Has Virginia Adopted the Doctrine of the Unconscionability of Contracts of Adhesion?[1]

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Part I

Many years ago, I ventured to a General District Court in Southside Virginia to defend my financial services company client against a consumer claim. During arguments on a motion to strike, I reviewed with the Court the exculpatory provisions of the contracts between my client and the plaintiff. The Court's response was, in effect, that the contract was a "contract of adhesion" and therefore it should not be enforced. I did not recall in all my years as a commercial litigator, that Virginia ever adopted the principle that contracts were unenforceable under some definition of "adhesion."

When I returned to my office, I conducted a computer based definitional search of "adhesion" in Virginia law. Nearly all the references were of construction cases describing the failure of building materials to properly seal. I found no Virginia case adopting a doctrine where a court defined "contract of adhesion" was rendered unenforceable. As I later discovered, much has changed since I conducted my earlier research.

Adhesion Contracts

My research efforts then turned to adhesion contracts in general. Adhesion contracts are defined as those contracts which are offered to consumers of goods and services on a non-negotiated basis without affording the consumer a realistic opportunity to bargain, offering no other option to acquire the goods or services except by accepting the contract. The contract is generally a standardized form and the consumer is regarded as the weaker party in the bargaining process. The contract is then declared as an unconscionable contract and is void as violating "public policy."[2]

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[1] **Editor's Note – Confronted with space limitations, we were only able to publish Part I of Mr. Callahan's article in the current edition of the Corporate Counsel Section newsletter. The Section is delighted to present the entirety of Mr. Callahan's article in this posting on the Section's website.**

[2] John Edward Murray, Jr., Murray on Contracts 350 (2nd Revised Ed. 1974).

John Edward Murray, Jr. in his treatise Murray on Contracts cites Henningsen v. Bloomfield Motors, Inc. 32 N.J. 358, 161 A2nd 69, 75 (1960) as the representative landmark case in the deliniation of the doctrine of the unconscionability of a contract of adhesion. The case turned on the disclaimer or warranty in the purchase of an automobile. The New Jersey Court of Appeals stated that:

> "The gross inequality of bargaining position occupied by the consumer in the automobile industry is thus apparent. There is no competition among the carmakers in the area of express warranty. Where can the buyer go to negotiate for better protection? Such control and limitation of his remedies are inimical to the public welfare and, at the very least, call for great care by the courts to avoid injustice through the application of strict common-law principles of freedom of contract." [3]

Arguably, Virginia rejected this doctrine in Marshall v. Murray Oldsmobile Company, Inc. 204 VA 972, 154 S.E. 2nd 140 (1967) where the court specifically stated that "…A reading of the Henningsen case and a tracing of its questionable acceptance in other jurisdictions since it was decided in 1960 failed to convince us of the efficacy of following the action of the New Jersey Court. We are loath to make such abrupt changes in the settled law and reluctant to declare invalid the formal undertakings of parties for such vague reasons of public policy."[4] With a seeming rejection of this "contract of adhesion" doctrine, has there been any development in the common law of Virginia since?

The N.J. Court took "the forthright position that the attempted disclaimer is that the instant case was so inimical to the public good as to compel an adjudication of its invalidity."[5] Do form contracts with extensive risk limiting provisions generally rise to the level of unconscionability under Virginia common law? The standard for reaching unconscionability in Virginia is not an easy threshold to obtain. Under Virginia common law, an unconscionable bargain is one in which no man in his senses and not under a delusion would make and no that no fair man would accept. The conscience must be shocked. Smyth Bros., McCleary, McClellan Co. v. Beresford, 128 VA 137, 104 S.E. 2 371 (1920).

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[3] Henningsen v. Bloomfield Motors, Inc., 87 161 A. 2d 69, 87 (1960)
[4] Marshall v. Murray Oldsmobile Company, Inc., 204 VA. 972, 977 (1967)
[5] Henningsen, supra, 161A. 2d, at p. 95

UNCONSCIONABILITY

The issue of unconscionable contracts as reflected in Virginia has most often appeared in the context of the interpretations and enforceability of separation agreements and property settlement agreements in divorce matters. In Derby v. Derby, 8 Va App. 19, 378 S.E. 2nd 74 (1989) the Court of Appeals of Virginia set aside a separation agreement where the husband had conveyed nearly all of his marital property to the wife. In this case, counsel was not present for either party during the negotiation phase. The wife had her attorney draft the one-sided agreement in advance and had her husband sign it before he reviewed it with counsel, holding out the prospect of reconciliation. The Court refused to enforce the agreement ruling that the contract was unconscionable. The Court stated that in reviewing a settlement agreement it is concerned with the intrinsic fairness of the terms in relation to all attendant circumstances, including the relationship and duties between the parties. According to the Court, the wife may not have committed fraud but she has engaged in such overbearing and oppressive conduct in securing an agreement which is so patently unfair that a court of equity may refuse to enforce the agreement.[6] In a later case, Pelfrey v. Pelfrey, 25 Va. App 239 (1997) the Court of Appeals of Virginia declared the settlement agreement unconscionable and set the standard for conscionability in Virginia:

> "To determine whether the agreement is unconscionable, the court must examine adequacy of price or quality of value: if adequacy of price or inequality of value are the only indicia of unconscionability the case must be extreme to justify equitable relief…If gross disparity in value exchanged exists under the agreement, the Court should consider whether oppressive influences affected agreement to the extent that the process was unfair and the terms of the resulting agreement unconscionable." [7]

The Court stated that the initial threshold for a finding of unconscionability is to present by clear and convincing evidence a great disparity in value. If such evidence is not present, then the court would not further examine the circumstances surrounding the formation of the contract to determine whether there exists oppressive influences.

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[6] Derby v. Derby, 8 Va. App. 19, 32. (1989)
[7] Pelfrey v. Pelfrey, 25 Va. App. 239, 244, 245. (1997)

Part II

RECENT CASES

A recent challenge to a contract on the grounds that it constitutes an unconscionable adhesion contract is found in Gardner v. Ryan; U.S. District Court W.D. VA (lexis 17985.) (2001) Here the plaintiff challenged the arbitration clause contained in her employment contract as being unconscionable. The U. S. District Court for the Western District stated:

> "The plaintiff first argues that the Agreement is an unconscionable adhesion contract. Virginia law defines an unconscionable contract as "one that no man in his senses and not under a delusion would make, on the one hand, and as no fair man would accept, on the other." *Smyth Bros. – McCleary – McClellan Co. v. Beresford, 128 Va. 137, 104 S.E. 371, 382 (Va. 1920*).
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> Furthermore, the Eighth Circuit, in applying an identically worded standard, found that the Agreement at issue in this case was not an unconscionable adhesion contract. See Lyster v. Ryan's Family Steak Houses, Inc., 239 F.3d 943, 947(8th Cir. 2001). [*6] [8]

However, contractual arbitration clauses have presented Virginia Courts with a lively grist to challenge their enforceability on unconscionability grounds. The Supreme Court of the United States in Green Tree Financial - Alabama v. Randolph, 531 U.S. 79 (2000) held an arbitration clause which does not describe arbitration costs may be unenforceable because "it fails to affirmatively protect a party from potentially steep arbitration costs." [9] Likewise, citing Randolph, the United States District Court for the Western District of Virginia held that a party, who may show the inevitability of incurring significant costs in arbitrating a dispute may avoid the requirement of arbitration as provided in their contract. Camacho v. Holiday Homes, Inc., 167 F.Supp.2nd 892, 895 (W.D.Va. 2001) Camacho, supra, was distinguished in Russell County School Board v. Conseco Life Ins. Co., 2001 WL 1593233 (W.D.Va., Dec 12, 2001) This case involved a dispute over an insurance policy. Notably the conscionability of an arbitration provision in a contract seems to receive the most attention in consumer disputes. For a fuller discussion of the enforceability of arbitration provisions, see Matt Kirsner's excellent article Arbitrations: Which Party Should Bear The Cost, Virginia Lawyer, April 2002. Commensurately, along with Camacho, one Circuit Court in Virginia has invalidated contract arbitration

[8] Gardner v. Ryan's, lexis 17985, United States of District Court W. D. Va. (2001)
[9] Green Tree Financial – Alabama v. Randolph, 531 U.S. 79,91 (2000)

provisions and generally adopted an approach of the unconscionability of the arbitration clause on the basis of a doctrine of adhesion. In the case of Philyaw v. Platinum Enterprises, Inc., 54 Va.Cir. 364 (2001) the Court in a consumer purchase of automobile dispute, refused to enforce the arbitration provision in a contract. The Court stated:

> "This vehicle service agreement contains many aspects of a contract of adhesion. A contract of adhesion is a standard form contract , prepared by one party and presented to a weaker party-- usually, a consumer-- who has no bargaining power and little or no choice about the terms. BLACK'S LAW DICTIONARY (7th Ed.) p.318. Warranties are confusing and misleading. A retail consumer cannot bargain with the manufacturer or seller or other warrantor to adjust the terms of the warranties offered. See Senate Report on the Magnuson-Moss Warranty Act, quoted in *40 Fed. Reg. 60, 168 (1975)*, and in the dissenting opinion in *Southern Energy Homes v. Lee, 732 So. 2d 994 (Ala. 1999).* The contract in this case is preprinted seven-page form document with Wynn's logo at the top. It is apparent that even if the consumers understood the ramifications of the arbitration clause, they could not have bargained for better terms under the circumstances of this case.
> For this reason, the court holds that the arbitration cause under review is unenforceable because it is patently unconscionable." [10]

The Court, however, did not nullify the entire contract and "severed" the offending provision from the remainder of the contract.

The only other Virginia case which I found that mentions "contract of adhesion" was a brief Circuit Court decision in the case of Weiland v. Bennie's Mobile Home Sales, Inc., 5 Va.Cir. 72 (1983). The case apparently involved a mobile home sale wherein the purchasers, after making a number of installment payments missed some payments and were threatened with forfeiture of their home. The Court in this case held that:

> "Plaintiff here has alleged substantive unconscionability rather than procedural unconscionability. Also, the "contract" at issue here is a contract of adhesion in that it was prepared by the defendant and the plaintiff apparently had no realistic choice as to its terms. However, this does not in and of itself render a contract or clause therein unconscionable. Since there is a dearth of evidence as to the actual bargaining between the parties, strengths and weaknesses of the individuals, whether the parties are literate or illiterate, it was difficult to determine whether the contract was one of adhesion. My finding of a contract of adhesion was based upon the fact that the contract was the work of the defendant and that it contained a forfeiture clause rather than an acceleration clause upon default." [11]

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[10] Philyaw v. Platinum Enterprises, Inc., 54 Va. Cir. 364 (2001)
[11] Weiland v. Bennies Mobile Home Sales, Inc., 5 Va. Cir. 72 (1983)

While this opinion does not involve a detached analysis of the doctrine of adhesion, and cites no Virginia case in support of its finding, it does arguably hold that a contract is unconscionable as a contract of adhesion upon the basis that the consumer has no realistic choices to terms and where there exists a clause which causes a forfeiture of the consumer's property.

CONCLUSION

In 1967, the Supreme Court of Virginia rejected the doctrine enunciated in Henningsen, supra, that a contract of adhesion, as such, is per se unenforceable as being unconscionable. Nevertheless, we have seen the growth of cases inspired by the opinion in Green Tree which attack the viability of arbitration clauses in consumer contracts on grounds of conscionability, with at least one Virginia U.S. District Court in Camacho having struck down such a provision citing Green Tree. At least one Circuit Court has adopted a view that arbitration provisions contained in a contract may be unconscionable if they are found in the context of a contract of adhesion, the opinion going so far as to formally define adhesion and mention it as a factor in the determination to nullify the arbitration clause. Reviewing these cases indicates, however, that the highest court of law in this Commonwealth has yet to adopt such an interpretation of contract law which departs from the traditional notion of freedom of contract.