,* 465 U.S. 1, 104 S Ct 852, 79 L.Ed.2d 1 (1984) (FAA applies in state court); and that, under section 2 of the FAA, an arbitration agreement may be challenged in state court "upon such grounds as exist at [state] law or in equity for the revocation of any contract," including unconscionability. The parties disagree, however, about the proper forum in which to challenge the validity of an arbitration agreement by asserting its unconscionability and about whether the agreement in this case is unconscionable. Plaintiffs contend that the trial court correctly determined that the issue should be decided by the court, and that the court correctly decided that the arbitration rider was unconscionable and therefore unenforceable. Defendant argues that the issue of the arbitration clause's validity should have been submitted to the arbitrator, and that, in any event, even if the court was the proper forum, it erred in deciding that the arbitration agreement was unconscionable.

A. *Who decides whether the arbitration rider is enforceable?*

*4 The outcome of the dispute about the proper forum depends on how we interpret two United States Supreme Court cases: *Prima Paint v. Flood & Conklin,* 388 U.S. 395, 87 S Ct 1801, 18 L.Ed.2d 1270 (1967), and *Buckeye Check Cashing, Inc. v. Cardegna,* 546 U.S. 440, 126 S Ct 1204, 163 L.Ed.2d 1038 (2006) (*Buckeye*). In *Prima Paint,* the parties entered into a contract under which Flood & Conklin (F & C) was to provide consulting services to Prima Paint, in return for which Prima Paint would pay F & C a percentage of its receipts. *Prima Paint,* 388 U.S. at 397. The contract contained an arbitration clause. *Id.* at 398. Prima Paint received information that F & C was insolvent; instead of paying F & C, Prima Paint deposited the payment into an escrow account and notified F & C that, in Prima Paint's opinion, F & C had secured the contract through a fraudulent inducement. *Id.* F & C served Prima Paint with a "notice of intention to arbitrate"; Prima Paint then filed suit seeking rescission on the basis of fraudulent inducement and, at the same time, petitioned the court to enjoin F & C from proceeding to arbitration, arguing that the arbitration agreement had been fraudulently induced and was therefore unenforceable. *Id.* at 398-99. F & C, for its part, cross-moved to stay the court proceedings, pending arbitration, with the arbitrator empowered to decide whether the arbitration agreement was valid. *Id.* at 399. The District Court granted F & C's cross-motion, and the Second Circuit Court of Appeals dismissed Prima Paint's appeal.

The Supreme Court affirmed. Relying on section 4 of the FAA, the Court explained that a trial court

"is instructed to order arbitration to proceed once it is satisfied that 'the making of the agreement for arbitration or the failure to comply [with the arbitration agreement] is not in issue.' [9 USC § 4.] Accordingly, if the claim is fraud in the inducement of the arbitration clause itself-an issue which goes to the 'making' of the agreement to arbitrate-the federal court may proceed to adjudicate it. But the statutory language does not permit the federal court to consider claims of fraud in the inducement of the contract generally. * * * We hold, therefore, that in passing upon [an] application for a stay while the parties arbitrate, a federal court may consider only issues relating to the making and performance of the agreement to arbitrate. In so concluding, we not only honor the plain meaning of the statute but also the unmistakably clear congressional purpose that the arbitration procedure, when selected by the parties to a contract, be speedy and not subject to delay and obstruction in the courts."

Id. at 403-04 (footnotes omitted). The Court then held that the trial court did not err in letting the case go to arbitration because, "In the present case, no claim has been advanced by Prima Paint that F & C fraudulently induced it to enter into the agreement to arbitrate." *Id.* at 406. Thus, the teaching of *Prima Paint* appears to be that a challenge to the validity of an arbitration agreement may be adjudicated by the court only when that challenge is based on a *legal theory* that applies solely to the arbitration clause; if the challenge is based on a legal theory that applies to the entire contract, it goes to the arbitrator.

*5 After the trial court's decision in this case, the United States Supreme Court examined once again the question "whether a court or an arbitrator should consider the claim that a contract containing an arbitration provision is void for illegality." *Buckeye,* 546 U.S. at ___, 126 S Ct at 1207. In that case, two borrowers sued a payday loan company, alleging usurious interest rates and violations of Florida consumer protection laws; the loan company then moved to compel arbitration pursuant to a clause in the loan agreement. *Id.* The trial court denied the motion, and the Florida Supreme Court ultimately affirmed that decision. *Id.* As had several state and federal courts in the wake of *Prima Paint,* the Florida court had held that the *Prima Paint* rule did not extend to situations in which the contract containing the arbitration clause was alleged to be void as opposed to merely voidable. *Id.*

The Supreme Court rejected that reasoning, holding that, under *Prima Paint,* it was "irrelevant." *Buckeye,* 546 U.S. at ___, 126 S Ct at 1209. The Court explained:

"Challenges to the validity of arbitration agreements * * * can be divided into two types. One type challenges specifically the validity of the agreement to arbitrate. The other challenges the contract as a whole, either on a ground that directly affects the entire agreement (*e.g.,* the agreement was fraudulently induced), or on the ground that the illegality of one of the contract's provisions renders the whole contract invalid. Respondents' claim is of this second type. The crux of the complaint is that the contract as a whole (including its arbitration provision) is rendered invalid by the usurious finance charge."

Id. at 1208 (citation and footnote omitted). The Court characterized its holding as a "reaffirm[ation]" of the *Prima Paint* rule, which it stated as follows: "[A] challenge to the validity of the contract as a whole, and not specifically to the arbitration clause, must go to the arbitrator." *Id.* at 1210.

Although the Court in *Buckeye* stated that the case reaffirms *Prima Paint,* it also appears to add a significant gloss to that earlier case. While *Prima Paint* focused on the legal theory asserted in the claim, *Buckeye* focused on the scope of the claim: if the claim is directed solely at the arbitration agreement, then the court can decide the validity of the arbitration clause, but if the claim is directed at "the contract as a whole (including its arbitration provision)," then the arbitrator decides the validity of the arbitration clause. Read together, the cases establish that the court is the proper forum if the claim addresses only the arbitration clause or if it addresses the arbitration clause under a legal theory that is different from the theory that it deploys to challenge the entire contract.

Neither case, however, directly addresses a related issue: What is "the claim" to which the rule applies? At least two answers are plausible. "The claim" might refer to the complex of issues that the plaintiff raises in the complaint or other pleadings. Alternatively, the term might refer to all of the issues that are properly before the trial court when it is called on to decide whether to compel arbitration, whether those issues arise from pleadings or from subsequent motions.

*6 That question is dispositive in the present case. If "the claim" refers only to pleadings, the court erred. The legal theories in plaintiffs' pleadings did not challenge or otherwise implicate the arbitration clause. The complaint contained two relevant claims.[FN2] The first, for "Misrepresentation," alleged that defendant "made * * * false verbal representations" by telling plaintiffs that the interest rate would be fixed at no more than 7.8 percent when in fact it was much higher and by telling them that their monthly mortgage payment included taxes and insurance. The second claim, "Truth in Lending Act," alleged that defendant "failed to clearly and conspicuously deliver all material disclosures required by TILA" by making the same false representations alleged in the first complaint. Thus, if "the claim" as conceived by the Court means only those claims pleaded in the complaint, the case should have gone to arbitration, because "the claim" did not challenge the arbitration clause at all. The challenge to the arbitration rider arose only in response to defendant's motion to compel.

FN2. Two additional claims are unrelated to the loan contract *per se;* rather, they deal with defendant's actions after plaintiffs paid off the loan. They are not related to this appeal. The third claim alleged that, in violation of ORS 86.720(1), defendant failed to effectuate the reconveyance to plaintiffs of the estate of real property that had secured the loan. The fourth claim (unjust enrichment) alleged that defendant unlawfully continued to withdraw and retain funds from plaintiffs' checking account after the loan was paid off.

On the other hand, if "the claim" as conceived by the Court includes all of the issues properly before a court when it makes the decision whether to compel arbitration, then the trial court did not err. The gravamen of the relevant claims in the complaint-common-law misrepresentation, and misrepresentation under TILA-is that defendant concealed the truth from plaintiffs. The "claim" against the arbitration rider, on the other hand, is that it is unconscionable. Although, as we discuss below, deception in the process of contract formation can play a role in determining whether a contract or contractual provision is unconscionable, the "primary focus" of an unconscionability claim is not whether a party to a contract was deceived about what the terms were; rather, it is whether one party was disadvantaged by a "substantial disparity in bargaining power combined with terms that are unreasonably favorable to the party with the greater power." *Carey v. Lincoln Loan Co.,* 203 Or.App. 399, 422, 125 P3d 814 (2005), *rev allowed,* 341 Or 449 (2006). Thus, although there is some minor overlap between the legal theory deployed against the substantive terms of the loan contract and the theory deployed against the arbitration rider, the two theories are for all intents and purposes distinct. For that reason, if "the claim" encompasses all of the assertions properly before the trial court when it makes the decision whether to stay proceedings, then the court properly denied the motion to compel under *Prima Paint* and *Buckeye.*

One phrase in *Buckeye* indicates that the proper frame of reference is the complaint. After dividing the universe of claims into two categories, the Court explains, "Respondents' *claim* is of this second type. The crux of the *complaint* is that the contract as a whole (including its arbitration provision) is rendered invalid by the usurious finance charge." 546 U.S. at ___, 126 S Ct at 1208 (emphasis added). Further, as a term of art, "claim" sometimes refers to particular specifications within a complaint. *See, e.g.,* ORCP 13 A ("The pleadings are the written statements by the parties of the facts constituting their respective *claims* and defenses." (Emphasis added.)).

*7 However, we find these indications unpersuasive. The reference to the respondents' "complaint" in *Buckeye* is offset by other references in the opinion to a plaintiff's "challenge" to an arbitration clause. *Buckeye,* 546 U.S. at ___, 126 S Ct at 1208-10 (containing 15 references to the respondents' "challenge"). Further, the term "claim" generally encompasses more than the particular allegations contained in a complaint; the relevant definitions in *Black's Law Dictionary* are "[t]he aggregate of operative facts giving rise to a right enforceable by a court" and "[a]n interest or remedy recognized at law; the means by which a person can obtain a privilege, possession, or enjoyment of a right or thing." *Black's Law Dictionary* 264 (8th ed 2004). These definitions would include plaintiffs' assertion that they are entitled to be freed from the binding effect of the arbitration clause, regardless of when, in the litigation process, they make that assertion.

We also note that, in *Prima Paint,* the Court explained that the rule derives from the text of 9 USC section 4: "Under § 4, * * * the federal court is instructed to order arbitration to proceed once it is satisfied that 'the making of the agreement for arbitration * * * is not *in issue.*' " *Id.* at 403 (emphasis added). That language strongly suggests that, under the *Prima Paint* rule, the trial court should focus on what is *in issue* at the time it is called on to decide whether to stay proceedings pending arbitration, and not merely on the complaint and other pleadings. Finally, in both *Prima Paint* and *Buckeye,* the Court appeared to imply that, in determining whether the plaintiffs' "claim" focused on the contract generally or on the arbitration clause itself, the proper frame of reference includes not merely the pleadings, but subsequently filed motions as well. In both cases, the challenge to the arbitration clause arose not in the complaint but in subsequently filed motions to compel arbitration. The Court nonetheless implied that, if the challenge to the arbitration clauses had been distinct, the trial court could have decided arbitrability itself, despite the fact that the claim against the arbitration clauses arose after the pleadings. Had the Court believed that the focus was exclusively on the complaint, it could easily have disposed of both cases on that ground.

For the foregoing reasons, we conclude that the proper focus in applying the *Prima Paint* and *Buckeye* rule is the entire set of issues properly before the trial court at the time it is called upon to determine arbitrability, and not merely the pleadings. The trial court, properly considering the issues raised in plaintiffs' complaint as well as its response to the motion to compel arbitration, properly concluded that the challenge to the arbitration agreement was distinct from the challenges to the substantive provisions of the contract. For that reason, the court did not err in deciding the validity of the arbitration rider instead of staying proceedings while the arbitrator decided it. *Accord Jenkins v. First American Cash Advance of Georgia*, 400 F3d 868 (11th Cir2005), *cert den*, ___ U.S. ___, 126 S Ct 1457 (2006); *Luna v. Household Finance Corp. III*, 236 F Supp 2d 1166 (WD Wash 2002); *ACORN v. Household Intern., Inc.*, 211 F Supp 2d 1160 (ND Cal 2002); *contra Arellano v. Household Finance Corp.*, 2002 WL 221604 (ND Ill Feb 3, 2002).

B. *Is the arbitration rider unconscionable?*

1. *Unconscionability in Oregon law*

*8 The facts underlying a determination of unconscionability are reviewed for any evidence and, in this case, are undisputed. Whether those facts constitute unconscionability is a question of law to be assessed on the basis of facts in existence at the time the contract was made. *Best v. U.S. National Bank*, 303 Or 557, 560, 739 P.2d 554 (1987).

Unconscionability in Oregon, as elsewhere, has both a procedural and a substantive component. *W.L. May Co. v. Philco-Ford Corp.*, 273 Or 701, 707-08, 543 P.2d 283 (1975); *Dex Media, Inc. v. National Management Services*, 210 Or.App. 376, 387 n 4, ___P3d___(2007); *Carey*, 203 Or.App. at 422-23. Procedural unconscionability generally refers to the conditions of contract formation and

"focuses on two factors: oppression and surprise. Oppression arises from an inequality of bargaining power which results in no real negotiation and an absence of meaningful choice. Surprise involves the extent to which the supposedly agreed-upon terms of the bargain are hidden in a prolix printed form drafted by the party seeking to enforce the terms."

ACORN, 211 F Supp 2d at 1168 (invalidating under California law an arbitration rider identical to the one in this case) (internal quotation marks and citations omitted). Substantive unconscionability generally refers to the terms of the contract as opposed to the circumstances of formation and "focuses on the one-sided nature of the substantive terms." *Id.* at 1169. In some jurisdictions, unconscionability requires both components. *See, e.g., id.* at 1168. In others, the courts may invalidate a contract or a contract term on either procedural or substantive grounds. *See, e.g., Luna*, 236 F Supp 2d at 1174 (invalidating under Washington law an arbitration rider identical to the one in this case). Oregon has not adopted a formal template. Rather, this court has described the analysis as follows:

"The primary focus * * * appears to be relatively clear: substantial disparity in bargaining power, combined with terms that are unreasonably favorable to the party with the greater power may result in a contract or contractual provision being unconscionable. Unconscionability may involve deception, compulsion, or lack of genuine consent, although usually not to the extent that would justify rescission under the principles applicable to that remedy. The substantive fairness of the challenged terms is always an essential issue."

Carey, 203 Or.App. at 422-23; *accord Dex Media, Inc.*, 210 Or.App. at 387 n 4. Thus, both procedural and substantive unconscionability are relevant, although only substantive unconscionability is absolutely necessary. With that proviso, each case is decided on its own unique facts.

2. *Procedural unconscionability: Disparity in bargaining power*

The circumstances under which the contract in this case was formed strongly suggest unconscionability. Plaintiffs were given a standard form "take it or leave it" contract drafted by defendant-a classic contract of adhesion, *Reeves v. Chem Industrial Co.*, 262 Or 95, 100-01, 495 P.2d 729 (1972) (defining adhesion contract), which, in some jurisdictions, is *per se* procedurally unconscionable, *see, e.g., Ting v. AT & T,* 319 F3d 1126, 1148 (9th Cir), *cert den,* 540 U.S. 811 (2003) (California). Even if defendant had countenanced the possibility of allowing particular borrowers such as plaintiffs to bargain for changes to individual terms-a supposition for which there is no support in the record or in common experience-plaintiffs had neither the ability nor the motivation to do so. They lacked ability because the contract was in a language that they did not understand, and they lacked motivation because defendant misled them into thinking that the terms expressed in that language were favorable.

*9 Further, the trial court found as fact (and evidence supports the finding) that plaintiffs "were not told that the arbitration would be binding." Instead, they were fundamentally misled by a half-truth: they were told that they could "go to court after submitting to arbitration." Although Oregon statutes do provide that the losing party in an arbitration has the opportunity to "go to court" afterward, the grounds for obtaining the vacation of an award are extremely narrow in comparison with the scope of review available to litigants in court.[FN3] Thus, the circumstances of contract formation in this case involved both oppression and surprise.

FN3. ORS 36.705 establishes the only grounds for vacating an arbitration award:
"(1) Upon petition to the court by a party to an arbitration proceeding, the court shall vacate an award made in the arbitration proceeding if:
"(a) The award was procured by corruption, fraud or other undue means;
"(b) There was:
"(A) Evident partiality by an arbitrator appointed as a neutral arbitrator;
"(B) Corruption by an arbitrator; or
"(C) Misconduct by an arbitrator prejudicing the rights of a party to the arbitration proceeding;
"(c) An arbitrator refused to postpone the hearing upon showing of sufficient cause for postponement, refused to consider evidence material to the controversy or otherwise conducted the hearing contrary to ORS 36.665 so as to prejudice substantially the rights of a party to the arbitration proceeding;
"(d) An arbitrator exceeded the arbitrator's powers;
"(e) There was no agreement to arbitrate * * *; or
"(f) The arbitration was conducted without proper notice of the initiation of an arbitration as required in ORS 36.635 so as to prejudice substantially the rights of a party to the arbitration proceeding."

Defendant argues that the legal significance of plaintiffs' inability to understand English should be discounted for two reasons: first, because defendant, as a non-fiduciary, had no duty to explain the terms to plaintiffs; and, second, because plaintiffs had a three-day "cooling off" period before the contract was final. The first argument is meritless. As defendant surely recognizes, there is a significant legal difference between a duty to explain and a duty to refrain from lying. The second argument has some force, but not much: it amounts to defendant's contention that there is nothing unconscionable in lying to customers or clients if the lie does not become binding for three days. All things considered, we conclude that, because the parties had unequal bargaining power and because defendant affirmatively concealed the arbitration rider's terms, the arbitration rider was to some significant degree procedurally unconscionable.

3.*Substantive unconscionability: Unreasonable terms*

By itself, that fact would not necessarily render the arbitration rider unenforceable. Under Oregon law, as noted above, procedural unconscionability is relevant, but the emphasis is clearly on substantive unconscionability: "The substantive fairness of the challenged terms is always an essential issue." *Carey,* 203 Or.App. at 423. Here, plaintiffs' case for the substantive unconscionability of the arbitration rider rests on the argument that three of its terms are unreasonably favorable to defendant: the class action ban, the cost-splitting provision, and the confidentiality requirement.

a. Class action ban

On its face, the class action ban applies equally to plaintiffs and defendant:
"No class actions or joiner [*sic*] or consolidation of any Claim with the claim of any other person are [*sic*] permitted in arbitration without the written consent of you and us."

We are reminded of the observation by a character in an Anatole France novel that "the majestic equality of the laws * * * forbid[s] rich and poor alike to sleep under the bridges, to beg in the streets, and to steal their bread." Anatole France, *The Red Lily,* 95 (Winifred Stephens trans., Frederic Chapman Ed. 1894). Although the arbitration rider with majestic equality forbids lenders as well as borrowers from bringing class actions, the likelihood of the lender seeking to do so against its own customers is as likely as the rich seeking to sleep under bridges.

*10 Further, the opportunity that the class action ban denies to borrowers is, in many instances, a crucial one, without which many meritorious claims would simply not be filed. As the United States Supreme Court has noted, " '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.'' ' *Amchem Products, Inc. v. Windsor,* 521 U.S. 591, 617, 117 S Ct 2231, 138 L.Ed.2d 689 (1997) (quoting *Mace v. Van Ru Credit Corp.,* 109 F3d 338, 344 (7th Cir1997)); *accord Deposit Guaranty Nat. Bank v. Roper,* 445 U.S. 326, 338, 100 S Ct 1166, 63 L.Ed.2d 427 (1980) ("[A class action] may motivate [plaintiffs] to bring cases that for economic reasons might not be brought otherwise, [thereby] vindicating the rights of individuals who otherwise might not consider it worth the candle to embark on litigation in which the optimum result might be more than consumed by the cost."). We find the observation by then-Justice Mosk of the California Supreme Court to be as trenchant and as relevant today as it was when he wrote it 35 years ago:

"Frequently 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 is 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."

Vasquez v. Superior Court of San Joaquin County, 4 Cal 3d 800, 808, 94 Cal Rptr 796, 484 P.2d 964, 968-69 (1971).

Defendant contends that the class action ban is not unconscionable for four reasons: First, it argues, even if individual plaintiffs are unlikely to bring small claims to an arbitral forum, defendant still remains vulnerable to consumer protection actions by the Oregon Department of Justice; second, class actions are cumbersome and it is therefore impractical to resolve them in arbitration; third, TILA provides for attorney fees for prevailing plaintiffs, so borrowers with small claims will be able to vindicate their rights despite the cost of arbitration; and fourth, the ban is irrelevant to plaintiffs' claim because they did not file a class action.

We find none of these arguments to be persuasive. As the Attorney General points out in an *amicus curiae* brief for the State of Oregon, the Department of Justice cannot represent private individual plaintiffs, even those seeking class relief. *See* ORS 180.060. Nor has an Oregon appellate court held that either the Unfair Trade Practices Act, ORS 646.605 to 646.652, or the Consumer Finance Act, ORS 725.010 to 725.910, provides for actions of the type that might serve as an analog to a class action against a predatory lender. Further, the Attorney General observes that the amount of consumer fraud in the state far exceeds the Department of Justice's ability to investigate and prosecute it; therefore, the possibility of state action cannot reliably serve as a substitute for private actions.

*11 Regarding the unsuitability of class actions in arbitral fora, we note that the United States Supreme Court has observed that class-wide relief may be sought in arbitration. *Green Tree Financial Corp. v. Bazzle,* 539 U.S. 444, 452-53, 123 S Ct 2402, 156 L.Ed.2d 414 (2003). Further, all three of the arbitration services specified in defendant's arbitration rider have procedures for handling class actions.[FN4] We agree with the court in *Discover Bank v. Superior Court,* 36 Cal 4th 148, 172, 113 P3d 1100, 1116, 30 Cal Rptr 3d 76 (2005), that "classwide arbitrations are workable and appropriate in some cases."

FN4. *See* American Arbitration Association, *American Arbitration Policy on Class Actions* (2005), http://www.adr.org/Classarbitrationpolicy (AAA class action procedures); National Arbitration Forum, *Code of Procedure* 20 (2006), http:// www.adrforum.com/users/naf/resources/200 60501CodeOfP rocedure072106.pdf (National Arbitration Forum rule permitting consolidation of claims); JAMS, *Class Action Mass Tort* (last visited Jan 24, 2007), http:// www.jamsadr.com/welcome/class.asp (JAMS/Endispute class action procedures).

With respect to the argument that attorney fees under TILA provide adequate incentive for small-stake plaintiffs to pursue claims against defendant through arbitration, we are simply unconvinced that any significant number of plaintiffs with claims of under, say, $50.00, would be sufficiently motivated to spend the time and risk the expense necessary to take the claim to arbitration. Finally, the fact that plaintiffs have not filed a class action is irrelevant; the unconscionability of a contract is gauged as of the time it is formed. *Best*, 303 Or at 560. In short, the class action ban is unilateral in effect and, more significantly, it gives defendant a virtual license to commit, with impunity, millions of dollars' worth of small-scale fraud.

b. Cost-sharing

The unconscionability of the arbitration rider's class action provision is magnified by its cost-sharing provision:

"If Lender files a Claim, Lender shall pay all the filing costs. If you file a Claim, the filing costs shall be paid as follows: (a) Lender agrees to pay for the initial cost of the [*sic*] filing the Claim up to the maximum amount [of] $100.00; (b) for the filing costs over $100.00, such additional cost shall be divided equally between us up to the amount charged by the arbitration administrator for a Claim equal to your loan amount; and (c) all costs over the amount charged by the arbitration administrator for a Claim equal to your loan amount shall be paid by you. The cost of up to one full day of arbitration hearings will be shared equally between us. Fees for hearings that exceed one day will be paid by the requesting party."

The trial court found this provision unconscionable on the basis of plaintiffs' uncontradicted affidavit demonstrating that, by the second hour of the second day of arbitration, they would owe $1,000 in arbitration fees and that, with their current earnings and expenses, they would need six months to save that amount of money. Defendant does not dispute those facts. Rather, it argues that the cost-sharing provision cannot be unconscionable because defendant volunteered during litigation to waive the provision and pay costs itself, and, in any event, plaintiffs failed to demonstrate that the cost of arbitration would be larger than the cost of pursuing their claim in court. Plaintiffs respond that defendant's offer to waive the cost of arbitration after the case began is irrelevant in light of the rule that unconscionability is gauged as of the time of contract formation and that, regardless, they adequately demonstrated that arbitration would be significantly more expensive than a trial.

*12 Defendant's first argument is transparently meritless. Oregon law clearly establishes that unconscionability "applies to contract terms rather than to contract performance." *Best*, 303 Or at 560. Thus, defendant cannot rehabilitate an unconscionable contract term long after the contract has been in effect and a dispute as to that term has arisen. Otherwise, defendant would be free to proffer standard form contracts filled with unconscionable terms and "then make the bare minimum modifications necessary to obtain the court's approval." *LeLouis v. Western Directory Co.*, 230 F Supp 2d 1214, 1225 (D Or 2001); *accord Morrison v. Circuit City Stores, Inc.*, 317 F3d 646, 676-77 (6th Cir2003).

Defendant's second argument-that plaintiffs have not shown that the cost of arbitration is prohibitive-is similarly unpersuasive. An arbitration agreement is unenforceable under the FAA if it denies a litigant the opportunity to vindicate his or her rights in the arbitral forum. *Green Tree Financial Corp.-Ala. v. Randolph*, 531 U.S. 79, 90, 121 S Ct 513, 148 L.Ed.2d 373 (2000) (*Green Tree*). As the Court has noted, "[i]t may well be that the existence of large arbitration costs" effects such a denial. *Id.*[FN5] Most courts considering the question have held that it does. *See, e.g., Ting*, 319 F3d at 1151 (applying California law); *Morrison*, 317 F3d at 663 (applying Tennessee law); *Circuit City Stores, Inc. v. Adams*, 279 F3d 889 (9th Cir), *cert den*, 535 U.S. 1112 (2002) (applying California law); *Luna*, 236 F Supp 2d at 1181-82 (applying Washington law; cost-sharing provision identical to the one in this case); *LeLouis*, 230 F Supp 2d at 1223-24 (applying Oregon law); *ACORN*, 211 F Supp 2d at 1173-74 (applying California law; cost-sharing provision identical to the one in this case). Indeed, some courts have held that the existence of a cost-sharing provision amounts to a *per se* denial of access to the arbitral forum. *See Morrison*, 317 F3d at 658-59 (citing cases). Other courts have adopted a case-by-case approach. *See, e.g., id.* at 663. We need not choose between these two options, however, because, as we explain below, even under the option more favorable to defendant-the case-by-case option-the clause is unconscionable.

FN5. *Green Tree* deals with federal civil rights statutes, but we see no reason why it should not be extended to state law involving, for example, predatory lending claims, as was done in *Smith v. Beneficial Ohio, Inc.*, 284 F Supp 2d 875, 879 (S D Oh 2003) (extending *Green Tree* to allegedly predatory lender using an arbitration clause identical to the one at issue in this case).

Denial of access to an arbitral forum occurs when the cost of arbitration is large in absolute terms, but also, comparatively, when that cost is significantly larger than the cost of a trial; otherwise, it is the existence of the claim itself and not the forum choice that deters the plaintiff. Defendant points out that the Court in *Green Tree*, while acknowledging the possibility that excessive arbitration costs could make an arbitration agreement unenforceable, also held that, because the record in that case was silent with respect to costs, it was "too speculative to justify the invalidation of the arbitration agreement." 531 U.S. at 91. Thus, defendant argues, because plaintiffs in this case did not present any evidence that an arbitration would cost more than a trial, their claim that the cost-sharing term is unconscionable must fail.

*13 We disagree. We find the court's reasoning in *LeLouis* to be persuasive:

"The arbitration agreement in *Green Tree* did not specify the proportion of arbitration costs to be borne by the plaintiff, the organization that would conduct the arbitration, or the rules that would govern the arbitration. Consequently, the Court would not only have had to estimate the costs involved, but also had to speculate as to the manner in which those costs were to be divided. In the present case, although the specific fee schedule has not been determined, the allocation of costs is stated in the agreement."

LeLouis, 230 F Supp 2d at 1224. In this case, as in *LeLouis*, the arbitration agreement *does* allocate costs; no speculation in that respect is necessary. That being the case, we can state with confidence that plaintiffs' cost of arbitration would not only be high in the absolute sense-plaintiffs' estimate of $1000, or six months' savings, stands uncontradicted-but high in comparison to a trial. That is because, regardless of whether filing fees are relatively equal in court and arbitration, the fact remains that most of the cost involved in an arbitration will be the arbitrator's fees; in court, by contrast, neither party has to pay for the judge. Under the terms of the arbitration, plaintiffs will have to pay half of the arbitrator's fee for the first day and all of the fees thereafter. That fact alone demonstrates that the cost-sharing provision is sufficiently onerous to act as a deterrent to plaintiffs' vindication of their claim. *Accord ACORN*, 211 F Supp 2d at 1174 (cost of arbitrating claim under terms of arbitration rider identical to the one in this case would be "approximately ten times" cost of going to court); *Luna*, 236 F Supp at 1182 (same).

c. Confidentiality

The arbitration rider provides, "The parties agree that the award shall be kept confidential." Citing *Ting*, 319 F 3d at 1151, the trial court ruled that the confidentiality provision is substantively unconscionable because such provisions "usually favor companies over individuals." Defendant maintains, however, that declaring confidentiality provisions unconscionable would render many arbitration agreements unenforceable and, further, that the provision is actually favorable to plaintiffs because it allows them and other borrowers to maintain the privacy of their financial affairs. *See, e.g., Iberia Credit Bureau, Inc. v. Cingular Wireless*, 379 F3d 159, 175 (5th Cir2004) ("Confidentiality can be desirable to customers.").

We conclude that the confidentiality provision is not only facially even-handed, but also roughly even-handed in effect. The argument in favor of unconscionability relies on the proposition that significant benefits in arbitrations flow to "repeat players." *See Ting v. AT & T*, 182 F Supp 2d 902, 932 (ND Cal 2002), quoting Llewellyn Joseph Gibbons, *Private Law, Public "Justice": Another Look at Privacy, Arbitration, and Global E-Commerce*, Ohio St J on Disp Resol 769, 786-87 (2000) (so concluding based on empirical data). "Repeat players," Gibbons theorizes, tend to accumulate large quantities of information regarding the preferences of arbitrators, the relative force of particular arguments, and the existence of precedential rulings. *See id.*; *Cole v. Burns Intern. Security Services*, 105 F3d 1465, 1476 (DC Cir1997). One-time players can acquire access to the same information only if the results of arbitrations are public. Confidentiality provisions, therefore, favor repeat players by preserving their superior knowledge base. *Ting*, 319 F3d at 1151; *Luna*, 236 F Supp 2d at 1180-81; *ACORN*, 211 F Supp 2d at 1171-72.[FN6]

FN6. One commentator argues:

> "The typical arbitral requirement of privacy can itself be viewed as a substantive term that favors the company over the consumer. Where one party wants publicity and the other party wants privacy, it is likely to be the plaintiff/consumer who favors publicity, as a way of informing others of the way in which she was harmed by an unethical broker, a negligent pest exterminator, or a careless doctor. The consumer may also wish to set a precedent to prevent the company from engaging in future similar wrongdoing or to publicize wrongdoing by the company. Further, a consumer's attorney often relies on public information gained from other lawsuits to build her own claims of negligent or intentional misconduct. Repeat-player companies can gain similar information through private channels. Thus, by requiring private arbitration the company may again deprive the consumer of certain relief she might have obtained through litigation."
>
> Jean R. Sternlight, *Panacea or Corporate Tool?: Debunking the Supreme Court's Preference for Binding Arbitration*, 74 Wash U L Q 637, 686 (1996).

*14 Although there is some force to this argument, it fails to account for several countervailing considerations. First, the confidentiality provision in the present case does not apply to facts, parties, arbitrators' identities, arguments, or outcomes (in the sense of who wins and who loses); rather, it applies only to the amount of the award. Second, it fails to take into consideration the fact that the nonconfidential information, while not officially reported, is widely available to plaintiffs' lawyers through informal networks and organizations. Thus, any advantage conferred on repeat players and their counsel is marginal and, we conclude, it is roughly offset by the advantage that privacy about their financial affairs confers on plaintiffs.

4. *Severance or nonenforcement*

The arbitration rider is infected with serious procedural and substantive unfairness. Plaintiffs and defendant entered the agreement with significant disparity of bargaining power. Defendant affirmatively concealed key aspects of the agreement, including the fact that it called for mandatory arbitration with no opportunity for meaningful judicial review. Moreover, two of the provisions that it concealed-the class action ban and the cost-sharing requirement-conferred important benefits to defendant and imposed significant detriments to plaintiffs. In sum, the arbitration rider is unconscionable.

That being the case, the trial court could have severed the unconscionable provisions or declared the entire rider to be unenforceable. *See* ORS 72.3020(1) (so stating under UCC); *Restatement (Second) of Contracts*, § 184 comment b (1981). The trial court chose the latter option; defendant assigns error to that choice. In doing so, however, it faces the difficult task of persuading us that the court's decision was an abuse of discretion, that is, that the choice was not among the lawful alternatives available to the court. *State v. Rogers*, 330 Or 282, 312, 4 P3d 1261 (2000). We are not persuaded. The court explained its choice as resulting, at least in part, from the fact that the entire arbitration rider was "permeate[d]" with "significant procedural defects." As described above, we agree. Merely excising the offensive substantive provisions would not cure that unfairness; the resulting agreement would still have come about through unequal bargaining power and deception regarding the availability of judicial review.[FN7] Further, severing the unconscionable provisions would leave the arbitration rider with no provision regarding who would pay costs; to fill that gap, the trial court would have had to rewrite the contract. Thus, even if defendant is correct that the better option would have been to sever the unconscionable provisions-a proposition with which we do not agree-the trial court's decision to choose unenforceability was not an abuse of discretion.

> FN7. An additional consideration is that curing unconscionable contracts by severing the unconscionable provisions provides those who draft such contracts no disincentive to including such provisions in the first instance.

III. DEFENDANT'S AFFIRMATIVE DEFENSE

As an affirmative defense, defendant claimed that plaintiffs were barred from recovering damages because they fraudulently induced defendant to enter into the loan transaction.[FN8] The defense was based on the allegation that plaintiffs, as part of their loan application, asserted that they had fully disclosed all of their outstanding financial obligations when, in fact, they knowingly concealed a tax liability to the federal government, with the intention that doing so would induce defendant to approve their loan application. The trial court granted plaintiffs' motion for a directed verdict on the defense. Defendant renewed its argument by moving for a new trial after the jury returned its verdict. That motion was denied. Defendant assigns error to both rulings, and both assignments rest on the same theory.

> FN8. Defendant raised other affirmative defenses, the denial of only one of which is assigned as error: defendant's claim that plaintiffs' recovery was barred by the doctrine of unclean hands. Although defendant assigns error to the court's denial of that defense, it presents no argument for that assertion, and we therefore do not address it.

***15** According to defendant, plaintiffs had a financial liability to the federal government because their 1999 federal income tax returns, copies of which were submitted to defendant along with their loan application, fraudulently stated that each plaintiff was a head of household, each had two children, and that the four children were living with them. Those statements were misrepresentations, defendant contends, because plaintiffs are married and therefore cannot qualify as heads of households, and because they had nieces and nephews in Mexico but no children living with them. Because plaintiffs' tax returns contained these misstatements, they had a back-taxes liability that they should have disclosed.

The directed verdict for plaintiffs was appropriate only if they were entitled to prevail against the defenses as a matter of law on the basis of the evidence and all reasonable inferences that may be drawn from it, viewed in the light most favorable to defendant. *Shockey v. City of Portland,* 313 Or 414, 422-23, 837 P.2d 505 (1992), *cert den,* 507 U.S. 1017 (1993). Under that standard, we conclude that the trial court did not err.

That is so for several reasons. Most fundamentally, defendant does not even allege, much less attempt to prove, that plaintiffs had an actual undisclosed financial liability. Rather, defendant asserts that it "submitted ample evidence that * * * plaintiffs were aware of the *potential* tax liability." (Emphasis added.) That assertion is unaccompanied by any assertion that plaintiffs were asked to disclose *potential* liabilities or that defendant considered *potential* tax liabilities as relevant to its decision whether or not to make the loan. Nor is there any evidence that the *potential* tax liability, if there was one, would ever turn into an actual liability, that is, that the government would pursue penalties for underpayment or reimbursement for excessive refunds.

Over and above that fundamental flaw, defendant's argument has several additional shortcomings. To prevail on its affirmative defense of fraud, defendant needed to prove by clear and convincing evidence "(1) a representation [by plaintiffs]; (2) its falsity; (3) its materiality; (4) [plaintiffs'] knowledge of its falsity or ignorance of its truth; (5) [their] intent that it should be acted on by [defendant] and in the manner reasonably contemplated; (6) [defendant's] ignorance of its falsity; (7) [defendant's] reliance on its truth; (8) [defendant's] right to rely thereon; (9) and [defendant's] consequent and proximate injury." *Conzelmann v. N.W.P. & D. Prod. Co.,* 190 Or 332, 350, 225 P.2d 757 (1950); *OPERB v. Simat, Helliesen & Eichner,* 191 Or.App. 408, 423-24, 83 P3d 350 (2004). Defendant presented no evidence from a tax expert (or anybody else) that plaintiffs' tax returns were, in fact, false; without such evidence, and contrary to defendant's assertion that "[a] reasonable juror plainly would understand that such misconduct exposed plaintiffs to potential tax liability," a jury would have had no basis to conclude that a household can have only one "head"; that a "head of household" cannot be married; or that nephews and nieces living in Mexico cannot be claimed as children.[FN9] Thus, no reasonable juror could have found on the evidence presented that plaintiffs made a false representation. In addition, even if it could be inferred that plaintiffs made a false representation, there is no evidence from which a jury could infer that, because of that representation, they potentially owed money to the federal government and therefore concealed a potential liability. That conclusion would require facts showing that plaintiffs' tax liability as a childless married couple was more than their liability as two heads of household with two dependents each, *and* that the federal government did not, at the time of trial, owe plaintiffs a refund on some independent ground so as to offset any outstanding liability.

> FN9. Under 26 USC sections 152(b)(3)(A) and (d)(2)(E), nieces and nephews living in a country contiguous to the United States who meet other criteria qualify as "dependents."

***16** Further, defendant presented no evidence to contradict plaintiffs' testimony that they did not prepare or read their own tax returns, but had them prepared by a friend to whom they told nothing but true facts, and whom they instructed to prepare the returns accurately and honestly. Thus, no reasonable juror could have found that plaintiffs knew that their returns were false, if, indeed, they were. Nor did defendant present any evidence that plaintiffs submitted their tax returns to defendant, whose representative knew that they were married, with an intent to defraud *defendant* by concealing a potential liability. The tax returns were submitted for the purpose of verifying plaintiffs' income, not their marital status, and were submitted only because plaintiffs could not find W-2 forms. If the tax returns showed an intent to defraud, it was the federal government and not defendant that was the fraud's target, and the intent was to reduce a tax obligation, not to obtain a loan.

Finally, defendant presented no evidence that it had a right to rely on plaintiffs' allegedly false returns. Under Oregon law, a party asserting fraud must prove by clear and convincing evidence not only that it relied on the other party's misrepresentation, but that the reliance was reasonable under the circumstances. *OPERB,* 191 Or.App. at 428. One of the circumstances to be taken into consideration is the sophistication of the party asserting fraud.

"[I]f a party is a large and sophisticated organization that has at its disposal a small army of attorneys, accountants and hired experts to evaluate a business deal, that party * * * probably 'ha[s] or can obtain equal means of information and [is] equally qualified to judge' the merits of a business proposition, thus making reliance on misstatements by another party unjustified. *Coy* [*v. Starling,* 53 Or.App. 76, 81-82, 630 P.2d 1323, *rev den,* 291 Or 662 (1981)]."

OPERB, 191 Or.App. at 428. Here, the evidence demonstrates that defendant is a sophisticated organization that employs underwriters whose job includes reviewing loan applications for misrepresentation. Defendant's witness testified:

"[W]e've always had a policy in regards to misrepresentation of information. If information is determined it might be misrepresented by the underwriter, they are to stop the underwriting process and escalate it up through their unit manager to the regional director level, where it is forwarded over to what is titled our fraud department for investigation."

The trial court ruled that, on these facts, no reasonable juror could find by clear and convincing evidence that defendant's reliance was reasonable:

"[I]t is clear that [defendant] had sufficient resources at its disposal to detect any existing liabilities plaintiffs had not disclosed either in their loan application or in their conversations with [defendant's] representative.

"Equally so, there is no evidence in the record that [defendant] could not have used these resources to investigate the discrepancies apparent from the information submitted to the underwriting department concerning plaintiffs' 2001 loan application, namely that plaintiffs' tax returns indicated that they were each claiming head of household status for 1999, although they were presently married and it was known that they had resided at the same residence for several years. Likewise, there was no evidence presented that it was reasonable for the underwriter to have overlooked these discrepancies. The same is true with respect to whether plaintiffs did or did not have the dependent children they claimed on their tax return."

*17 We agree. Thus, for each of the reasons discussed, we hold that the court did not err in granting plaintiffs' motion for a directed verdict on defendant's affirmative defense of fraud. It follows that the court similarly did not err in denying defendant's motion for a new trial based on the assertedly erroneous grant of the directed verdict.

IV. PUNITIVE DAMAGES

The jury awarded plaintiffs $31,639.73 in compensatory damages (including $5,000 in noneconomic damages) and $500,000 in punitive damages. Defendant filed a motion for remittitur, arguing that a punitive damage award of such magnitude violated the Due Process Clause of the United States Constitution and should be reduced to $100,000. Plaintiffs, in response, argued that the jury's award should stand. The trial court, applying the standards set out in *State Farm Mut. Automobile Ins. Co. v. Campbell,* 538 U.S. 408, 123 S Ct 1513, 155 L.Ed.2d 585 (2003) (*State Farm*), remitted the damages to $237,592.50, relying principally on the fact that the ratio between the punitive damages and compensatory damages awarded by the jury was approximately 15:1, whereas *State Farm* instructs that "few awards exceeding a single-digit ratio * * * will satisfy due process," *id.* at 425, and observed that a punitive damages award "of more than four times the amount of compensatory damages might be close to the line of constitutional impropriety." *Id.* at 425 (citing *Pacific Mutual Life Insurance Co. v. Haslip,* 449 U.S. 1, 23-24, 111 S Ct 1032, 113 L.Ed.2d 1 (1991) (*Haslip*)). The trial court's award of $237,592.50 was approximately 7.5 times the amount of the actual compensatory damages that plaintiffs suffered. Defendant appeals, arguing that even a 7.5 to 1 ratio is excessive.[FN10] Plaintiffs cross-appeal, arguing that the jury's award was not excessive under any standard.

> FN10. Defendant argues only that the amount of the award violates its rights under the substantive aspect of the Due Process Clause; it does not argue that the court violated its rights under the procedural aspect of the Clause. *See Parrott v. Carr Chevrolet, Inc.,* 331 Or 537, 550 n 9, 17 P3d 473 (2001) (explaining difference).

In reviewing an award of punitive damages, we "must resolve all disputes regarding facts and factual inferences in favor of the jury's verdict and then determine, on the facts as the jury was entitled to find them, whether the award violates the legal standard of gross excessiveness." *Parrott v. Carr Chevrolet, Inc.,* 331 Or 537, 556-57, 17 P3d 473 (2001). The latter question is a legal issue which we review for errors of law-what the federal courts call "de novo" review. *Waddill v. Anchor Hocking, Inc.,* 190 Or.App. 172, 176-77, 78 P3d 570 (2003).

The standard of gross excessiveness derives from the Due Process Clause, which prohibits punitive damages that are grossly excessive in relation to the state's legitimate interest in punishing unlawful conduct and deterring its repetition. *BMW of North America, Inc. v.. Gore,* 517 U.S. 559, 568, 116 S Ct 1589, 134 L.Ed.2d 809 (1996) (*Gore*). Determination of gross excessiveness has evolved into a more or less formulaic analysis summarized in *State Farm.* The appropriate guideposts for a court to consider are "(1) the degree of reprehensibility of the defendant's misconduct; (2) the disparity between the actual and potential harm suffered by the plaintiff and the punitive damages award; and (3) the difference between the punitive damages awarded by the jury and the civil penalties authorized or imposed in comparable cases." 538 U.S. at 418. To determine a defendant's reprehensibility, *State Farm* instructs courts to "consider[ ] whether: the harm caused was physical as opposed to economic; the tortious conduct evinced an indifference to or a reckless disregard of the health or safety of others; the target of the conduct had financial vulnerability; the conduct involved repeated actions or was an isolated incident; and the harm was the result of intentional malice, trickery, or deceit, or mere accident." *Id.* at 419.

*18 The second guidepost requires an examination of the ratio between the compensatory and punitive damages. Although the United States Supreme Court has rejected the notion that constitutionality may be determined by application of a simple mathematical formula, *Gore,* 517 U.S. at 582; *Haslip,* 499 U.S. at 18, the Court, as noted above, has provided numerical guidelines: "[F]ew awards exceeding a single-digit ratio * * * will satisfy due process," *State Farm,* 538 U.S. at 425, and a punitive damage "award of more than four times the amount of compensatory damages might be close to the line of constitutional impropriety," *id.* (citing *Haslip,* 499 U.S. at 23-24). The Court noted, however, that "ratios greater than those we have previously upheld may comport with due process where 'a particularly egregious act has resulted in only a small amount of economic damages." ' *State Farm,* 538 U.S. at 425 (quoting *Gore,* 517 U.S. at 582).

The final guidepost instructs courts to compare the punitive damages awarded to the amount of the civil penalties that could have been imposed as a result of the defendant's conduct. If a defendant is liable for significant civil sanctions, a larger punitive damage award may be justified. However, the Court has not placed strict limits on the ratio between punitive damages and civil penalties. *See State Farm,* 538 U.S. at 428-29 (indicating that a punitive damage award of $1 million dollars may be appropriate, although the only applicable civil sanction was a $10,000 fine for fraud).

We begin our analysis with the second *State Farm* factor, because it loomed large in the trial court's analysis and because defendant's challenge focuses on it exclusively. As noted above, the trial court calculated that the jury's punitive damages award of $500,000 was approximately 15 times as large as the compensatory damage award. In doing so, however, the court used actual damages, that is, the noneconomic damages plus the amount of money that plaintiffs paid defendant, over and above what they would have paid absent fraud, before they successfully refinanced the loan with another mortgage company. That was error. Under binding precedent from both the United States Supreme Court and the Oregon Supreme Court, the appropriate denominator in the punitive-to-compensatory ratio calculation is the amount of *potential* compensatory damages. In *Haslip*, the Court approved a standard comparing "the punitive damages award and the *harm likely to result* from the defendant's conduct as well as the harm that actually has occurred." 499 U.S. at 21 (emphasis added). In *TXO Productions Corp. v. Alliance Resources Corp.*, 509 U.S. 443, 460, 113 S Ct 2711, 125 L.Ed.2d 366 (1993), the Court held, "It is appropriate to consider the magnitude of the *potential harm* that the defendant's conduct would have caused to its intended victim if the wrongful plan had succeeded." (Emphasis in original.) Again, in *State Farm*, 538 U.S. at 418, the Court directed the attention of reviewing courts to "the disparity between the actual or potential harm suffered by the plaintiff and the punitive damage award[.]" In *Williams v. Philip Morris Inc.*, 340 Or 35, 127 P3d 1165, *cert granted*, ___ U.S. ___, 126 S Ct 2329 (2006), the Oregon Supreme Court explicitly interpreted *State Farm* as calling for the use of potential damages in the denominator of the ratio. *Id.* at 60 ("To determine the denominator of the ratio, we consider not only the harm actually suffered by plaintiff, but also the potential harm to plaintiff.").

*19 Defendant argues that we should not use potential damages as the denominator because "[t]he cases where potential harm is used as the base figure are typically those where the defendant undertakes no effort to mitigate or prevent the harm, and the potential harm avoided might have been catastrophic." Here, by contrast, defendant "voluntarily waived a pre-payment penalty, before the lawsuit was filed, to mitigate the harm," and, presumably, the potential harm to plaintiffs was not "catastrophic." Even if defendant's theory about what kind of cases should focus on potential harm were valid-a theory which they support only by unelaborated "*see* " citations to a California case (*Simon v. San Paolo U.S. Holding Co ., Inc.*, 35 Cal 4th 1159, 1174 n 3 and 1177, 113 P3d 63 (Cal 2005)), a case from the Court of Appeals of Louisiana (In re *New Orleans Train Car Leakage Fire*, 795 So2d 364, 386 (La Ct App 2001)), and *TXO*, 509 U.S. at 460 (which does not involve either mitigation or catastrophe)-it would not help them here. Although defendant ultimately did waive plaintiffs' prepayment fee, it told their new mortgage broker, when plaintiffs were still unrepresented by counsel, that it would *not* do so, and "voluntarily" agreed to waive the fee only after plaintiffs hired an attorney and he persuaded them to do so during negotiations. And, if defendant's "wrongful plan had succeeded," *TXO*, 509 U.S. at 460, the results *would* have been catastrophic, at least to plaintiffs: unable to make their mortgage payments to defendant and also pay their real estate taxes, they would have lost their home.

We therefore conclude that we must compare the potential damages to the punitive damages. Plaintiffs argued below, and argue again on appeal, that the appropriate figure for potential damages is $326,751.57, the amount of interest defendant would have earned over the life of the loan. Defendant did not respond to that argument at trial. For the first time on appeal, in a footnote in its reply brief, defendant argues, without elaboration, that a more appropriate measure is "the difference in interest between the [c]onsolidated [l]oan [from defendant] and [plaintiffs'] two mortgages before they refinanced"-an amount that defendant either does not know or does not choose to share. We therefore accept plaintiffs' figure and, as a consequence, conclude that the ratio between the jury's punitive damage award ($500,000) and the potential compensatory damages ($326,751.57) is approximately 1.53 to 1.

Whether such a ratio is permissible depends on the reprehensibility of defendant's conduct; the more reprehensible the conduct, the higher the permitted ratio. *State Farm*, 538 U.S. at 425. Thus, in *Williams*, where the defendant tobacco company was found to have engaged in a 40-year campaign of fraud resulting in the suffering and death not only of the plaintiff's decedent but of other Oregonians as well, the Court of Appeals noted, "[I]t is difficult to conceive of more reprehensible misconduct for a longer duration on the part of a supplier of consumer products to the Oregon public," and approved a ratio of over 90 to 1, *Williams v. Philip Morris Inc.*, 193 Or.App. 527, 562, 92 P3d 126 (2004), and the Oregon Supreme Court affirmed, *Williams*, 340 Or at 64. On the other hand, in *Goddard v. Farmers Ins. Co.*, 202 Or.App. 79, 120 P3d 1260 (2005), *adh'd to on recons*, 203 Or.App. 744, 126 P3d 682, *rev allowed*, 341 Or 366 (2006), where the defendant insurance company was found to have engaged in a bad faith failure to settle within policy limits, the court held that a punitive damage award of three times the compensatory damages was the maximum permissible under the constitution.

*20 Thus, a punitive-to-compensatory damages ratio of 1.5 to 1 would be appropriate in a case of only moderate reprehensibility (if that is not in itself an oxymoron). Here, we have such a case. *State Farm*, as noted, suggests five factors that might be considered in gauging reprehensibility: "whether: the harm caused was physical as opposed to economic;

the tortious conduct evinced an indifference to or a reckless disregard of the health or safety of others; the target of the conduct had financial vulnerability; the conduct involved repeated actions or was an isolated incident; and the harm was the result of intentional malice, trickery, or deceit, or mere accident." 538 at 419. As the parties agree, two of these factors are implicated in this case: plaintiffs were financially vulnerable, and defendant's conduct involved intentional trickery and deceit. Its employee actively solicited plaintiffs. After learning that they were satisfied with their current loan, he convinced them to take out a significantly less advantageous one by lying to them about the new loan's terms. As a result, they suffered not only financial loss, but anxiety about the apparently potential repossession of their home for nonpayment of real estate taxes. We conclude that, even though plaintiffs experienced no physical injury and presented no evidence that defendant engaged in repeated instances of deceit, a punitive damages award amounting to only 1.5 times the potential compensatory damages was appropriate to the level of reprehensibility. *Compare Goddard,* 202 Or.App. at 122 (solely financial harm; court approved 3:1 ratio).

The third *State Farm* factor, a comparison of the punitive damages award and civil penalties authorized in comparable cases, 538 U.S. at 428, reinforces our conclusion that the jury's original award was not constitutionally infirm. The Oregon Supreme Court has provided the following instruction regarding the "comparable sanctions" guidepost:

"[T]he 'comparable sanctions' guidepost requires three steps. First, courts must identify comparable civil or criminal sanctions. Second, courts must consider how serious the comparable sanctions are, relative to the universe of sanctions that the legislature authorizes to punish inappropriate conduct. Third, courts must then evaluate the punitive damage award in light of the relative severity of the comparable sanctions. The guidepost may militate against a significant punitive damage award if the state's comparable sanctions are mild, trivial, or nonexistent. However, the guidepost will support a more significant punitive damage award when the state's comparable sanctions are severe."

Williams, 340 Or at 58.

Although neither party nor *amicus* points to ORS 59.930, that statute provides:

"It is unlawful for any person, directly or indirectly, in connection with the conduct of a mortgage banker or mortgage broker business:

"(1) To employ any device, scheme or artifice to defraud;

*21 "(2) Knowingly to make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they are made, not misleading."

Violation of the statute is a Class C felony. ORS 59.992(1). It is therefore punishable by up to five years' imprisonment, ORS 161.605, or a fine of $125,000, ORS 161.625. In addition to those penalties, a person who violates ORS 59.930 "shall be subject to a penalty of not more than $5,000 for every violation. * * * [I]n the case of a continuing violation, each day's continuance is a separate violation, but the maximum penalty for any continuing violation shall not exceed $20,000 for each offense." ORS 59.996. It is beyond dispute, then, that the punitive damages awarded by the jury cannot be questioned as disproportionate to the sanctions that defendant could have received and of which it therefore was or should have been aware. *See Williams,* 340 Or at 58-60 (noting that, although criminal sanctions should be relied on only with care, they are nonetheless relevant); *Groth v. Hyundai Precision and Ind. Co.,* 209 Or 781, 791, ___ P3d ___ (2006).

V. ATTORNEY FEES

As prevailing parties on their TILA claim, plaintiffs are entitled to an award of reasonable attorney fees. 15 USC § 1640(a)(3). The trial court awarded plaintiffs $182,107.50. It arrived at that figure by multiplying the number of hours spent on the TILA claim by the hourly rate charged by the various attorneys who worked those hours. Defendant does not contest the number of hours or the method of calculation insofar as it is a product of hours times rates; rather, defendant objects to the trial court's decision to apply a "multiplier factor" to the attorneys' standard billing rates. Instead of using the standard rates of $250 for partners and $135 to $140 for associates, the court used a rate of $322 for partners and $207 for an associate.

TILA attorney fee awards are governed by federal law. *Long v. Storms,* 52 Or.App. 685, 688, 629 P.2d 827 (1981). That body of law requires the so-called "lodestar" method, under which attorneys' fees are "calculated by multiplying the number of hours the prevailing party reasonably expended on the litigation by a reasonable hourly rate. Although in most cases, the lodestar figure is presumptively a reasonable fee award, the * * * court may, if circumstances warrant, adjust the lodestar to account for other factors which are not subsumed within it."

Ferland v. Conrad Credit Corp., 244 F3d 1145, 1149 n 4 (9th Cir2001) (citations omitted). Factors that may support a deviation from the lodestar amount include

"(1) the time and labor required, (2) the novelty and difficulty of the questions involved, (3) the skill requisite to perform the legal service properly, (4) the preclusion of other employment by the attorney due to acceptance of the case, (5) the customary fee, (6) whether the fee is fixed or contingent, (7) time limitations imposed by the client or the circumstances, (8) the amount involved and the results obtained, (9) the experience, reputation, and ability of the attorneys, (10) the 'undesirability' of the case, (11) the nature and length of the professional relationship with the client, and (12) awards in similar cases."

*22 *Kerr v. Screen Extras Guild, Inc.*, 526 F.2d 67, 70 (9th Cir1975), *cert den*, 425 U.S. 951 (1976); *accord Ferland*, 244 F3d at 1149 n 4. The facts underlying a court's attorney fee decision are reviewed for any evidence. *State High. Com. et al v. Kendrick et al*, 227 Or 608, 613, 363 P.2d 1078 (1961). The award itself is reviewed for abuse of discretion. *Squier Associates, Inc. v. Secor Investments, LLC*, 196 Or.App. 617, 622, 103 P3d 1129 (2004).

In this case, the trial court increased the fee award based on evidence submitted by plaintiffs "establish[ing] that few lawyers in [Oregon] are willing to represent clients in unfair or predatory mortgage lending cases because they are financially risky and involve complex issues," and "the firm's exclusive work on this case in January required the firm to decrease the number of potential new client intake interviews by 1/3." Those factual findings are amply supported by evidence in the record.

As required, the trial court calculated the attorney fee award according to the lodestar method and adjusted the hourly rate based on factors established by federal law and attested to by uncontradicted evidence. Accordingly, we conclude that the trial court's attorney fee award was not an abuse of discretion.

VI. CONCLUSION

In sum: The trial court correctly decided that it, and not an arbitrator, should decide whether the arbitration rider was unconscionable, because the claim against the arbitration rider was distinct from the claim against the contract itself; further, the court then correctly decided that the arbitration rider was unconscionable, based on the oppressive circumstances of its formation, as well as its ban on class actions and its costsharing provisions. The trial court also correctly granted plaintiffs' motion for a directed verdict on defendant's affirmative defense based on an allegation of fraud; on the evidence presented, no reasonable juror could have found clear and convincing evidence that plaintiffs intended to defraud defendant by submitting, as proof of their income, federal income tax returns with allegedly (but not demonstrably) erroneous information regarding their marital status and family. The court did err, however, in remitting the jury's punitive damage award, because the court based its decision on the ratio between the punitive damages award and the actual damages suffered, instead of the ratio between the punitive damages and the potential damages. Finally, the court did not abuse its discretion in awarding plaintiffs attorney fees based on enhanced hourly rates.

On appeal, affirmed. On cross-appeal, reversed and remanded with instructions to enter judgment awarding punitive damages in the amount found by jury.

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— P.3d ----, 2007 WL 294116 (Or.App.)

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