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## Is Arbitration Under Attack?: Exploring the Recent Judicial Skepticism of the Class Arbitration Waiver and Innovative Solutions to the Unsettled Legal Landscape

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### Recommended Citation

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# IS ARBITRATION UNDER ATTACK?: EXPLORING THE RECENT JUDICIAL SKEPTICISM OF THE CLASS ARBITRATION WAIVER AND INNOVATIVE SOLUTIONS TO THE UNSETTLED LEGAL LANDSCAPE

*Ramona L. Lampley\**

*Courts have become increasingly likely in recent years to find class arbitration waivers in consumer product sales unenforceable due to the lack of incentives for consumers and their attorneys to recover for “low-value” claims. This Article explores the history of the unconscionability and vindication-of-statutory rights doctrines invoked by those courts. It then analyzes the progression of the class arbitration waiver in the consumer products industry, with emphasis on the third-generation “incentivizing” agreement. This “incentivizing” agreement, if viewed at the time of the purchase agreement, can be mutually beneficial to seller and consumer. Some consumers may wish to forego the option for class representation of classic “low-value” claims in turn for inexpensive and swift arbitration of more substantial claims. Further, the “third generation” class arbitration waiver cures the concerns traditionally identified by courts by providing incentives to the consumer for pursuing low-value claims, in that the consumer is afforded a windfall premium if the seller/manufacture does not “pay up” on valid claims prior to arbitration.*

INTRODUCTION .....	478
I. LEVELING THE ARBITRATION PLAYING FIELD .....	483
A. <i>Questions of Preemption</i> .....	485
B. <i>Questions of Arbitrability</i> .....	486
II. ENFORCEMENT OF ARBITRATION AGREEMENTS WITH CLASS ARBITRATION WAIVERS .....	489

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A.	<i>The Unconscionability Defense</i> .....	489
B.	<i>The Corollary to Unconscionability: Vindication of Statutory Rights</i> .....	492
1.	The Vindication-of-Statutory-Rights Trilogy.....	493
a.	Vindication of statutory rights: A judicially created defense .....	494
b.	<i>Mitsubishi's</i> legacy: Arbitrating employment discrimination claims .....	496
c.	Drafting a defense: <i>Green Tree Financial Corp.-Alabama v. Randolph</i> .....	497
d.	The <i>Mitsubishi</i> trilogy summarized .....	499
2.	Contemporary Usage of the Vindication-of-Statutory-Rights Analysis. ....	499
III.	THE EVOLVING ARBITRATION AGREEMENT .....	503
A.	<i>First-Generation Consumer Products Arbitration Clauses</i> .....	503
B.	<i>The Short-Ccomings of the Second-Generation Arbitration Clause</i> .....	508
IV.	THE CONSUMER PRODUCT INDUSTRY'S RESPONSE: OPTIONAL INCENTIVIZING INDIVIDUAL ARBITRATION AGREEMENTS .....	509
A.	<i>Freedom to Choose</i> .....	510
B.	<i>Incentivizing Agreements</i> .....	512
C.	<i>Deterrence</i> .....	517
	CONCLUSION.....	518

## INTRODUCTION

Is arbitration under attack? Since the Supreme Court held that the Federal Arbitration Act (FAA) created a body of federal substantive law placing arbitration agreements on the same footing as other contracts,<sup>1</sup> it has become fashionable in the consumer products industry to include in a services or sales contract a provision requiring the purchaser and provider to submit all claims to binding arbitration.<sup>2</sup> In order to streamline

<sup>1</sup> *Southland Corp. v. Keating*, 465 U.S. 1, 10 (1984) ("In enacting § 2 of the federal Act, Congress declared a national policy favoring arbitration and withdrew the power of the states to require a judicial forum for the resolution of claims which the contracting parties agreed to resolve by arbitration.").

<sup>2</sup> For a history of the adoption of the consumer-product arbitration agreement, see Myriam Gilles, *Opting out of Liability: The Forthcoming, Near-Total Demise of the Modern Class Action*, 104 MICH. L. REV. 373, 394-98 (2005); Jeffrey W. Stempel, *Mandating Minimum Quality in Mass Arbitration*, 76 U. CIN. L. REV. 383, 398 (2008) ("The practical consequences of the new legal era were significant. Arbitration left the province of particular business guilds or commercial environments and shifted to a massive privatization of the adjudicatory function. . . . [A] genre of new arbitration arose, in which arbitration agreements were essentially imposed upon a large, general class of consumers and workers.").

the arbitration process and alleviate the burden of costly consumer class action suits, manufacturers and service providers have started to require that consumers waive the right to proceed in court or in arbitration on a class-wide basis. These agreements to binding individual arbitration are present in consumer credit agreements, wireless or cable service agreements, and a burgeoning array of consumer products sales agreements.<sup>3</sup> Almost any cell-phone wielding, credit-card bearing, cable-network consumer has, knowingly or not, agreed to a form of binding individual arbitration.

At the outset, courts embraced arbitration-with-class-waiver provisions in light of the general policy favoring arbitration agreements.<sup>4</sup> In recent years, however, courts have examined the class-waiver arbitration agreement with increased paternalism on behalf of the consumer. Under the FAA, an arbitration clause may be invalidated solely on general contract defenses grounded in state law; states and courts may not adopt

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<sup>3</sup> See, e.g., *Discover Bank v. Superior Court*, 113 P.3d 1100, 1103 (Cal. 2005) (setting forth Discover Bank's arbitration policy); AT&T Wireless Service Agreement para. 6, <http://www.wireless.att.com/learn/articles-resources/wireless-terms.jsp> (follow "Terms of Service" hyperlink) (last visited April 8, 2009); Comcast Agreement for Residential Services § 13(c), <http://www.comcast.com> (follow "Customers"; then follow "Customer Agreements/Policies"; then follow "Customer Agreement for Residential Services" hyperlink) (last visited April 8, 2009); Time Warner Cable Residential Subscriber Agreement § 14, [http://help.twcable.com/html/twc\\_sub\\_agreement.html](http://help.twcable.com/html/twc_sub_agreement.html) (last visited April 8, 2009); Dell's Online Policies: Terms and Conditions of Sale § 12, <http://www.dell.com> (follow "Terms of Sale" hyperlink at bottom of page) (last visited April 8, 2009); T-Mobile Terms & Conditions § 2, <http://www.t-mobile.com> (follow "Terms & Conditions" hyperlink at bottom of page) (last visited Apr. 8, 2009).

<sup>4</sup> See, e.g., *Hall St. Assocs., L.L.C. v. Mattel, Inc.*, 128 S. Ct. 1396, 1402 (2008) ("Congress enacted the FAA to replace judicial indisposition to arbitration with a 'national policy favoring [it] and plac[ing] arbitration agreements on equal footing with all other contracts.'" (quoting *Buckeye Check Cashing, Inc. v. Cardegna*, 546 U.S. 440, 443 (2006))); see also *Scherk v. Alberto-Culver Co.*, 417 U.S. 506, 511 n.4 (1974) (explaining that American courts adopted the English view that arbitration agreements ousted the courts of jurisdiction, and refused to enforce such agreements). To that end, the FAA provides that arbitration agreements "shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract." 9 U.S.C. § 2 (2006). Additionally, a court must stay its proceedings if the issue before it is arbitrable under the agreement. *Id.* § 3. The court must issue an order compelling arbitration if there has been a "failure, neglect, or refusal" to comply with the arbitration agreement. *Id.* § 4. Furthermore, a court may vacate an arbitration award only if (1) "procured by corruption, fraud, or undue means;" (2) "evident partiality" is present in one or more of the arbitrators; (3) "the arbitrators were guilty of misconduct" whereby the rights of the party have been prejudiced (such as refusing to postpone a hearing); or (4) "the arbitrators exceeded their powers, or so imperfectly executed them that a mutual, final, and definite award upon the subject matter submitted was not made." *Id.* § 10. Similarly, an arbitration award may be modified only (1) where there is an "evident material miscalculation" or mistake referred to in the award; (2) "[w]here the arbitrators have awarded upon a matter not submitted to them"; or (3) "the award is imperfect in [a] . . . form not affecting the merits." *Id.* § 11. And then, the court may only modify or correct the award "so as to effect the intent thereof and promote justice between the parties." *Id.* This limited scope of judicial review for extreme arbitral conduct may not be contractually modified by the parties. *Hall St. Assocs.*, 128 S. Ct. at 1403-04.

contract rules or defenses that operate to discriminate against arbitration provisions.<sup>5</sup> Thus, most courts faced with an issue of enforceability initially focused on whether an arbitration agreement with a class arbitration waiver clause was unconscionable. Some courts, most notably the federal courts in the Ninth Circuit and state courts in California, have found that a class arbitration waiver is almost always unconscionable because the costs of pursuing arbitration individually would discourage the individual consumer from filing the arbitration claim.<sup>6</sup> But most courts have not held an arbitration agreement to be unconscionable at the time it was formed, even if it included a class-action waiver.<sup>7</sup>

However, the judicial support for arbitration in some contexts is waning, perhaps unnecessarily so. In the wake of literature predicting “The Forth-Coming, Near-Total Demise of the Modern Class Action,”<sup>8</sup> courts are now looking to whether the class arbitration waiver deprives a plaintiff of his opportunity to vindicate a statutory right. And some courts are invalidating the arbitration agreement, class arbitration waiver, or both, in the name of preserving the class action.<sup>9</sup> Scholars are now

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<sup>5</sup> See, e.g., *Rodriguez de Quijas v. Shearson/Am. Express, Inc.*, 490 U.S. 477, 483 (1989) (quoting § 2 of the FAA); *Shearson/Am. Express, Inc. v. McMahon*, 482 U.S. 220, 226 (1987) (quoting § 2 of the FAA).

<sup>6</sup> See, e.g., *Shroyer v. New Cingular Wireless Servs., Inc.*, 498 F.3d 976, 984 (9th Cir. 2007) (holding class action waiver in cell phone agreement unconscionable pursuant to California law); *Ingle v. Circuit City Stores, Inc.*, 328 F.3d 1165, 1176 (9th Cir. 2003) (holding class arbitration waiver in employment contract unconscionable); *Ting v. AT&T*, 319 F.3d 1126, 1150 (9th Cir. 2003) (holding class arbitration waiver in contract for telephone services unconscionable); *Discover Bank*, 113 P.3d at 1108 (holding that “class action waivers found in [adhesion] contracts may also be substantively unconscionable inasmuch as they may operate effectively as exculpatory contract clauses that are contrary to public policy”); *Szetela v. Discover Bank*, 118 Cal. Rptr. 2d 862, 867–68 (Cal. Ct. App. 2002) (holding class action waiver in credit card agreement unconscionable for lacking mutuality in agreement).

<sup>7</sup> See, e.g., *Carter v. Countrywide Credit Indus. Inc.*, 362 F.3d 294, 301 (5th Cir. 2004) (holding that prohibition of collective action in arbitration agreement not unconscionable); *Livingston v. Assocs. Fin., Inc.*, 339 F.3d 553, 559 (7th Cir. 2003) (enforcing class arbitration waiver in a Truth in Lending Act (TILA) claim); *Snowden v. Checkpoint Check Cashing*, 290 F.3d 631, 638 (4th Cir. 2002); *Randolph v. Green Tree Fin. Corp.*, 244 F.3d 814, 818–19 (11th Cir. 2001) (holding that right to class action under TILA is not non-waivable).

<sup>8</sup> Gilles, *supra* note 2, at 375 (predicting that corporate America will increasingly adopt the class action waiver and “class actions will soon be virtually extinct”).

<sup>9</sup> See *id.* at 430 (predicting that the class arbitration waiver will find success in the courts, but advocating legislation to preserve the class action); see also *In re Am. Express Litig.*, 554 F.3d 300, 311–12 (2d Cir. 2009) (“[T]he wisdom and utility of these [class waiver] provisions has become the subject of intense debate.”). Professor Gilles’s article has been cited by at least four courts in striking a class action waiver as unconscionable. See *Skirchak v. Dynamics Research Corp.* 508 F.3d 49, 63 (1st Cir. 2007) (finding class action waiver unconscionable); *Kristian v. Comcast Corp.*, 446 F.3d 25, 42, 55 (1st Cir. 2006) (invalidating class arbitration waiver under vindication-of-statutory-rights analysis); *Cooper v. QC Fin. Servs., Inc.*, 503 F. Supp. 2d 1266, 1288 (D. Ariz. 2007) (finding class arbitration waiver unconscionable); *Muhammad v. County Bank of Rehoboth Beach*, 912 A.2d 88, 102 n.6 (N.J. 2006) (finding class action waiver unconscionable).

calling for action by the Supreme Court on this issue,<sup>10</sup> and others are calling for Congressional legislation prohibiting *all* predispute collective action waivers.<sup>11</sup> Already we have seen the proposal of wide-sweeping legislation to amend the FAA (introduced by the plaintiff's advocacy group Public Citizen),<sup>12</sup> through the proposed Arbitration Fairness Act (AFA), which would render unenforceable any pre-dispute arbitration agreement of (1) "an employment, consumer, or franchise dispute" or (2) "a dispute arising under any statute intended to protect civil rights or to regulate contracts or transactions between parties of unequal bargaining power."<sup>13</sup> Not only would the AFA cover almost any contractual relationship, but it would also apply to contracts entered into *prior* to the passage of the legislation.<sup>14</sup> And some states have passed legislation—no doubt preempted by the FAA<sup>15</sup>—directing courts to find class action waivers in consumer arbitration agreements unenforceable, or to apply heightened scrutiny to such contracts.<sup>16</sup>

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<sup>10</sup> See, e.g., Bryon Allyn Rice, Comment, *Enforceable or Not?: Class Action Waivers in Mandatory Arbitration Clauses and the Need for a Judicial Standard*, 45 Hous. L. Rev. 215, 219 (2008) (urging that "[t]he time has come for the Supreme Court to settle the question once and for all").

<sup>11</sup> Meredith R. Miller, *Contracting out of Process, Contracting out of Corporate Accountability: An Argument Against Enforcement of Pre-Dispute Limits on Process*, 75 TENN. L. REV. 365, 404 (2008). Miller proposes that Congress amend the FAA to state "that predispute arbitration terms that ban collective action, limit discovery or shorten the statute of limitations in standardized form agreements . . . are *per se* unenforceable." *Id.* at 404–05. This *per se* ban on pre-dispute limitations is not limited to solely consumer, or even employment, arbitration agreements; it ostensibly extends even to arbitration agreements between businesses. *Id.* at 405.

<sup>12</sup> See Miller, *supra* note 11, at 370 (referring to the Arbitration Fairness Act as "[m]aligned as the plaintiff bar's 'pro-lawsuit legislation'"); see also Joan Claybrook, Letter to the Editor, *Party at Joan's*, WALL ST. J., Nov. 17, 2007, at A9 (Response letter by Public Citizen stating, "We oppose *mandatory* not voluntary arbitration requirements . . ."). The legislation backed by Public Citizen would do more than invalidate non-voluntary arbitration agreements—it would render unenforceable *per se* any pre-dispute agreement to waive class claims in the consumer, employment, or franchise context regardless of whether the waiver is voluntary or not.

<sup>13</sup> Arbitration Fairness Act of 2007, S. 1782, H.R. 3010, 110th Cong. §3 (2007) (introduced July 12, 2007). The Arbitration Fairness Act was reintroduced on February 12, 2009, as the Arbitration Fairness Act of 2009, H.R. 1020, 111th Cong. (2009), and has been referred to the House Committee on the Judiciary. See H.R. 1020 Bill Status and Summary, www.thomas.gov (search "Search Bill Summary & Status" for "Arbitration Fairness Act"; then follow "H.R.1020" hyperlink; then follow "All Information" hyperlink") (last visited Apr. 8, 2009).

<sup>14</sup> Arbitration Fairness Act of 2007, § 5 (requiring that the proposed amendments "apply with respect to any dispute or claim that arises on or after [enactment of this Act]"). Perhaps due to its almost limitless scope, the AFA is not likely to be enacted. See Miller, *supra* note 11, at 370.

<sup>15</sup> See *infra* Part I.A; see also *Fiser v. Dell Computer Corp.*, 188 P.2d 1215, 1219 (N.M. 2008) (recognizing that New Mexico statute declaring arbitration with class waiver clauses unenforceable "may be preempted by the FAA").

<sup>16</sup> See CONN. GEN. STAT. ANN. § 36a-746c(7) (2004) ("A high cost home loan shall not provide for or include . . . [a] mandatory arbitration clause or a waiver of participation in a

But is this broad legislation, or even a bright-line Supreme Court prohibition of the class arbitration waiver, prudent?<sup>17</sup> Assuming that a party can always pursue arbitration for his claim, no matter how little the value is, does the waiver of the opportunity to bring a collective action really deprive that consumer of his opportunity to vindicate a statutory right?<sup>18</sup> And can agreements that provide cost-effective measures for pursuing individual claims really be unconscionable—if the parties' positions are assessed as they existed at the time the agreement was formed, instead of after a cause of action has potentially arisen? Would the consideration be different if the agreement provided opt-out opportunities and cost-savings provisions for potential parties?

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class action.”) (effective April 22, 2002); GA. CODE ANN. § 16-17-2(c)(2) (2007) (requiring courts to consider “[w]hether the contract restricts or excludes damages or remedies that would be available to the borrower in court, *including the right to participate in a class action*” in determining whether an arbitration agreement is unconscionable, and hence, unenforceable (emphasis added)) (effective May 1, 2004); N.M. STAT. ANN. §§ 44-7A-1(b)(4), 44-7A-5 (2004) (declaring a “disabling civil dispute clause” in an arbitration agreement is unenforceable and voidable by the consumer, borrower, tenant, or employee; a “disabling civil dispute clause” is defined, in part, as a clause which requires the consumer, tenant or employee to “decline to participate in a class action”) (effective July 1, 2001); OKLA. STAT. ANN. tit. 12, § 1880 (Supp. 2008) (requiring that courts “closely review[ ]” arbitration agreements that “deny[ ] the ability to consolidate arbitrations or to have arbitration for a class of persons involving substantially similar issues” for unconscionability) (effective Jan. 1, 2006). To the extent any of these laws purport to treat arbitration agreements, and class action waivers within arbitration agreements, differently from other general contracts, they are preempted by the FAA. *See Doctor’s Assocs., Inc. v. Casarotto*, 517 U.S. 681, 687 (1996) (“Courts may not, however, invalidate arbitration agreements under state laws applicable *only* to arbitration provisions.”). Utah, however, has enacted legislation recognizing that class action waivers (whether in an arbitration agreement or not) are enforceable so long as the waiver is conspicuously drafted. UTAH CODE ANN. §§ 70C-3-104, 70C-4-105 (Supp. 2008) (allowing creditor to contract with debtor for waiver of class action if the provision is in bold and all caps) (effective Mar. 15, 2006).

<sup>17</sup> There are numerous reasons that the Supreme Court would reject a bright-line ruling that class arbitration waivers are unenforceable, and equivalent reasons that a *per se* approval of all class arbitration waivers is equally unlikely. *See infra* Part II.B.1.c (discussing *Green Tree Fin. Corp.-Ala. v. Randolph*, 531 U.S. 79 (2000), and the burden of proof placed on the party resisting arbitration). The question of *who* decides whether the class action waiver is enforceable at all is an issue much more likely to be resolved by the Court in light of *Buckeye Check Cashing, Inc., v. Cardegna*, 546 U.S. 440, 445–46 (2006) (“[U]nless the challenge is to the arbitration clause itself, the issue of the contract’s validity is considered by the arbitrator in the first instance.”). The resolution of this question, however, is far from clear. *See infra* Part I.B (discussing the problems with determining whether a class arbitration waiver is a gateway issue of arbitrability).

<sup>18</sup> Although opponents of the class arbitration waiver often refer to the “right” to a class action, it is clear that “there is no substantive right to a class remedy; a class action is a procedural device.” *Blaz v. Belfer*, 368 F.3d 501, 505 (5th Cir. 2004); *see also* *Califano v. Yamasaki*, 442 U.S. 682, 700–01 (1979) (referring to class action as “an exception to the usual rule that litigation is conducted by and on behalf of the individual named parties only”); *Caudle v. Am. Arbitration Ass’n*, 230 F.3d 920, 921 (7th Cir. 2000) (referring to a certified class action as merely a “procedural device aggregating multiple persons’ claims” that “does not entitle anyone to *be* in litigation”).

This Article examines the evolution of the class-waiver arbitration agreement, and concludes that there is no need for broad legislation restricting freedom of contract. Nor is there a need for judicial paternalism in holding that all class arbitration waiver procedures are *per se* unenforceable (whether through the unconscionability rubric or vindication-of-statutory-rights defense). Neither remedy is necessary because the businesses which desire the enforcement of these particular forms of arbitration agreements are proactively curing the issue.<sup>19</sup> The American public is engaging in a dialogue with corporate America, using the court system as their mouthpiece to demand what is reasonable and important in binding arbitration, and corporate America is listening. The result is an evolution of new “consumer-friendly” arbitration contracts—contracts *designed* by corporations to remedy defects found by courts voiding the clauses on the basis of unconscionability—whereby traditional concerns are alleviated.<sup>20</sup>

Part I of this Article will outline the landscape of attacks on the enforcement of individual arbitration of consumer claims, and describe the three areas in which issues regarding arbitrability arise. Part II will then turn to the question of enforceability, by describing the defense of unconscionability, exploring the origins of the vindication-of-statutory-rights doctrine, and analyzing their recent use in voiding class arbitration waivers. Part III will then examine how the market has responded to cases invalidating the class action waiver in the past, and propose that the solution is forthcoming: an arbitration agreement that provides an opportunity to opt out of binding arbitration and provides incentives for arbitrating even low-dollar individual claims. Finally, Part IV will explore the benefits of optional “incentivizing” arbitration agreements for both consumers and corporate providers in entering into the new phase of consumer arbitration agreements. These incentivizing arbitration agreements provide a tailored, inexpensive method of preserving the contract for binding, individual arbitration while ensuring that valid, albeit low-recovery claims, are capable of being pursued.

## I. LEVELING THE ARBITRATION PLAYING FIELD

Under the FAA, all “contract[s] evidencing a transaction involving commerce to settle by arbitration a controversy shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity

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<sup>19</sup> The latest iteration of arbitration agreements that are “consumer-friendly” are undoubtedly reactions to cases in jurisdictions that were universally hostile to class-waiver arbitration provisions. That these progressions are reactionary, however, does not take away from their evolution towards a class-waiver provision that should be enforceable under the traditional unconscionability or vindication-of-statutory-rights defenses.

<sup>20</sup> See *infra* Part IV.



for the revocation of any contract.”<sup>21</sup> In a series of cases, the Supreme Court interpreted this statutory provision as creating a substantive body of federal law, applicable in state courts, that places arbitration agreements on equal footing with other contracts.<sup>22</sup> Arbitration agreements may only be invalidated on state law grounds if the defense arose to govern the validity of general contracts.<sup>23</sup> In other words, state laws which operate solely to invalidate or discriminate against arbitration agreements are preempted by the FAA.<sup>24</sup> Not only did the Supreme Court advance the “liberal federal policy favoring arbitration agreements”<sup>25</sup> through these decisions, it has also held that in cases contesting the validity of the contract, as opposed to the arbitration clause alone, the decision of validity or enforcement is for the arbitrator—not the court.<sup>26</sup>

Thus, in the vast landscape of arbitration-land, there are generally three main vehicles to bring a party back to the familiar territory of the court: (1) Questions of Preemption; (2) Questions of Arbitrability—or “Who decides?”; and (3) Questions of Enforceability. Each of these questions is inter-related, particularly in the context of the class arbitration waiver.

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<sup>21</sup> 9 U.S.C. § 2 (2000).

<sup>22</sup> See, e.g., *Allied-Bruce Terminix Co. v. Dobson*, 513 U.S. 265, 281–82 (1995); *Perry v. Thomas*, 482 U.S. 483, 484 (1987) (invalidating state law that limited wage-collection actions to state court, “without regard to the existence of any private agreement to arbitrate” (citing CAL. LAB. CODE ANN. § 229 (West 1971))); *Southland Corp. v. Keating*, 465 U.S. 1, 10 (1984) (“In enacting § 2 of the federal Act, Congress declared a national policy favoring arbitration and withdrew the power of the states to require a judicial forum for the resolution of claims that the contracting parties agreed to resolve by arbitration.”); see also, Diane P. Wood, *The Brave New World of Arbitration*, 31 CAP. U. L. REV. 383 (2003) (“[T]here can be no denying that . . . the Court has systematically dismantled the remaining legal constraints that stood in the way of the recognition of agreements to arbitrate, the enforcement of such agreements, and the enforcement of the resulting arbitral awards.”).

<sup>23</sup> E.g., *Doctor’s Assocs., Inc., v. Casarotto*, 517 U.S. 681, 687 (1996); *Perry*, 482 U.S. at 492; *Southland*, 465 U.S. at 16.

<sup>24</sup> See, e.g., *Doctor’s Assocs., Inc.*, 517 U.S. at 687; *Perry*, 482 U.S. at 492.

<sup>25</sup> *Moses H. Cone Mem’l Hosp. v. Mercury Constr. Corp.*, 460 U.S. 1, 24 (1983). The Court has explicitly applied Section 2’s liberal policy favoring arbitration agreements to consumer contracts. As the Court stated in *Allied-Bruce Terminix Co. v. Dobson*, “We agree that Congress, when enacting [Section 2], had the needs of consumers, as well as others, in mind. . . . Indeed, arbitration’s advantages often would seem *helpful* to individuals, say, complaining about a product, who need a less expensive alternative to litigation.” 513 U.S. at 280 (emphasis added).

<sup>26</sup> *Buckeye Check Cashing, Inc. v. Cardegna*, 546 U.S. 440, 445–46 (2006) (“[U]nless the challenge is to the arbitration clause itself, the issue of the contract’s validity is considered by the arbitrator in the first instance.”); *Prima Paint Corp. v. Flood & Conklin Mfg. Co.*, 388 U.S. 395, 403–04 (1967) (“[I]f 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.”).

### A. *Questions of Preemption*

Although the FAA may have originally been intended to apply to only federal courts,<sup>27</sup> since the Supreme Court's 1984 decision in *Southland v. Keating*, the FAA's substantive application in state courts and preemption of state laws undercutting the enforceability of arbitration agreements has been accepted.<sup>28</sup> Clear cases of preemption by the FAA arise when state laws, on their face, purport to treat arbitration agreements differently from other contracts.<sup>29</sup> Section 2 of the FAA explicitly forbids this.<sup>30</sup> Thus, state laws cannot require arbitration agreements to be placed in a particular font,<sup>31</sup> nor can they foreclose certain classes of disputes from arbitration.<sup>32</sup>

A less clear issue is whether a state law defense generally applicable to all contracts, but developed in a specific way so as to apply only to arbitration clauses, is also preempted. This issue has particular significance to the class-arbitration-waiver analysis because some states have declared class arbitration waivers to be universally—or almost universally—void according to state law principles of unconscionability or public policy.<sup>33</sup> For example, in *Discover Bank v. Superior Court*,<sup>34</sup> the California Supreme Court set forth a standard of unconscionability in which most class arbitration waivers will be deemed substantively unconscionable.<sup>35</sup> Thus, in California, state law has potentially developed

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<sup>27</sup> See Stephen L. Hayford & Alan R. Palmiter, *Arbitration Federalism: A State Role in Commercial Arbitration*, 54 FLA. L. REV. 175, 182–85 (2002) (“[T]he FAA created no new rights and no independent federal-question jurisdiction. Rather, cast as a “procedural” statute, it declared the validity of arbitration agreements and mandated procedures to ensure their enforceability in the federal court . . .” (emphasis added)); see also *Southland*, 465 U.S. at 25 (“[O]ne rarely finds a legislative history as unambiguous as the FAA’s. That history establishes conclusively that the 1925 Congress viewed the FAA as a procedural statute, applicable only in federal courts . . .”) (O’Connor, J., dissenting); Wood, *supra* note 22, at 383 (“[The Court] has federalized the law of arbitration to a degree astonishing to those who have thought of the Rehnquist Court as the new expositor of states’ rights and federalism.”).

<sup>28</sup> *Southland*, 465 U.S. at 16.

<sup>29</sup> See *supra* note 24 and accompanying text.

<sup>30</sup> *Id.*

<sup>31</sup> *Doctor’s Assocs., Inc. v. Casarotto*, 517 U.S. 681, 687 (1996); see also *Allied-Bruce Terminex Co. v. Dobson*, 513 U.S. 265, 281 (1995) (holding that Section 2 of the FAA preempts state law making written pre-dispute arbitration agreements unenforceable).

<sup>32</sup> This was the issue in *Southland*. The Court held that § 31512 of the California Franchise Investment Law, to the extent the California Supreme Court interpreted it to require judicial consideration of claims brought under it, was preempted by the FAA. *Southland*, 465 U.S. at 16.

<sup>33</sup> See, e.g., *Discover Bank v. Superior Court*, 113 P.3d 1100, 1110 (Cal. 2005); *Scott v. Cingular Wireless*, 161 P.3d 1000 (Wash. 2007) (determining class arbitration waiver to be void as against public policy and unconscionable).

<sup>34</sup> *Discover Bank*, 113 P.3d at 1110.

<sup>35</sup> See *infra* note 59 and accompanying text. It should not be surprising that no California or Ninth Circuit court has found any consumer class arbitration waiver satisfactory under this test.

to treat arbitration agreements with class arbitration waivers differently from other contracts. If it is the case that according to state law, any arbitration agreement containing a class arbitration waiver is *per se* unenforceable—surely California’s strict treatment of arbitration agreements with class arbitration waivers would be preempted.<sup>36</sup> Although this issue may present a case for preemption on some occasion, the preemption issue has not evolved to an appropriate place for Supreme Court review at this juncture. Since state courts have carefully crafted language to indicate that their decisions are applicable only to the case at hand—and do not operate to invalidate *all* class arbitration waivers—it is possible, even probable, that the industry will develop an arbitration clause with a class waiver that is unsusceptible to unconscionability and vindication-of-statutory-rights defenses. However, before one arrives at the question of class-arbitration-waiver enforcement, one must first answer the question of who decides each of the foregoing issues—judge or arbitrator?

### B. *Questions of Arbitrability*

Certain issues may arise in which it must be determined “who decides” whether the claim proceeds to arbitration—the court or the arbitrator? Questions of arbitrability, which are reserved for the courts to determine in the first instance, are issues governing the *validity* of an arbitration clause or its applicability to the parties.<sup>37</sup> These questions of arbitrability are circumstances in which it is assumed that the parties intended courts, not arbitrators, to determine whether the matter should be referred to arbitration.<sup>38</sup> Other questions of contract interpretation such

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<sup>36</sup> This is the precise question raised by the petition for certiorari in *T-Mobile USA Inc v. Laster*, No. 07-976, 2008 WL 218932, *cert. denied*, 128 S. Ct. 2500 (2008) (seeking certiorari on the question presented, “Whether, under the Federal Arbitration Act, a federal court may refuse to enforce the terms of an agreement to arbitrate based upon a state-law policy that individual arbitration is unconscionable in cases involving small claims by a consumer?”). *Laster* was a petition for certiorari from a Ninth Circuit decision refusing to compel arbitration under California’s holding in *Discover Bank*. See *Laster v. T-Mobile USA, Inc.*, 252 Fed. Appx. 777 (9th Cir. 2007); see also *Subert v. Wells Fargo Auto Fin.*, No. 08-3754, 2008 WL 5451021 (D. N.J. Dec. 31, 2008) (holding that to the extent N.J. law renders class arbitration waivers unconscionable, it is preempted under the FAA). Whether a state could forbid the waiver of the right to a class action generally is a different question. No state yet has attempted to do so, and perhaps with good reason. Perhaps state legislatures and society want to preserve the right of parties to waive the right to class representation in exchange for lower consumer product prices, or facilitated individual representation.

<sup>37</sup> *Green Tree Fin. Corp. v. Bazzle*, 539 U.S. 444, 452 (2003).

<sup>38</sup> See *id.* If the primary question is always governed by the parties’ intent, one would assume the parties could draft an arbitration provision stating that questions of enforceability are always questions for an arbitrator to determine. But the remaining issue is whether there are some issues that courts assume parties always intended the court to decide, such as issues regarding the arbitration provision’s validity and scope, regardless of contractual language to the contrary.

as those concerning the arbitration procedural mechanisms,<sup>39</sup> the applicability of certain contract defenses (waiver, delay, etc.),<sup>40</sup> the interpretation of certain terms in the arbitration agreement,<sup>41</sup> or even a contest to the overall contract,<sup>42</sup> are questions that the arbitrator should decide. If the contest to the arbitration agreement is based on the enforceability of a class arbitration waiver—i.e., a *procedural* mechanism<sup>43</sup>—the determination of the validity of this measure should arguably be left to the arbitrator to decide. In other words, because the contest is not to the arbitration agreement, but to the interpretation of a procedural mechanism within the agreement, the matter should proceed to arbitration. But no court thus far has adopted this interpretation of the arbitrability analysis.<sup>44</sup>

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<sup>39</sup> *Id.* at 452 (holding that the determination of whether an arbitration agreement permits class arbitration is to be determined by arbitrator, not the court).

<sup>40</sup> *Howsam v. Dean Witter Reynolds, Inc.*, 537 U.S. 79, 84 (2002) (“[P]rocedural questions which grow out of the dispute and bear on its final disposition are presumptively *not* for the judge, but for an arbitrator, to decide. So, too, the presumption is that the arbitrator should decide allegations of waiver, delay, or a like defense to arbitrability.” (internal quotation marks and citations omitted)).

<sup>41</sup> *Pacificare Health Sys., Inc. v. Book*, 538 U.S. 401, 406 (2003) (determining the question of whether the exclusion of punitive damages renders an arbitration agreement unenforceable is a question for an arbitrator to determine).

<sup>42</sup> *Buckeye Check Cashing, Inc. v. Cardegna*, 546 U.S. 440, 445 (2006). (“[A]s a matter of substantive federal arbitration law, an arbitration provision is severable from the remainder of the contract,” thus, if the defense is to the contract as whole, as opposed to the arbitration agreement alone, the validity of the *contract* is a matter for the arbitrator, not the court, to determine).

<sup>43</sup> *See, e.g., Blaz v. Belfer*, 368 F.3d 501, 504–05 (5th Cir. 2004) (“[T]here is no substantive right to a class remedy; a class action is a procedural device” that does not “‘alter the parties’ burdens of proof, right to a jury trial, or the substantive prerequisites to recovery under a given tort’” (quoting *Southwestern Ref. Co., Inc. v. Bernal*, 22 S.W.3d 425, 437 (Tex. 2000))).

<sup>44</sup> *See, e.g., In re Am. Express Litig.*, 554 F.3d 300, 311–12 (2d Cir. 2009) (holding enforceability of class action waiver in arbitration clause was a “challenge to the arbitration clause itself,” and therefore, a gateway issue of judicial interpretation (internal quotation marks omitted)); *Gay v. Creditinform*, 511 F.3d 369 (3d Cir. 2007) (deciding issue of enforceability of class action waiver with no discussion of whether it is a gateway issue); *Kristian v. Comcast Corp.*, 446 F.3d 25, 42, 54 (1st Cir. 2007) (concluding that none of the plaintiffs’ claims presented clear questions of arbitrability, but deciding that the court should determine the enforceability of the class arbitration waiver because class representation was clearly prohibited which directly implicated the enforceability of the arbitration agreement); *Shroyer v. New Cingular Wireless Servs. Inc.*, 498 F.3d 976 (9th Cir. 2007) (deciding that the class action waiver, and the attendant arbitration clause were unenforceable without addressing the issue of arbitrability); *Jenkins v. First Am. Cash Advance*, 400 F.3d 868, 877 (11th Cir. 2005) (holding that the issue of the enforcement of the class action waiver “may be decided by federal court” because it attacks the validity of the arbitration agreement). *But see Anderson v. Comcast Corp.*, 500 F.3d 66, 72 (1st Cir. 2007) (holding that the class arbitration waiver applied “unless [state] laws provide otherwise,” and the statute under which the plaintiffs asserted their claims provided for the class mechanism. The issue of interpreting the applicability of the class arbitration waiver is not a gateway issue for a court to decide).

Given the schism between the Supreme Court's question-of-arbitrability analysis and its implementation by the state and federal courts in order to address the procedural issue of the class arbitration waiver, one might wonder why courts are taking it upon themselves to decide. One answer is precedent. In *Green Tree Financial Company-Alabama v. Randolph*,<sup>45</sup> the Court decided a similar issue regarding whether a plaintiff would be deprived of her opportunity to vindicate statutory rights due to potentially high arbitration costs.<sup>46</sup> The Court held that the plaintiff had not met her burden of showing prohibitive costs without addressing whether the "prohibitive costs" contest should be determined by the arbitrator in the first instance.<sup>47</sup> In subsequent years, courts faced with addressing the question of whether the class arbitration waiver presents a prohibitive costs problem have relied on *Randolph* in determining that this issue is in the proper province of the court.<sup>48</sup> A second reason courts may be deciding the issue is one of practicality. Some arbitration services have explicit mandates that would effectively bar them from deciding the validity of a class arbitration waiver, thereby leaving the courts as the sole available authority.<sup>49</sup> The final, and perhaps best reason, is that in some cases the validity of the arbitration agreement does depend, in some sense, on the enforcement of the class arbitration waiver.<sup>50</sup> For example, many arbitration clauses in consumer-products agreements state that if the class waiver is found unenforceable, then the entire arbitration agreement is unenforceable.<sup>51</sup> Thus, when the class arbitration

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<sup>45</sup> 531 U.S. 79 (2000).

<sup>46</sup> *Id.* at 90–91.

<sup>47</sup> *Id.*

<sup>48</sup> See, e.g., *Kristian*, 446 F.3d at 55. But reliance on *Randolph* in this arena is misplaced. *Bazzle* was decided three years after *Randolph* and established that the question of whether an arbitration agreement permits a class arbitration is a procedural matter for the arbitrator to decide. *Green Tree Fin. Corp. v. Bazzle*, 539 U.S. 444, 453 (2003).

<sup>49</sup> See, e.g., American Arbitration Association, AAA Policy on Class Arbitrations (July 14, 2005), <http://www.adr.org/Classarbitrationpolicy> (last visited Apr. 8, 2009). The AAA Policy states:

The Association is not currently accepting for administration demands for class arbitration where the underlying agreement prohibits class claims, consolidation or joinder, unless an order of a court directs the parties to the underlying dispute to submit any aspect of their dispute involving class claims, consolidation, joinder or the enforceability of such provisions, to an arbitrator or to the Association.

*Id.*

<sup>50</sup> Of course, the response to this argument is that because the class arbitration waiver is a procedural measure, its enforcement is an issue for the arbitrator to decide, and whether the arbitration agreement stands or falls based on that decision similarly becomes within the province of the arbitrator. This was the result of the Court's decision in *Pacificare Health Sys., Inc. v. Book*, 538 U.S. 401, 406–07 (2003).

<sup>51</sup> For example, Dell Corp. requires binding arbitration and a non-severable class waiver in connection with its retail computer sales:

NEITHER CUSTOMER NOR DELL SHALL BE ENTITLED TO JOIN OR CONSOLIDATE CLAIMS BY OR AGAINST OTHER CUSTOMERS, OR ARBI-

waiver is nonseverable from the arbitration agreement, it is at least arguable that the gateway issue of the validity of the arbitration clause is dependent on the enforceability of the class action waiver.<sup>52</sup> Whatever the reason, courts are deciding the issue of class-arbitration-waiver enforceability, which leads to the second, more important issue of whether an arbitration provision with the class waiver can, or should be, enforced.

## II. ENFORCEMENT OF ARBITRATION AGREEMENTS WITH CLASS ARBITRATION WAIVERS

Disputes as to the enforcement of class arbitration waivers in the context of consumer products generally come in two flavors: unconscionability and vindication of statutory rights. Although the two defenses are commonly considered interchangeably,<sup>53</sup> the nature of the elements involved when properly applied has made the vindication-of-statutory-rights defense more threatening to the enforcement of arbitration agreements with class waivers.

### A. *The Unconscionability Defense*

Unconscionability, a general state law defense to contracts, became the defense of choice in early cases contesting arbitration clauses in em-

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TRATE ANY CLAIM AS A REPRESENTATIVE OR CLASS ACTION OR IN A PRIVATE ATTORNEY GENERAL CAPACITY. The individual (non-class) nature of this dispute provision goes to the essence of the parties' arbitration agreement, and if found unenforceable, the entire arbitration provision shall not be enforced.

Dell's Online Policies, Terms and Conditions of Sale § 12, <http://www.dell.com> (follow "Terms of Sale" at bottom of page) (last visited Apr. 8, 2009). For similar non-severability clauses, see Time Warner Cable Residential Services Subscriber Agreement, § 14, [http://help.twcable.com/html/twc\\_sub\\_agreement.html](http://help.twcable.com/html/twc_sub_agreement.html) (last visited Apr. 8, 2009) ("If any portion of this section is held to be unenforceable, the remainder shall continue to be enforceable, except that if the prohibition against consolidated or class action arbitrations set forth above is found to be unenforceable, then the entirety of this arbitration clause shall be null and void."), and T-Mobile Terms & Conditions § 2, <http://www.t-mobile.com> (follow "Terms & Conditions" hyperlink at bottom of page) (last visited Apr. 8, 2009) ("If a court or arbitrator determines in a claim between you and us that your waiver of any ability to participate in class or representative actions is unenforceable under applicable law, the arbitration agreement will not apply . . ."). See also, Mark J. Levin, Drafting a "Bulletproof" Arbitration Agreement and Related Practice Issues, Presentation for CLE Teleconference: Class Action Arbitration Clauses Under Fire: Crafting Agreements to Withstand Court Scrutiny (May 16, 2007) (advising that the "arbitration clause should state that if the class action waiver is found to be unenforceable, the entire arbitration provision fails").

<sup>52</sup> Although there are arguments in favor of a court deciding the enforceability of a class arbitration waiver, the better result, and the one adopted by the Court in *Pacificare*, is that the procedural question is one for the arbitrator to decide. *Pacificare Health Sys., Inc. v. Book*, 538 U.S. 401, 406 (2003).

<sup>53</sup> *Kristian*, 446 F.3d at 60 n.22 ("[T]he unconscionability analysis always includes an element that is the essence of the vindication of statutory rights analysis—the frustration of the right to pursue claims granted by statute.").

ployment or consumer agreements.<sup>54</sup> The basic concept of unconscionability, as explained in the Official Comment to Uniform Commercial Code § 2-302, is “whether, in the light of the general commercial background and the commercial needs of the particular trade or case, the clauses involved are so one-sided as to be unconscionable under the circumstances existing at the time of the making of the contract.”<sup>55</sup> The unconscionability doctrine, of course, usually involves a now rudimentary two-pronged approach. The arbitration clause contestant must prove that the clause was either procedurally unconscionable or substantively unconscionable, and in most states, both. Procedural unconscionability focuses on the formation of the agreement; substantive unconscionability focuses on the actual terms of the agreement.<sup>56</sup> In both analyses, however, the crucial vantage point is viewing the fairness of the contract “under circumstances existing at the time of the making of the contract.”<sup>57</sup>

Defenses to arbitration agreements, in particular those with class action waivers, via the unconscionability rhetoric obtained only minimal victories at the early stages of these battles.<sup>58</sup> However, California

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<sup>54</sup> See Gilles, *supra* note 2, at 399 (“Plaintiffs challenging collective action waivers looked first to the common law contract doctrine of unconscionability.”); Susan Randall, *Judicial Attitudes Toward Arbitration and the Resurgence of Unconscionability*, 52 BUFF. L. REV. 185, 194–95 (2004) (postulating that in 2002–2003 68.5 percent of cases raised unconscionability as a defense involved arbitration agreements); Stephen J. Ware, *The Case for Enforcing Adhesive Arbitration Agreements—With Particular Consideration of Class Actions and Arbitration Fees*, 5 J. AM. ARB. 251, 265 (2006) (“Unconscionability is the contract-law ground on which courts most often rely in denying enforcement to adhesive arbitration agreements.”); Wood, *supra* note 22, at 407–08 (recognizing the “rhetoric of unconscionability” as a major theme in arbitration-clause defense).

<sup>55</sup> U.C.C. § 2-302 official cmt. (2003) (“The principle is one of the prevention of oppression and unfair surprise . . . and not of disturbance of allocation of risks because of superior bargaining power.”); Restatement (Second) of Contracts § 208 cmt. b (1981) (“Traditionally, a bargain was said to be unconscionable in an action at law if it was ‘such as no man in his senses and not under delusion would make on the one hand, and as no honest and fair man would accept on the other . . . .’”).

<sup>56</sup> See generally WILLISTON ON CONTRACTS § 18:10.

<sup>57</sup> U.C.C. § 2-302 official cmt.; see also Restatement (Second) of Contracts § 208 cmt. a (1981) (“The determination that a contract or term is or is not unconscionable is made in the light of its setting, purpose and effect.”); Ware, *supra* note 54, at 267 (“It is clear that a proper application of the unconscionability doctrine involves an assessment of the contract *ex ante*, rather than *ex post*.”).

<sup>58</sup> The Third, Fourth, Seventh, and Eleventh Circuits have refused to invalidate arbitration clauses with class action waivers due to a claim of unconscionability. See, e.g., Gay v. Creditinform, 511 F.3d 369, 395 (3d Cir. 2007); Jenkins v. First Am. Cash Advance, 400 F.3d 868, 878 (11th Cir. 2005) (class action waiver not unconscionable); Livingston v. Assocs. Fin., Inc., 339 F.3d 553, 557 (7th Cir. 2003) (rejecting plaintiffs’ claims that binding arbitration would preclude them from vindicating statutory rights due to plaintiffs’ failure to offer specific evidence of prohibitive costs and ordering individual arbitration); Snowden v. Checkpoint Cashing Co., 290 F.3d 631, 638 (4th Cir. 2002) (rejecting plaintiff’s unconscionability claim that without the class action vehicle, she will be unable to maintain legal representation given the small amount of individual damages). Several state courts have followed this trend.

courts (and federal courts applying California law), proved early on to be much less hospitable to any form of class arbitration waiver. In *Szetela v. Discover Bank*,<sup>59</sup> the California Court of Appeals held that an arbitration clause in a consumer credit-card agreement, waiving a right to participate in a representative action or act as a class representative, was “harsh and unfair to Discover customers who might be owed a relatively small sum of money” and “serve[d] as a disincentive for Discover to avoid the type of conduct that might lead to class action litigation in the first place.”<sup>60</sup> Since, according to the *Szetela* court, the clause exposed Discover to only small amounts of damages on behalf of those consumers who actually pursued arbitration (Szetela did in fact recover his \$29 through arbitration),<sup>61</sup> Discover’s allegedly bad business practices could go unchecked.<sup>62</sup> The Ninth Circuit adopted *Szetela*’s reasoning in 2003 in *Ting v. AT&T*,<sup>63</sup> and the California Supreme Court relied heavily on this reasoning in *Discover Bank v. Superior Court*,<sup>64</sup> when it held:

We do not hold that all class action waivers are necessarily unconscionable. But when the waiver is found in a consumer contract of adhesion in a setting in which disputes between the contracting parties predictably involve small amounts of damages, and when it is alleged that the party with the superior bargaining power has carried out a scheme to deliberately cheat large numbers of consumers out of individually small sums of money, then . . . the waiver becomes in practice the exemption of the party “from responsibility for [its] own fraud, or willful injury to the person or property of another.” Under these circumstances, such waivers are unconscionable under California law and should not be enforced.<sup>65</sup>

With the exception of California state courts and the federal courts in the Ninth Circuit, most courts have rejected the idea that binding indi-

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<sup>59</sup> 118 Cal. Rptr. 2d 862 (Cal. Ct. App. 2002).

<sup>60</sup> *Id.* at 868. The court held the agreement also exhibited procedural unconscionability, rejecting Discover’s argument that the availability of similar goods or services elsewhere reduced the adhesiveness of the contract, by focusing on the fact that the plaintiff was presented with the arbitration agreement on a “take it or leave it” basis “without opportunity for meaningful negotiation.” *Id.* at 867.

<sup>61</sup> *Id.* at 865.

<sup>62</sup> *Id.* at 868 (“By imposing this clause on its customers, Discover has essentially granted itself a license to push the boundaries of good business practices to their furthest limits, fully aware that relatively few, if any, customers will seek legal remedies, and that any remedies obtained will pertain to that single customer without collateral estoppel effect.”).

<sup>63</sup> 319 F.3d 1126, 1150 (9th Cir. 2003).

<sup>64</sup> 113 P.3d 1100, 1107 (Cal. 2005).

<sup>65</sup> *Id.* at 1110 (quoting CAL. CIV. CODE § 1668 (West 2009)) (internal citation omitted).



vidual arbitration is “so one-sided and unfair” as to be unconscionable.<sup>66</sup> In recent years, however, state courts and some federal courts have stricken arbitration agreements under the rhetoric of unconscionability.<sup>67</sup> The popularity of the defense is catching on, particularly when intermingled or confused with the vindication-of-statutory-rights defense.<sup>68</sup>

### B. *The Corollary to Unconscionability: Vindication of Statutory Rights*

A close corollary to the unconscionability defense is the argument that some class arbitration waivers are invalid because they render a party to the agreement unable to vindicate his statutory rights.<sup>69</sup> Despite early courts clearly rejecting the theory, the “vindication of statutory rights” analysis appears to be the new front-runner in attacking otherwise valid arbitration clauses.<sup>70</sup> A closer look at the origins of the vindica-

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<sup>66</sup> See, e.g., *Carter v. Countrywide Credit Indus., Inc.*, 362 F.3d 294, 301 (5th Cir. 2004) (applying Texas law in finding that a class action waiver was not unconscionable). Many courts in this context have failed to draw the distinction between viewing the fairness of the arbitration’s terms at the time of its making as is required by the traditional unconscionability analysis, see *Ware*, *supra* note 54 and accompanying text, and instead, have focused on whether the plaintiff’s predicament at presently being forced to arbitrate his particular claim is *ex post* unconscionable in light of potential costs involved. Nevertheless, those courts to initially address the issue under the unconscionability analysis still refused to find them so oppressive as to require that they not be enforced. See *supra* note 58.

<sup>67</sup> See, e.g., *Dale v. Comcast Corp.*, 498 F.3d 1216, 1224 (11th Cir. 2007); *Kinkel v. Cingular Wireless*, 857 N.E.2d 250, 278 (Ill. 2006); *Scott v. Cingular Wireless*, 161 P.3d 1000, 1009 (Wash. 2007).

<sup>68</sup> By focusing on the claimant’s ability to vindicate statutory rights in the unconscionability analysis, a court will improperly view the fairness of the terms of the contract as they exist after the dispute has arisen, as opposed to the fairness of the terms as they existed at the time the parties entered the agreement. For example, in *Kinkel v. Cingular Wireless*, the Supreme Court of Illinois explained that its doctrine of substantive unconscionability as applied to a case involving class action waivers required analysis of:

... [W]hether a waiver of the ability to bring a class claim is so onerous or oppressive that it is substantively unconscionable when: (1) the waiver is contained in a contract that contains a mandatory arbitration provision, but does not reveal the cost of arbitration to the claim, (2) the cost will be \$125, and (3) the *underlying claim* involves actual damages of \$150.

The nature of the underlying claim is also relevant to this inquiry. . . .

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... Thus, when considering the cost-price disparity factor of substantive unconscionability, we must consider that the cost to the plaintiff of attempting to vindicate her \$150 claim, in the absence of the ability to bring a class claim, would be \$125 plus her attorney fees. As a result, if she were to prevail on the merits of her claim and be awarded \$150 in damages, it is an absolute certainty that she would not be made whole.

857 N.E.2d at 267–68 (emphasis added) (internal quotation marks and citations omitted).

<sup>69</sup> See e.g., *Kristian v. Comcast Corp.*, 446 F.3d 25, 61 (1st Cir. 2006); *Scott*, 161 P.3d at 1006.

<sup>70</sup> For courts rejecting the vindication-of-statutory-rights theory as a viable defense, see *Johnson v. W. Suburban Bank*, 225 F.3d 366, 373 (3d Cir. 2000) (“[E]ven if plaintiffs who sign valid arbitration agreements lack the procedural right to proceed as part of a class, they

tion-of-statutory-rights defense, however, reveals that the courts invoking this defense to invalidate some class arbitration waivers may be missing the mark.

### 1. The Vindication-of-Statutory-Rights Trilogy

Ironically, the vindication-of-statutory-rights defense did not develop as a defense to arbitration agreements, but rather as an implicit recognition of the equality of the arbitral forum with the judicial forum. The Supreme Court first used the “effectively vindicate” language in *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*,<sup>71</sup> a case concerning the applicability (and enforcement) of an arbitration agreement between a domestic corporation and an international corporation with respect to domestic antitrust claims.<sup>72</sup> The jurisprudence at that time was that pre-dispute agreements to arbitrate were unenforceable with respect to domestic antitrust claims,<sup>73</sup> and in *Mitsubishi Motors Corp.*, the First

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retain the full range of rights created by the TILA.”); *Randolph v. Green Tree Fin. Corp.-Ala.*, 244 F.3d 814, 819 (11th Cir. 2001) (“[A] contractual provision to arbitrate TILA claims is enforceable even if it precludes a plaintiff from utilizing class action procedures in vindicating statutory rights under TILA”); and *Livingston v. Assocs. Fin., Inc.*, 339 F.3d 553, 557 (7th Cir. 2003) (rejecting the plaintiffs’ claims that binding arbitration would preclude them from vindicating statutory rights due to the plaintiffs’ failure to offer specific evidence of prohibitive costs and ordering individual arbitration).

<sup>71</sup> 473 U.S. 614, 637 (1985).

<sup>72</sup> *Mitsubishi Motors Corporation*, a Japanese automobile manufacturer, entered into an agreement with Soler Chrysler-Plymouth that provided for the direct sales of Mitsubishi products to Soler and allowed Soler, a Chrysler dealer, to sell and market these Mitsubishi products in Puerto Rico. *Id.* at 617. The sales agreement also provided for mandatory arbitration of all disputes arising out of the agreement. *Id.* The arbitration was required to proceed in Japan pursuant to the rules of the Japan Commercial Arbitration Association. *Id.* Mitsubishi brought an action against Soler in the United States District Court for the District of Puerto Rico seeking to compel arbitration of breach-of-contract claims in accordance with the Sales Agreement. *Id.* at 618–19. Soler denied the allegations in Mitsubishi’s complaint, and counter-claimed against both Mitsubishi and its co-defendant, alleging various breach-of-contract claims by Mitsubishi, defamation claims, and statutory claims, including a cause of action under the Sherman Act, 15 U.S.C. §§ 1–16 (2006). *Mitsubishi*, 473 U.S. at 619–20.

<sup>73</sup> The United States Court of Appeals for the Second Circuit held that rights conferred under federal antitrust laws were “of a character inappropriate for enforcement by arbitration” in *American Safety Equipment Corp. v. J.P. Maguire & Co.*, 391 F.2d 821, 827 (2d Cir. 1968). The other circuits uniformly adopted this holding. *See, e.g.*, *Applied Digital Tech., Inc. v. Cont’l Cas. Co.*, 576 F.2d 116, 117 (7th Cir. 1978) (refusing to enforce an arbitration agreement when antitrust issues permeate the case); *Cobb v. Lewis*, 488 F.2d 41, 47 (5th Cir. 1974) (recognizing exception for post-dispute arbitration agreements); *Helpfenbein v. Int’l Indus.*, 438 F.2d 1068, 1070 (8th Cir. 1971); *A. & E. Plastik Pak Co. v. Monsanto, Co.*, 396 F.2d 710, 715–16 (9th Cir. 1968). Each of these cases prohibiting the arbitration of domestic antitrust claims, of course, was impliedly overturned by *Mitsubishi* and *Rodriguez v. Shearson/Am. Express, Inc.*, 490 U.S. 477, 480 (1989) (reversing *Wilko v. Swan*, 346 U.S. 427 (1953), and holding that pre-dispute arbitration agreements covering claims arising under §14 of the Securities Act, 15 U.S.C. § 77, are enforceable because “*Wilko* is pervaded by . . . ‘the old judicial hostility to arbitration.’” (quoting *Kulukundis Shipping Co. v. Amtorg Trading Corp.*, 126 F.2d 978, 985 (2d Cir. 1942))).

Circuit held that this policy was valid even in the wake of an international agreement.<sup>74</sup> The Supreme Court granted certiorari for the case “primarily to consider whether an American court should enforce an agreement to resolve antitrust claims by arbitration when that agreement arises from an international transaction,”<sup>75</sup> but the Court’s decision had implications beyond the international-arbitration-agreement context.

a. Vindication of statutory rights: A judicially created defense

Before addressing the issue of the arbitrability of antitrust claims in the international context, the Court discussed defendant Soler’s contention that a court may not construe an arbitration agreement to reach statutory claims unless the party that the statute was designed to protect expressly agreed to arbitrate those statutory claims.<sup>76</sup> Relying on prior precedent requiring the Court to “rigorously enforce agreements to arbitrate,”<sup>77</sup> the Court stated, “[A]s with any other contract, the parties’ intentions control, but those intentions are generously construed as to issues of arbitrability.”<sup>78</sup> The Court then rejected any basis for departing from the federal substantive law favoring arbitration to create a judicial exception to arbitration for claims founded on statutory rights.<sup>79</sup> Although the Court did not foreclose the idea that statutory claims may ever be excluded from the realm of arbitrability, it held that an explicit Con-

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74 *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*, 723 F.2d 155, 169 (1st Cir. 1983). The First Circuit reversed the district court’s holding that the international character of the Mitsubishi-Soler agreement required enforcement of the arbitration agreement, despite contrary circuit court authority. *Id.* It held that the “nonarbitrability of antitrust issues is alive, well, [and] justified both in its conception and in its application,” even as to international agreements. *Id.* at 163. The court set forth four rationales for this “judicially created” exception for antitrust claims from the strong policy in favor of arbitration governed by the FAA: (1) private parties play an intrinsic role in aiding government enforcement of the antitrust laws via the private action with treble damages, of which judicial action is an indispensable ingredient; (2) the “strong possibility” that contracts which generate antitrust disputes may be contracts of adhesion; (3) antitrust issues are “prone to be complicated, and the evidence extensive and diverse;” and (4) antitrust issues are “too important to be lodged in arbitrators chosen from the business community—particularly those from a foreign community that has had no experience with or exposure to our law and values.” *Id.* at 162. These arguments are remarkably similar to those voiced in opposition to permitting class arbitration waivers in the context of consumer products or employment agreements.

75 *Mitsubishi*, 473 U.S. at 624.

76 *Id.* at 626.

77 *Id.* at 626 (quoting *Dean Witter Reynolds, Inc. v. Byrd*, 470 U.S. 213, 221 (1985)).

78 *Id.*

79 The Court acknowledged that agreements to arbitrate may be revoked on the same grounds as those that would require the revocation of any contract, such as fraud or overwhelming economic power, but it stated that “absent such considerations, the [FAA] provides no basis for disfavoring agreements to arbitrate statutory claims by skewing the otherwise hospitable inquiry into arbitrability.” *Id.*

gressional intention to exclude the statutory claim from the ambit of the FAA must be evident.<sup>80</sup>

The Court's reasoning for the express-exclusion requirement provides the basis for modern-day vindication-of-statutory-rights attacks on arbitration clauses: "By agreeing to arbitrate a statutory claim, a party does not forgo the substantive rights afforded by the statute; it only submits to their resolution in an arbitral, rather than a judicial, forum."<sup>81</sup> Because the protected party's substantive rights under the statute are preserved and capable of vindication in the arbitral forum, the party has only "trad[ed] the procedures and opportunity for review of the courtroom for the simplicity, informality, and expedition of arbitration."<sup>82</sup>

Turning to the arbitrability of antitrust issues between a domestic and an international party, the Court held that rules of international comity, The Arbitration Convention, and the presumption in favor of enforcement of freely negotiated, contractual choice-of-forum provisions outweighed judicial protectionism of antitrust claims.<sup>83</sup> The Court reiterated that a party resisting arbitration may directly attack the arbitration clause if enforcement would be "unreasonable and unjust or [if] proceedings in the contractual forum will be so gravely difficult and inconvenient that [the resisting party] will for all practical purposes be deprived of his day in court."<sup>84</sup>

The Court also rejected the proposition that an arbitration proceeding would pose innate hostility to the free-market ideal of competition: "We decline to indulge the presumption that the parties and arbitral body conducting a proceeding will be unable or unwilling to retain competent, conscientious, and impartial arbitrators."<sup>85</sup> Finally, the Court rejected the public policy suggestion that the importance of the private litigant,

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<sup>80</sup> *Id.* at 627. Of course, parties to the agreement could always draft an arbitration agreement excluding all or some statutory claims.

<sup>81</sup> *Id.* at 628.

<sup>82</sup> *Id.*

<sup>83</sup> Regarding *American Safety Equipment Corp. v. J.P. Maguire & Co.*, 391 F.2d 821 (2d Cir. 1968), and the four doctrinal rationales distilled by the First Circuit with skepticism, the Court found the second rationale—the possibility that contracts which generate antitrust issues may be contracts of adhesion—unjustified. *Mitsubishi*, 473 U.S. at 632. With respect to the third rationale—the judicial retention rationale (based on the complexity of the law and the proof)—the Court adhered to the view that "adaptability and access to expertise are hallmarks of arbitration" and that parties are free to take into account the complexity of the issue when appointing the arbitrators. *Id.* at 633. In addition, the Court noted that at the time of the contract, the parties when contracting, mutually preferred a procedure that would produce "streamlined proceedings and expeditious results"—a preference that would be well-served by reduced complexity. *Id.* The Court also recognized that most lower courts following the *American Safety* doctrine were quite willing to enforce post-dispute agreements to arbitrate antitrust issues regardless of levels of complexity. *Id.*

<sup>84</sup> *Mitsubishi*, 473 U.S. at 632 (internal quotation marks omitted) (alteration in original).

<sup>85</sup> *Id.* at 634.

aided by the promise of treble damages, to promoting the enforcement of antitrust laws could remove antitrust claims from the arbitral sphere.<sup>86</sup> Although the clear import of the treble damages provision is to enable an injured competitor to gain remedial damages,<sup>87</sup> the cause of action remains at all times under the control of the individual: no citizen is required to bring an antitrust suit, and no citizen is prohibited from settling an antitrust suit for less than full value.<sup>88</sup> Thus, a prospective litigant may provide in advance for a mutually agreeable procedure to settle his controversies, including his antitrust claims.<sup>89</sup> The cornerstone of the Court's theory was based on this premise: "[S]o long as the *prospective* litigant effectively may vindicate its statutory cause of action in the arbitral forum, the statute will continue to serve both its remedial and deterrent function."<sup>90</sup> Thus, in a case intended to cast arbitration, even of remedial statutes, on equal or more favorable footing as the judicial forum, the Court crafted language that would soon give rise to a method for invalidating arbitration agreements.

b. *Mitsubishi's* legacy: Arbitrating employment discrimination claims

*Mitsubishi* laid the cornerstone for the Court's sheltered fostering of arbitration agreements. In the years following *Mitsubishi*, the Court held enforceable arbitration agreements arising out of various protective statutes such as § 10(b) of the Securities Exchange Act of 1934,<sup>91</sup> the Racketeer Influenced and Corrupt Organizations Act (RICO),<sup>92</sup> and § 12(2) of the Securities Act of 1933<sup>93</sup>. The next progression in the evolution of the vindication-of-statutory-rights defense came in *Gilmer v. Interstate/Johnson Lane Corp.*,<sup>94</sup> another pro-arbitration case, holding enforceable

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<sup>86</sup> *Id.* at 636.

<sup>87</sup> The Court recounted the legislative history of § 4 of the Clayton Act which, when reenacted in 1914, was still "conceived primarily as open[ing] the door of justice to every man, whenever he may be injured by those who violate the antitrust laws, and [giving] the injured party ample damages for the wrong suffered." *Id.* at 636 (quoting *Brunswick Corp. v. Pueblo Bowl-O-Mat, Inc.*, 429 U.S. 477, 486 n. 10 (1977) (internal quotation marks omitted)).

<sup>88</sup> *Id.* at 636.

<sup>89</sup> *Id.*

<sup>90</sup> *Id.* at 637 (emphasis added). The Court's focus on the *prospective* litigant in this language should not be overlooked. So long as the parties, at the time of drafting the arbitration agreement, are not foreclosed of the opportunity to vindicate statutory rights by choosing the arbitral forum (and it is hard to see how they would be), the arbitration agreement should be upheld regardless of the parties' changed circumstances in light of post-contractual litigation. Thus, like the unconscionability analysis, the Court's focus under a vindication-of-statutory-rights analysis should be guided by the *ex ante* position of the parties.

<sup>91</sup> *Shearson/Am. Express, Inc. v. McMahon*, 482 U.S. 220, 238 (1987).

<sup>92</sup> *Id.* at 242.

<sup>93</sup> *Rodriguez de Quijas v. Shearson/Am. Express, Inc.*, 490 U.S. 477, 481 (1989).

<sup>94</sup> 500 U.S. 20, 28–29 (1991).

an arbitration agreement to handle disputes arising under the Age Discrimination in Employment Act (ADEA).

The *Gilmer* plaintiff contended that claims arising under the ADEA were unsuitable for arbitration because the ADEA was designed to address important social policies in addition to individual grievances.<sup>95</sup> After recognizing *Mitsubishi's* holding that the arbitral forum is an equal, if not better, forum for furthering broad social purposes, the Court reiterated, "So long as the prospective litigant effectively may vindicate [his or her] statutory cause of action in the arbitral forum, the statute will continue to serve both its remedial and deterrent function."<sup>96</sup>

Part of *Gilmer's* argument that arbitration procedures could not adequately further the purposes of the ADEA was based on the fact that the procedures did not provide for class actions or broad equitable relief. The Court disagreed that this procedural inconsistency rendered arbitration irreconcilable with the ADEA, noting that arbitrators do have the power to fashion equitable relief and that the arbitration rules at issue also provided for collective proceedings. But the Court noted, "even if the arbitration could not go forward as a class action or class relief could not be granted by the arbitrator, the fact that the [ADEA] provides for the possibility of bringing a collective action does not mean individual attempts at conciliation were intended to be barred."<sup>97</sup> Thus, the Court impliedly recognized that an employee still maintains the ability to effectively vindicate his or her statutory rights under the ADEA in the arbitral forum even if that forum results in the waiver of the opportunity to bring a class action.

c. Drafting a defense: *Green Tree Financial Corp.-Alabama v. Randolph*

Although the Court mentioned the litigants' opportunity to "effectively . . . vindicate" statutory rights in both *Mitsubishi* and *Gilmer*, it

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<sup>95</sup> *Id.* at 27.

<sup>96</sup> *Id.* at 28. (citing *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*, 473 U.S. 614, 637 (1985) (alterations in original)). In contrast to *Mitsubishi*, which involved an agreement between two commercial organizations, *Gilmer* involved an agreement between an employee and employer. Nonetheless, the Court found the distinction irrelevant, stating that "[m]ere inequality in bargaining power . . . is not a sufficient reason to hold that arbitration agreements are never enforceable in the employment context." *Id.* at 33. The Court reminded other courts to "remain attuned to well-supported claims that the agreement to arbitrate resulted from the sort of fraud or overwhelming economic power that would provide grounds for the revocation of any contract." *Id.* (quoting *Mitsubishi*, 473 U.S. at 627). The Court, however, found no such proof in this case. *Id.*

<sup>97</sup> *Id.* at 32 (quoting *Nicholson v. CPC Int'l Inc.*, 877 F.2d 221, 241 (3d Cir. 1989) (Becker, J., dissenting)). Any concerns about relinquishing class relief through binding arbitration were lessened by the Court's recognition that arbitration agreements do not preclude the EEOC from bringing actions that seek class-wide and equitable relief. *Id.*

was in the context of recognizing the arbitral forum as equally adequate to a judicial forum for the vindication of those rights as the judicial forum. It was not until *Green Tree Financial Corp.-Alabama v. Randolph*<sup>98</sup> that the opportunity—or purported lack thereof—to vindicate statutory rights based on prohibitive costs was presented to the Court as a defense to arbitration. Plaintiff Randolph filed class claims under the Truth in Lending Act (TILA) and Equal Credit Opportunity Acts, and defendant Green Tree moved to compel arbitration pursuant to a binding arbitration agreement.<sup>99</sup> The plaintiff contended that the arbitration agreement's silence as to costs and fees created a risk that she would be required to pay prohibitive arbitration costs if relegated to the arbitral forum, forcing her to forgo any statutory claims she possessed.<sup>100</sup> Placing the burden of proof of prohibitive costs on the plaintiff, the Court held that given the arbitration agreement's silence as to costs and the absence of reliable evidence in the record as to what her costs would be, she had not carried that burden.<sup>101</sup> But the Court did not completely foreclose the possibility of an "effectively vindicate" defense, stating: "It may well be that the existence of large arbitration costs could preclude a litigant such as Randolph from effectively vindicating her federal statutory rights in the arbitral forum."<sup>102</sup> This recognition that costs could, if properly and conclusively proven, form a defense to an arbitration clause laid the foundation for a new strategy in the anti-arbitration defense.

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<sup>98</sup> 531 U.S. 79 (2000).

<sup>99</sup> Although the arbitration agreement apparently did not expressly preclude class arbitration, the Court did not address this argument, nor did it address the propriety of class arbitration. *Green Tree Fin. Corp. v. Bazzle*, 539 U.S. 444, 452 (2003), in which the Court held that the arbitrator must decide whether the arbitration agreement permits class arbitration when silent with respect thereto, was not decided until three years later.

<sup>100</sup> Neither party disputed the arbitration clause's applicability to all claims, even statutory claims, arising under the contract, and Ms. Randolph did not contend that the TILA evinces a clear intention by Congress to preclude waiver of judicial (or class) remedies. *Randolph*, 531 U.S. at 90.

<sup>101</sup> *Id.* at 92.

<sup>102</sup> *Id.* The Court declined to address the plaintiff's contention that the arbitration agreement was unenforceable because it prevented her from bringing her TILA claims as a class action because the court of appeals had not yet decided on that issue. *Id.* at 92 n.7. The Court also did not address the underlying question of whether the vindication-of-statutory-rights issue is a question of arbitrability reserved for a court to determine, or whether it is a matter for the arbitrator to decide. On the one hand, if the existence of prohibitive arbitration costs did actually deprive a plaintiff of her opportunity to effectively vindicate statutory rights, the arbitration agreement would be unenforceable, and hence, a question for the court to decide in the first instance. See *Buckeye Check Cashing, Inc. v. Cardegna*, 546 U.S. 440, 445–46 (2006). On the other hand, if the crux of vindication-of-statutory-rights argument is based on an interpretation of the procedures and penalties available in the arbitration procedures, such as limits on discovery, costs, and damages, the question should be for the arbitrator to decide. See *Bazzle*, 539 U.S. at 452 (holding that the arbitrator should decide procedural gateway matters, such as whether an arbitration clause permits a class action).

d. The *Mitsubishi* trilogy summarized

Three main principles can be gleaned from *Mitsubishi* and its progeny. First, absent an explicit expression from Congress that it intends the substantive protection afforded by the statute to include prohibiting the waiver of a judicial forum, the statutory claim will be facially arbitrable.<sup>103</sup> Second, by agreeing to arbitration, a party does not relinquish the substantive protection of the statute. Much like the operation of a specialized forum selection clause, the party has simply agreed to the adjudication of his rights in an arbitral, rather than judicial forum.<sup>104</sup> Finally, “so long as the *prospective* litigant *effectively* may vindicate its statutory cause of action in the arbitral forum, the statute will continue to serve both its remedial and deterrent purposes.”<sup>105</sup> In particular, the third principle prompted the use of the defense based on prohibitive costs against the enforcement of the class arbitration waiver.<sup>106</sup>

2. Contemporary Usage of the Vindication-of-Statutory-Rights Analysis

Drawing on *Mitsubishi*, the *Randolph* Court contemplated whether an arbitration clause may be rendered invalid if the proven costs are so prohibitive as to prevent the litigant from affording him or herself of the statutory protection.<sup>107</sup> But *Randolph* also recognized that the burden of proof is on the party resisting arbitration.<sup>108</sup> How much proof is necessary before the opposing party can succeed on a cost-based, vindication-

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<sup>103</sup> *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*, 473 U.S. 614, 628 (1985); see also *Gilmer v. Interstate/Johnson Lane Corp.*, 500 U.S. 20, 26 (1991) (noting that the burden is on the party opposing arbitration to show “that Congress intended to preclude a waiver of a judicial forum for ADEA claims”); *Rodriguez de Quijas v. Shearson/Am. Express*, 490 U.S. 477, 483 (1989); *Shearson/Am. Express, Inc. v. McMahon*, 482 U.S. 220, 227 (1987) (“If Congress did intend to limit or prohibit waiver of a judicial forum for a particular claim, such an intent will be deducible from [the statute’s] text or legislative history, or from an inherent conflict between arbitration and the statute’s underlying purposes.” (internal quotation marks omitted)). To date, the Court has never found a Congressional intent to preclude a waiver of the judicial forum from any contested remedial statute. *Gilmer*, 500 U.S. at 26. The three potential areas for the Court to discern such an intent are from the text, legislative history, or an “inherent conflict” between the arbitration and the statute’s underlying purposes. *Id.* It is in this third area that the controversy typically arises. *Id.* Of course, this premise does not foreclose any party from contractually *exempting* statutory claims from arbitration. See, e.g., *Mitsubishi*, 473 U.S. at 628.

<sup>104</sup> *Gilmer*, 500 U.S. at 27; *Mitsubishi*, 473 U.S. at 628.

<sup>105</sup> *Mitsubishi*, 473 U.S. at 637 (emphasis added).

<sup>106</sup> See, e.g., *In re Am. Express Merchants’ Litig.*, 554 F.3d 300, 319 (2d Cir. 2009) (relying on *Mitsubishi* to hold that the class arbitration waiver precluded the vindication of antitrust claims when the cost of litigating individual claims exceeded estimated individual recovery).

<sup>107</sup> *Green Tree Fin. Corp.-Ala. v. Randolph*, 531 U.S. 79, 92 (2000).

<sup>108</sup> *Id.*



of-statutory-rights claim?<sup>109</sup> And how much expense to be incurred is prohibitive?<sup>110</sup> Is the prohibitive-cost analysis always dependent on the amount of damages at stake, or the plaintiff's subjective capability to pay? If it is, are plaintiffs deprived of their opportunity to vindicate statutory rights in the presence of court filing fees?<sup>111</sup> The *Randolph* Court declined to answer these questions, concluding that the plaintiff did not timely produce evidence substantiating the costs she would incur as to merit consideration.<sup>112</sup>

In addressing the question of cost-prohibitive arbitration in light of a class arbitration waiver, other courts have been increasingly likely to assume that consumers will forgo small recovery claims absent the class mechanism.<sup>113</sup> For example, in *Kristian v. Comcast Corp.*, the court held that the plaintiffs would be prohibited from vindicating their anti-trust claims through individual arbitration for three reasons: (1) the com-

<sup>109</sup> Compare *Kristian v. Comcast Corp.*, 446 F.3d 25, 58 (1st Cir. 2006) (holding plaintiffs had proven prohibitive costs when plaintiffs produced unopposed expert affidavits describing the elaborate factual inquiry required to litigate antitrust claims and expert witness fees ranging upwards from \$300,000), with *Fiser v. Dell Comp. Corp.*, 165 P.3d 328, 348 (N.M. Ct. App. 2007), *rev'd*, 188 P.3d 1215 (N.M. 2008) (holding plaintiff's contention that "common sense dictates that consumers do not hire lawyers to privately arbitrate claims for amounts in the neighborhood of \$5-\$100," insufficient, in the absence of other evidence of costs, to prove that the plaintiff faced prohibitive costs).

<sup>110</sup> See, e.g., *Adler v. Dell, Inc.*, No. 08-CV-13170, 2008 WL 5351042, at 8-9 (E.D. Mich. Dec 18, 2008) (holding that the potential statutory recovery of \$250 plus attorney fees was sufficient to overcome the argument that without class certification, the plaintiff would be effectively prohibited from pursuing the claim).

<sup>111</sup> See, e.g., *Kinkel v. Cingular Wireless*, 857 N.E.2d 250, 275 (Ill. 2006) ("[T]he enforceability of a class action waiver, whether or not the contract provides for mandatory arbitration, must be determined on a case-by-case basis, considering the total of the circumstances. Relevant circumstances include . . . the cost of vindicating the claim relative to the amount of damages that might be awarded under the dispute resolution provisions of the contract.").

<sup>112</sup> *Randolph*, 531 U.S. at 92. *Randolph* had, however, presented some evidence—albeit in an untimely manner. *Id.* at 91. In her motion for reconsideration in the district court, *Randolph* alleged that if the arbitration proceeded before the American Arbitration Association, the combined fees would be \$500 for claims under \$10,000, not including the cost of the arbitrator or administrative fees. *Id.* at 91 n.6. The plaintiff also produced scant, indirect evidence that the arbitral fee could be \$700 per day. *Id.* The Court rejected these "unsupported statements" because the plaintiff failed to show that the AAA would conduct the arbitration proceeding (the agreement was silent with respect to arbitration services) or that she would be charged the complete filing fee and arbitrator's fee she identified. *Id.*

<sup>113</sup> See e.g., *Kristian*, 446 F.3d 25; *Scott v. Cingular Wireless*, 161 P.3d 1000 (Wash. 2007). No court to date has analyzed the bargain to waive potential recovery of small dollar amounts via the class mechanism in exchange for a relatively cheap, perhaps free, and streamlined proceeding to recover more substantial claims that would still be unworthy of litigating on an individual basis through a judicial forum. The court in *Johnson v. W. Suburban Bank*, 225 F.3d 366, 374 (3d Cir. 2000), came close however, by recognizing that class actions do not necessarily give plaintiffs better incentives to bring private enforcement actions: "The sums available in recovery to individual plaintiffs are not automatically increased by use of the class forum. Indeed individual plaintiff recoveries available in a class action may be lower than those possible in individual suits because the recovery under TILA's statutory cap is spread over the entire class."

plexity of litigating an antitrust case which involves an “elaborate factual inquiry;”<sup>114</sup> (2) the excessive costs of expert fees, which the plaintiffs’ economists estimated to be between \$300,000 and \$600,000;<sup>115</sup> and (3) the lack of a monetary incentive to encourage attorney representation in individual antitrust arbitration.<sup>116</sup> The plaintiffs estimated the individual recovery per class member ranged from a few hundred dollars to a few thousand dollars.<sup>117</sup> The *Kristian* court failed to recognize that even if individual claims could not be aggregated in a formal class proceeding pursuant to the arbitration agreement, nothing prevented the plaintiffs—and their attorneys—from informally coordinating efforts on factual discovery, expert witnesses, and litigation preparation to defray costs. Setting aside this oversight, the *Kristian* holding can basically be attributed to a lack of incentives for (1) the consumer to pursue low-dollar claims, and (2) attorneys to represent consumers in connection with low-dollar claims. The result of this lack of incentives, according to the *Kristian* court, is that:

Comcast [would] be essentially shielded from private consumer antitrust enforcement liability, even in cases where it has violated the law. Plaintiffs will be unable to vindicate their statutory rights. Finally, the social goals of federal and state antitrust laws will be frustrated because of the “enforcement gap” created by the de facto liability shield.<sup>118</sup>

Similarly, in *Scott v. Cingular Wireless*,<sup>119</sup> the Washington Supreme Court applied a vindication-of-statutory-rights analysis under the guise of

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<sup>114</sup> *Kristian*, 446 F.3d at 58. *But see* *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*, 473 U.S. 614, 632 (1985) (noting that at the time of the arbitration agreement the parties mutually preferred a procedure that would produce streamlined proceedings and expeditious results—a preference that would be well-served by the reduced complexity of arbitration, even as it pertains to antitrust claims).

<sup>115</sup> *Kristian*, 446 F.3d at 58. Similarly, in *In re American Express Merchants’ Litig.*, 554 F.3d 300, 317–18 (2d Cir. 2009), the Second Circuit relied on *Kristian* and found a class arbitration waiver unenforceable based on expert testimony that the antitrust claims could range from several hundred thousand dollars to over a million dollars, and that the median plaintiff’s recovery, when trebled, averaged approximately \$5,252.

<sup>116</sup> *Kristian*, 446 F.3d at 59 & n.21. The *Kristian* court recognized that antitrust statutes provide for an award of attorney’s fees for prevailing plaintiffs. *Id.* But it reasoned that, aside from being a poor investment, “being made whole is hardly a sufficient incentive for an attorney to invest in a case such as this when time spent on more predictable cases would be advantageous, and frankly, rational.” *Id.*

<sup>117</sup> *Id.* at 54.

<sup>118</sup> *Id.* at 61. The response to the *Kristian* court’s vindication-of-statutory-rights decision based on the consumer’s lack of incentives is that it would be entirely reasonable for the prospective litigant to relinquish the right or capability to litigate expensive, complex claims with a proportionally small payoff in exchange for the opportunity to cost-effectively arbitrate more substantial claims with a proportionally advantageous payoff.

<sup>119</sup> 161 P.3d 1000 (Wash. 2007).

unconscionability. The court held that the class arbitration waiver is unconscionable because it “effectively denies plaintiffs a forum to vindicate the consumer protections guaranteed by Washington law and effectively exculpates its drafter from liability for a broad range of wrongful conduct.”<sup>120</sup> Notably, the *Scott* arbitration clause involved a second-generation arbitration clause,<sup>121</sup> in which Cingular agreed to pay all costs of the arbitration, unless the consumer’s claim was found to be frivolous. In addition, Cingular agreed to pay the consumer’s reasonable attorney fees and expenses incurred in the arbitration if the consumer recovered at least the demand amount.<sup>122</sup> Even with these “laudable” provisions,<sup>123</sup> by which a consumer could arbitrate a legitimate dispute essentially for free, the Washington Supreme Court held it would be “impracticable to pursue on an individual basis” low-value claims.<sup>124</sup> Because the consumers were not likely to pursue low-value claims individually, and instead, according to the *Scott* court, would forgo the claim altogether, the individual consumer would have “far less” ability to vindicate the Washington Consumer Protection Act without the class mechanism.<sup>125</sup> Since the removal of the class mechanism would result in some low-dollar claims going unlitigated, it effectively exculpated Cingular from liability for “any wrong where the cost of pursuit outweighs the potential amount of recovery.”<sup>126</sup> Like *Kristian*, the *Scott* court’s decision came down to one of incentives—without the class mechanism, how can courts guarantee that consumers will bring meritorious claims, even if for minimal recovery amounts? Again, we see courts acting as the surrogate mouthpiece for the consumer, demanding what, in that court’s view, the reason-

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<sup>120</sup> *Id.* at 1009.

<sup>121</sup> *See infra* Part III.B.

<sup>122</sup> *Scott*, 161 P.3d at 1009.

<sup>123</sup> *Id.* at 1007.

<sup>124</sup> *Id.* The *Scott* plaintiffs alleged that Cingular had overcharged them between \$1 and \$45 per month by unlawfully adding roaming and hidden charges. *Id.* at 1002. The court did not estimate the maximum value of any individual plaintiff’s claim. *Id.*

<sup>125</sup> *Id.* at 1009. Of course, the court did not, and could not hold, that the consumers had been deprived of any opportunity to vindicate their state consumer protection claims. *See id.* Depending on the size of the demand and the likelihood of success, the consumer may have been more successful in vindicating the CPA claims via arbitration instead of class litigation. *See id.* Whether a state court could hold an arbitration agreement unenforceable because it deprives the consumer of an opportunity to vindicate a state statutory right, as opposed to a federal statutory right is not clear. *See id.* The state law right is likely preempted by the FAA. *See Ware, supra* note 54, at 270–71 (explaining that the “effectively vindicate” doctrine is not a ground for permitting the revocation of “any contract” at common law, thus it is not a permissible ground for denying enforcement of an arbitration contract permitted by FAA § 2 (internal quotations omitted)). Regardless, here, the Washington Supreme Court construed the reduced likelihood of consumers availing themselves of rights afforded by the state CPA as substantively unconscionable, a general state law ground, and concluded that its decision was not preempted by the FAA because it based its decision on the general state law ground of unconscionability. *Scott*, 161 P.3d at 1008.

<sup>126</sup> *Scott*, 161 P.3d at 1007.

able consumer would demand in an arms-length negotiation over the arbitration clause. The *Scott* court concluded that the class mechanism is the only practical mechanism to provide consumers with incentives to assert low-value claims.<sup>127</sup> Several courts in recent years have reached similar conclusions.<sup>128</sup> However, innovative arbitration-clause drafting may prove them wrong.

### III. THE EVOLVING ARBITRATION AGREEMENT

Myriam Gilles argues that the question of whether class action waivers should be enforced “totally and inevitably collapses into the question of whether class actions are a good thing or a bad thing.”<sup>129</sup> But must the issue be phrased in those simple terms? In the years that have passed since Gilles’s 2005 article, corporate America has evolved in response to valid challenges to the class action bar. Companies have developed new “consumer friendly” arbitration agreements that have the potential to preserve the three goals of (1) streamlining consumer litigation, (2) providing an avenue for consumers to vindicate statutory rights and recover on valid claims, and (3) providing an avenue for deterrence through costly—although not as costly—arbitration. What is occurring is a dialogue between the consumer products industry and the consumer (via the courts) in a process by which the arbitration agreement is evolving into an agreement that may eliminate the class action in many occasions, but is advantageous to the individual consumer. In other words, corporate America is listening.

#### A. *First-Generation Consumer Products Arbitration Clauses*

The roots of the class arbitration waiver demonstrate its evolutionary process. At the advent of the class action waiver,<sup>130</sup> some avaricious

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<sup>127</sup> *Id.* at 1009 (“Where many customers of the same company have the same or similar complaint and each is damaged a small amount, class action litigation or arbitration is the only practical remedy available.”).

<sup>128</sup> See, e.g., *Shroyer v. New Cingular Wireless Servs., Inc.*, 498 F.3d 976 (9th Cir. 2007); *Kinkel v. Cingular Wireless*, 857 N.E.2d 250, 275 (Ill. 2006) (holding that an arbitration clause with a class waiver “creates a situation where the cost of vindicating the claim is so high that the plaintiff’s only reasonable, cost-effective means of obtaining a complete remedy is as either the representative or member of a class.”). To say that the Ninth Circuit and California’s hostility to the class arbitration waiver is recent is a bit of a mischaracterization. See generally *Ting v. AT&T*, 310 F.3d 1126 (9th Cir. 2003); *Discover Bank v. Superior Court*, 113 P.3d 1100 (Cal. 2005). As discussed *supra* Part II.A., these courts have consistently refused to uphold class arbitration waivers, regardless of the plaintiffs’ ability to vindicate statutory rights in the arbitral forum, based on the view that the class waiver may operate as an exculpatory clause. See generally *Ting*, 210 F.3d 1126; *Discover*, 113 P.3d 1100.

<sup>129</sup> Gilles, *supra* note 2, at 429.

<sup>130</sup> Gilles documents that the class action waiver began to be advocated in corporate counsel trade journals in the late 1990s. In the wake of Y2K, the movement “accelerated” when the National Arbitration Forum cautioned corporate attorneys that “the only way to insulate their

drafters included terms that excluded punitive damages and incidental or consequential damages, prohibited attorneys fees, required the arbitration to proceed in a location far from the consumer's home, required the consumer to pay half or sometimes all of the arbitration fees, imposed mandatory confidentiality clauses, or gave the drafter the sole capability of selecting the arbitrator.<sup>131</sup> Each of these types of provisions has been considered unenforceable by at least one court.<sup>132</sup> In an effort to draft an arbitration clause that would be enforceable, the consumer products industry has accommodated the judicial admonitions. Current case law documents the evolutionary process.<sup>133</sup> Leading corporate counsel now advise fairness to the consumer as a fundamental principle in consumer arbitration-clause drafting.<sup>134</sup> Moreover, the arbitration industry commands it.

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clients from class action liability in general—and Y2K computer class action liability,” was to implement binding arbitration terms waiving the right to maintain a class action. *Id.* at 398.

<sup>131</sup> See, e.g., *Nagrampa v. Mailcoups, Inc.*, 469 F.3d 1257, 1287–88 (9th Cir. 2006) (holding a forum selection clause requiring the California plaintiff to arbitrate in Boston unconscionable); *Ting v. AT&T*, 182 F. Supp. 2d 902, 932 (N.D. Cal. 2002), *rev'd on other grounds*, 319 F.3d 1126 (9th Cir. 2003) (holding a confidentiality provision unconscionable); *In re Lucas*, 312 B.R. 407 (D. Nev. 2004) (holding a unilateral right to select an arbitrator substantively unconscionable); *Gutierrez v. Autowest, Inc.*, 7 Cal Rptr. 3d 267 (Cal. Ct. App. 2003) (holding a requirement for upfront consumer arbitration fees unconscionable); *Bellsouth Mobility LLC v. Christopher*, 819 So. 2d 171, 173 (Fla. Ct. App. 2002) (holding a limitation of liability to actual damages substantively unconscionable); *Powertel, Inc. v. Bexley*, 743 So. 2d 570, 576 (Fla. Ct. App. 1999) (discussing the limitation to actual damages); *Swain v. Auto Services, Inc.*, 128 S.W. 3d 103, 108–09 (Mo. Ct. App. 2003) (discussing an arbitration clause including a forum selection clause requiring arbitration in another state and precluding attorney's fees).

<sup>132</sup> See, e.g., *supra* note 131. But many of the provisions have been upheld by some courts. See, e.g., *Bragel v. Gen. Steel Corp.*, 21 Mass. L. Rptr. 408 at \*5–6 (Mass. Super. Ct. 2006) (forum selection clause and limitation of liability clauses in arbitration agreement not unconscionable). Despite this lack of uniformity in condemnation, the consumer products industry has still attempted to overcome the defects identified by some courts. And, in light of the consumer products procedures required by the large arbitration services, the likelihood that most of the more onerous provisions would be enforced is small. *But see* Stempel, *supra* note 2, at 417 (recognizing that “due process protocols have made a substantial step toward greater fairness in mass arbitration,” but arguing that legislative or executive enforcement of procedural minimum standards is necessary because the protocols are “insufficiently clear and directive”).

<sup>133</sup> See, e.g., *Kinkel*, 857 N.E.2d at 257 (discussing Cingular's second generation “consumer-friendly” arbitration clause which offered to pay all arbitration costs if the consumer's claim was nonfrivolous, to reimburse reasonable attorney fees if the claimant recovered the amount demanded, changed the location of the arbitration to the county of the claimant's billing address, and eliminated the confidentiality requirement (internal quotations omitted)); *Scott v. Cingular Wireless*, 161 P.3d 1000, 1003 (Wash. 2007) (documenting Cingular's revised arbitration clause which provided that Cingular would pay all filing, administrator, and arbitration fees unless the consumer's claim was found to be frivolous, and holding that Cingular would reimburse the consumer reasonable attorney fees and expenses if the consumer recovered at least the demand amount).

<sup>134</sup> Alan S. Kaplinsky, *The Use of Pre-Dispute Arbitration Agreements By Consumer Financial Services Providers*, Presentation for CLE Teleconference: Class Action Arbitration

The American Arbitration Association (AAA) has implemented a Consumer Due Process Protocol (Protocol) that attempts to require fundamental standards of fairness in the drafting and administration of arbitration claims involving the consumer.<sup>135</sup> In addition to setting forth minimum standards of fairness in the arbitration proceedings, the Protocol requires Providers to take reasonable measures to provide Consumers with “clear and adequate” notice of the ADR provision at the time the consumer contracts for goods or services,<sup>136</sup> to provide reasonable means for obtaining additional information regarding the ADR program,<sup>137</sup> to reserve both parties’ rights to seek relief in small claims courts,<sup>138</sup> to give the Consumer an equal voice in arbitrator selection,<sup>139</sup> and to provide that face-to-face proceedings be conducted at a “reasonably convenient location to both parties considering the parties’ ability to travel and other circumstances.”<sup>140</sup> The Protocol also instructs that each party must have an ability to obtain information material to the dispute.<sup>141</sup> Most importantly, the Protocol requires that the arbitrator’s capacity to grant relief not be limited,<sup>142</sup> and that Providers “develop ADR programs which entail reasonable cost to Consumers based on the circumstances of the dispute, including, among other things, the size and nature of the claim; the nature of goods or services provided; and the ability of the Consumer to pay.”<sup>143</sup> Under the AAA’s Consumer Related Disputes Supplementary

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Clauses Under Fire: Crafting Agreements to Withstand Court Scrutiny (May 16, 2007) (“My message to clients: Draft a fair clause!”). Kaplinsky further instructs practitioners to comply with the consumer requirements of the AAA, JAMS, and the NAF, to make the arbitration agreement mutually binding, and encourages drafters to agree to pay all arbitration fees other than what a consumer would pay as a court filing fee or than what is waived by the arbitration administrator, to give the consumers the option of rejecting the arbitration provision, and to give the consumer the right to obtain reasonable attorney’s fees if he prevails. *Id.*

<sup>135</sup> American Arbitration Association, Consumer Due Process Protocol (2007), [http://www.adr.org/sp.asp?id=22019#SCOPE\\_OF\\_THE\\_CONSUMER\\_DUE\\_PROCESS\\_PROTOCOL](http://www.adr.org/sp.asp?id=22019#SCOPE_OF_THE_CONSUMER_DUE_PROCESS_PROTOCOL) (last visited Apr. 8, 2009). A consumer is defined as “an individual who purchases or leases goods or services, or contracts to purchase or lease goods or services, intended primarily for personal, family or household use.” *Id.* at Glossary of Terms, Consumer. A Provider is “a seller or lessor of goods or services to Consumers for personal, family or household use.” *Id.* at Glossary of Terms, Provider. The Protocol was adopted with the realization that the majority of consumer ADR clauses are offered on a “take-it-or-leave-it” basis; thus the Protocol attempts to establish a “baseline of reasonable expectations for ADR in Consumer Transactions.” *Id.* at Principle 1, Reporter’s Comments.

<sup>136</sup> *Id.* at Principles 2, 11.

<sup>137</sup> *Id.* at Principle 2.

<sup>138</sup> *Id.* at Principle 5.

<sup>139</sup> *Id.* at Principle 3.

<sup>140</sup> *Id.* at Principle 7.

<sup>141</sup> *Id.* at Principle 13. Principle 13 also instructs, “Consumer ADR agreements which provide for binding arbitration should establish procedures for arbitrator-supervised exchange of information prior to arbitration, bearing in mind the expedited nature of arbitration.”

<sup>142</sup> *Id.* at Principle 14 (“The arbitrator should be empowered to grant whatever relief would be available in court under law or in equity.”).

<sup>143</sup> *Id.* at Principle 6.

Procedures, the Consumer's portion of the arbitrator's fees is capped at \$125 for claims under \$10,000,<sup>144</sup> whereas the business bears the totality of the \$750 administration fee.<sup>145</sup>

Similarly, the Judicial Arbitration and Mediation Service (JAMS) has a "Policy on Consumer Arbitrations Pursuant to Pre-Dispute Clauses Minimum Standards of Procedural Fairness."<sup>146</sup> Like the AAA Protocol, the JAMS policy purports to guarantee minimum standards of fairness in the administration and implementation of adhesive arbitration agreements in consumer agreements.<sup>147</sup> Thus, the JAMS Policy requires that the arbitration agreement be reciprocally binding on both parties; retain both parties' access to small claims court; provide clear notice to the consumer of the arbitration clause's existence, terms, and implications; reserve all remedies available at law; provide the consumer with an opportunity to participate in the arbitrator selection; give the consumer a right to a hearing in his "hometown area;" and allow for discovery.<sup>148</sup> With respect to costs, if the consumer initiates the dispute, the consumer cost is \$250.<sup>149</sup> All other costs must be paid by the company. If the company initiates the arbitration, the company must pay all fees.<sup>150</sup>

The third major arbitration service, the National Arbitration Forum (NAF), does not have a separate policy or protocol solely applicable to consumer cases, yet its Arbitration Bill of Rights,<sup>151</sup> Code of Procedure,<sup>152</sup> and Fee Schedule<sup>153</sup> treat consumers differently than commercial entities so that many of the same protections are afforded to consumers as those that are formally delineated under the AAA and

<sup>144</sup> American Arbitration Association, Consumer-Related Disputes Supplementary Procedures, at C-8 (2007), <http://www.adr.org/sp.asp?id=22014> (last visited Apr. 8, 2009).

<sup>145</sup> *Id.* This is the fee if neither party's claim or counter-claim exceeds \$10,000. If a hearing is held, the business must pay the \$200 hearing fee. If a claim exceeds \$10,000, the administrative and hearing fees go up, but the business still bears the burden of payment.

<sup>146</sup> JAMS Policy on Consumer Arbitrations Pursuant to Pre-Dispute Clauses Minimum Standards of Procedural Fairness (2007), [http://www.jamsadr.com/images/PDF/Consumer\\_Arbitration\\_Min\\_Std.PDF](http://www.jamsadr.com/images/PDF/Consumer_Arbitration_Min_Std.PDF).

<sup>147</sup> *Id.*

<sup>148</sup> *Id.* ¶ 1-5, 9. The policy is obviously directed at establishing minimum standards of fairness in the context of the form contract where no negotiations or viable options are reasonably available to the consumer. Thus, they do not apply "if the agreement to arbitrate was negotiated by the individual consumer and the company." *Id.* at n.1.

<sup>149</sup> *Id.* at § 7.

<sup>150</sup> *Id.*

<sup>151</sup> National Arbitration Forum, Arbitration Bill of Rights with Commentary (2007) [hereinafter NAF Arbitration Bill of Rights], <http://www.adrforum.com/users/naf/resources/ArbitrationBillOfRights3.pdf>

<sup>152</sup> National Arbitration Forum, Code of Procedure (2008) [hereinafter NAF Code of Procedure], <http://www.adrforum.com/users/naf/resources/CodeofProcedure2008-print2.pdf>.

<sup>153</sup> National Arbitration Forum, Fee Schedule to Code of Procedure 3 (2008) [hereinafter NAF Fee Schedule], <http://www.adrforum.com/users/naf/resources/2008FeeSchedule-FinalPrint1.pdf>.

JAMS. For example, the NAF's Bill of Rights delineates twelve principles to promote fair administration: "The FORUM will not administer arbitrations under contracts that do not meet these principles."<sup>154</sup> These principles include guarantees of reasonable access to information about the arbitration process,<sup>155</sup> convenient and efficient hearings,<sup>156</sup> "reasonable access" to information for discovery for both parties,<sup>157</sup> and the guarantee that "remedies resulting from arbitration must conform to the law."<sup>158</sup> The Bill of Rights also instructs that "[t]he cost of an arbitration should be proportionate to the claim and reasonably within the means of the parties, as required by applicable law."<sup>159</sup> Although this statement would carry little force on its own, the NAF implements this principle through their fee schedule. The fee schedule provides a sliding scale for fees such that a claim less than \$1,500 requires a \$19 filing fee, a claim between \$1,501-\$3,500 requires a \$29 filing fee, and so on.<sup>160</sup> Thus, most low-value consumer claims require a \$19 filing fee when the consumer is a claimant; there is no filing fee for a response.<sup>161</sup> The NAF requires the business to pay the \$200 administrative fee,<sup>162</sup> but the consumer would be required to pay one half of the fee for a participatory hearing, up to a maximum of \$250.<sup>163</sup> For claims under \$1,500, one half of the \$125 participatory hearing fee would be \$62.50, assessed to the consumer.<sup>164</sup> If the business requests the participatory hearing, it bears the full cost of the hearing.<sup>165</sup> Finally, the NAF consumer/party may

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<sup>154</sup> See NAF Arbitration Bill of Rights, *supra* note 151, at 1.

<sup>155</sup> *Id.* at Principle 2.

<sup>156</sup> *Id.* at Principle 10. Under the NAF Code of Procedure, *supra* note 152, R. 32(A), any in-person hearing must be held at "a reasonably convenient location within the United States federal judicial district or other national judicial district where the Respondent to the Initial Claim resides or does business. A Respondent Entity does business where it has minimum contacts with a Consumer." Thus, for most consumer cases, an in-person hearing would be held in the judicial district near the area in which the consumer engaged in the transaction giving rise to the dispute.

<sup>157</sup> NAF Arbitration Bill of Rights, *supra* note 151, at Principle 11.

<sup>158</sup> *Id.* at Principle 12. However, this guarantee is not as protective as those discussed in the AAA Protocol and the JAMS Policy. The AAA Protocol, *supra* note 135, and the JAMS Policy, *supra* note 146, instruct that arbitration clauses should not be drafted as to *limit* remedies available at law, whereas the NAF Bill of Rights specifies only that remedies should "conform to law." NAF Arbitration Bill of Rights, *supra* note 151.

<sup>159</sup> NAF Arbitration Bill of Rights, *supra* note 151, at Principle 6.

<sup>160</sup> NAF Fee Schedule, *supra* note 153, at 3.

<sup>161</sup> See *id.* at 3.

<sup>162</sup> This would be for a claim less than \$1,500. The administrative fee, like the filing fee, increases proportionally to the claim value, but the business is required to pay the administrative fee "unless otherwise provided by agreement of the Parties or by applicable law." *Id.*

<sup>163</sup> *Id.* at 3.

<sup>164</sup> *Id.*

<sup>165</sup> *Id.*



apply for indigent relief governed by the United States federal poverty standards or other applicable law.<sup>166</sup>

*B. The Short-Comings of the Second-Generation Arbitration Clause*

As the polices adopted by the three major arbitration services illustrate, after the first wave of consumer arbitration agreements, the consumer products industry as a whole (whether voluntarily or not) was required to draft arbitration agreements affording minimum standards of fairness, and providing arbitration to consumers at a relatively low dollar amount when compared with court filing fees.<sup>167</sup> In light of agreements offering to pay all costs of arbitration in excess of the \$125 (for example) attributed to the consumer, how could courts possibly consider these agreements unfair?

The problem, evidenced in the decisions of the courts in recent cases such as *Scott*, *Kinkel*, and *Kristian*,<sup>168</sup> was not that the cost of arbitrating a \$1,000 claim for \$125 was unfair to the consumer—considering very low dollar claims such as those for \$30, \$10, or even fifty cents—but that there was no *incentive* for the individual consumer to bring a recovery action.<sup>169</sup> In other words, without the collective action, the payout for a successful low-dollar claim would never overcome the initial barrier, whether it be \$125 or \$25. Thus, courts reasoned, for these very low-value claims for which the individual pay-out was insufficient to reward pursuit of the claim, the class arbitration waiver prevented the consumer from vindicating statutory rights by being prohibitively expensive to arbitrate. Moreover, according to these courts, the elimination of the class contingency fee eliminated any incentive for an attorney to represent a consumer with a low-value claim—even if the attorney could

<sup>166</sup> NAF Code of Procedure, *supra* note 152, R. 45(B).

<sup>167</sup> The filing fee in a typical state court may range from \$125 to \$350, depending on the damages claim, *see* Superior Court of California, Santa Clara County: Schedule of Fees (2009), <http://www.sccsuperiorcourt.org/fees.htm> (last visited Apr. 8, 2009), or \$350 for federal court, *see* United States District Court for the Central District of California: Schedule of Fees (2006), <http://www.cacd.uscourts.gov/Cacd/forms.nsf/0b2b50f03ce1d589882567c80058610a/66cc90529a00dc1688256dcf005f4ac3?OpenDocument> (last visited Apr. 8, 2009). In contrast, the maximum a consumer would pay under any of the three services for a traditionally “low-value claim”—i.e., under \$2,500, would be \$250 with the JAMs service. JAMS Policy on Consumer Arbitrations Pursuant to Pre-Dispute Clauses Minimum Standards of Procedural Fairness, *supra* note 146, at Standard 7. But the consumer could prevail for as little as the \$19 fee charged by the NAF. NAF Fee Schedule, *supra* note 153, at 3.

<sup>168</sup> *See supra* Part II.B.2.

<sup>169</sup> *Scott v. Cingular Wireless*, 161 P.3d 1000, 1007 (Wash. 2007) (“Shifting the cost of arbitration to Cingular does not seem likely to make it worth the time, energy, and stress to pursue such individually small claims”); *Kristian v. Comcast Corp.*, 446 F.3d 25, 58 (1st Cir. 2006) (“Plaintiffs have provided uncontested and unopposed expert affidavits demonstrating that without some form of class mechanism—be it class action or class arbitration—a consumer antitrust plaintiff will not sue at all.”).

recover attorney's fees, the promise of attorney fees was inadequate.<sup>170</sup> Although there is an argument that a consumer could have opted out of the right to maintain a class action for a "low-value claim" in exchange for the guarantee that he would preserve his right to arbitration for a more substantial claim (i.e., any claim for which the payout is more than the cost of arbitration, which could be as low as \$19); the lack of choice in accepting arbitration agreements made the likelihood of this trade-off slim. As the Illinois Supreme Court in *Kinkel* stated:

If there is a pattern in these cases [determining enforceability of class arbitration waivers] it is this: a class action waiver will not be found unconscionable if the plaintiff had a meaningful opportunity to reject the contract term or if the agreement containing the waiver is not burdened by other features limiting the ability of the plaintiff to obtain a remedy for the particular claim being asserted in a cost-effective manner.<sup>171</sup>

Thus, even with the Consumer Protocol, Policy, and Bill of Rights afforded by the arbitration institutions (and early case law), two main issues with the class arbitration waiver remained: providing options and providing incentives for low-dollar claims.

#### IV. THE CONSUMER PRODUCTS INDUSTRY'S RESPONSE: OPTIONAL INCENTIVIZING INDIVIDUAL ARBITRATION AGREEMENTS

As with the first wave of arbitration clauses in which more onerous provisions were held unenforceable by courts, and dropped from arbitration language by the industry, consumers—via the courts—have spoken, and the industry has adapted. One may wonder at this point, why continue to demand the class arbitration waiver? If class arbitration waivers may render the arbitration clause as a whole unenforceable, why choose to include them? The answer lies in the goals of arbitration, which is to allow parties less expensive, less complex, and a more expedient alternative to the formality of the courts. By permitting class arbitration, with its attendant discovery, class certification, and class settlement formalities, the parties essentially forgo the advantages of arbitration. Thus, the

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<sup>170</sup> See, e.g., *Kristian*, 446 F.3d at 59 n.21. ("[B]eing made whole is hardly a sufficient incentive for an attorney to invest in a case such as this when time spent on more predictable case would be advantageous, and frankly, rational.")

<sup>171</sup> *Kinkel v. Cingular Wireless*, 857 N.E.2d 250, 274 (Ill. 2006). The *Kinkel* court found Cingular Wireless's 2001 arbitration agreement unconscionable in that case because the arbitration clause, which did not specify the cost of arbitration to the consumer, contained a liquidated damages clause in the amount of \$150, which "creat[ed] a situation where the cost of vindicating the claim is so high that the plaintiff's only reasonable, cost-effective means of obtaining a complete remedy is as either the representative or a member of a class." *Id.* at 275.

question is not simply, whether class actions are a good thing or a bad thing, but whether there can ever be a contractually agreed-to alternative to the class mechanism.<sup>172</sup> The industry response has been encouraging, and shows a sign that the evolution of the consumer products arbitration clause has not reached its end.

### A. *Freedom to Choose*

The main obstacle in adhesive consumer arbitration agreements is the lack of choice—to remove the “take it or leave it” thumb that weighed heavily against the drafters of class arbitration waivers. The industry is beginning to accomplish this through the unremarkable, but seemingly successful “opt-out agreement.” For example, Comcast’s Corporation’s agreement for residential services requires binding arbitration with a class action waiver. But it also contains this provision:

Right to Opt Out. If you do not wish to be bound by this arbitration provision, you must notify Comcast in writing within 30 days of the date that you first receive this agreement by visiting [www.comcast.com/arbitration/optout](http://www.comcast.com/arbitration/optout), or by mail to Comcast . . . . Your decision to opt out of this arbitration provision will have no adverse effect on your relationship with Comcast . . . .<sup>173</sup>

Other consumer-products companies have adopted this provision in an effort to give consumers an opportunity to choose to waive binding arbitration if maintaining the right to a judicial forum, and the class mechanism, is sufficiently important to the consumer *at the time the contract is entered into*.<sup>174</sup> Because the consumer has the opportunity and choice to remove the arbitration agreement and the class arbitration

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<sup>172</sup> See *supra* note 118.

<sup>173</sup> Comcast Agreement for Residential Services, § 13(c), <http://www.comcast.com/follow/Customers>; then follow “Customer Agreements/Policies”; then follow “Customer Agreement for Residential Services” hyperlink (last visited Apr. 8, 2009). Although Comcast does give its consumers the right to opt out, which renders the contract less procedurally unfair, there are other components of its arbitration agreement that would be problematic in some venues. For example, Comcast’s arbitration agreement requires “all parties [to] waive any claim to indirect, consequential, punitive, exemplary or multiplied damages arising from or out of any dispute with Comcast unless the statute under which they are suing provides otherwise.” *Id.* § 13(f)(3). The savings clause excepting statutory claims may salvage this agreement from vindication-of-statutory-rights defenses, but the waiver of consequential and punitive damages of common law claims may cause some courts to view this provision as substantively unfair. Additionally, Comcast agrees to pay all costs of arbitration only if the claimant is successful, otherwise the consumer must reimburse Comcast for the fees and costs advances “to the extent awardable in a judicial proceeding.” *Id.* § 13(h).

<sup>174</sup> See, e.g., *Guadagno v. E\*Trade Bank*, 592 F. Supp. 2d 1263, 1270 (C.D. Cal. 2008) (noting that the option to opt out of arbitration agreement by providing notice in writing within 60 days provided meaningful choice to opt out, and therefore was not procedurally unconscionable).

waiver within 30 days of obtaining the service or product, and incurs no adverse consequences for opting out, this removes the elements of procedural unconscionability found onerous by some courts.<sup>175</sup> Opponents of the arbitration clause in the context of consumer agreement may still argue that the consumer has little choice: Consumers may not read a services/purchase agreement, or they may not know enough about arbitration at the time of the agreement to be expected to know whether he or she should opt out.<sup>176</sup> But ignorance, or worse, apathy, has almost never been held a defense to a freely entered contract in which the party had a legitimate option.

To be sure, there is an even better vehicle for ensuring contemplated consumer choice in accepting the arbitration clause: differentiated pricing by acceptance or rejection at the point of sale. If pre-dispute agreements to individual arbitration accomplish in practice what they should in theory—reduced litigation costs to the business—these savings should be passed along to the consumer in the form of lower prices for consumer products.<sup>177</sup> In other words, the consumer who opts out of binding arbitration in order to preserve a judicial forum and the class mechanism should have to pay a premium in order to preserve potentially expensive litigation to the supplier. Despite the attractions of the differentiated pricing scheme, it has not yet been widely adopted, perhaps due to administrative costs.<sup>178</sup> And, to some consumers, this approach would also be unfair—under the traditional opt-out agreements discussed above, the consumer can opt out of the arbitration agreement

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<sup>175</sup> See *supra* Part II.A.

<sup>176</sup> See Stempel, *supra* note 2, at 433 (“Consumers at a big-box retail outlet are not realistically able to conclude that their interests are best served by arbitrating all disputes before a select arbitration provider . . .”).

<sup>177</sup> See Ware, *supra* note 54, at 255–56. Ware explains:

In the case of consumer arbitration agreements, this benefit to businesses is also a benefit to consumers. That is because whatever lowers costs to businesses tends over time to lower prices to consumers. While the entire cost-savings is passed on to consumers only under conditions of perfect competition, some of the cost-savings is passed on to consumers under non-competitive conditions, even monopoly. The extent to which cost-savings are passed on to consumers is determined by the elasticity of supply and demand in the relevant markets. Therefore, the size of the price reduction caused by enforcement of consumer arbitration agreements will vary, as will the time it takes to occur. But it is inconsistent with basic economics to question the existence of the price reduction.

<sup>178</sup> Imagine undergoing a conversation with a cashier every time one engages in a consumer-product transaction in which the consumer is advised of binding arbitration, explained its terms in detail, and then offered the chance to accept it for a lower price. The inconvenience and extra costs in educating consumers and sales personnel make it seem an unlikely alternative. Additionally, without knowing the numbers of opt-ins or opt-outs, how does a manufacturer value the cost of the opt-out so as to set a fair price approximating the extra cost of some individuals’ decision to preserve the class action? Although these issues may not establish insurmountable barriers, they do present issues that are not present with the standard opt-out clause.

with no adverse effects or additional costs. Regardless of the advantages or disadvantages of either scheme, they both share the integral commonality of providing the consumer legitimate choices in agreeing to binding, individual arbitration. Instead of proposing paternalistic, all-encompassing legislation that would prevent any consumer from agreeing to pre-dispute arbitration, pro-consumer class action groups such as Public Citizen could devote their resources to educating the consumer public through mailing newsletters, internet broadcasts, and other modes about the nature of the class action and the situations in which it may be advisable to opt out of the class arbitration waiver.<sup>179</sup> The crucial point is that the opt-out agreement leaves the decision to the consumer to decide.

### *B. Incentivizing Agreements*

The second, and largest issue to be addressed by courts failing to enforce the class arbitration waiver, is the discovery of an adequate replacement for the class vehicle in motivating consumers to litigate low-value claims and in providing sufficient monetary incentives such that there will be reasonably accessible attorney assistance. Before exploring the incentivizing agreements, however, one must clarify the frame of analysis. Of course, if the goal is to retain the option to dispute *all* claims regardless of how small, frivolous, or unimportant, there is likely no alternative than the class vehicle. This mechanism, with its positive attributes, also provides a heavy weight for class representatives who would merely bring annoyance suits. But if one could envision an agreement by which a consumer agrees to forgo the right to class representation for low-value claims (claims for which the consumer may care very little about, and stand little to no chance for recovery),<sup>180</sup> in exchange for free, expedient arbitration for more substantial claims, this could be favorable to many consumers. In addition, unlike class actions which may take several years to litigate or result in a settlement payout, the arbitration process and reward is remarkably fast in comparison.<sup>181</sup>

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<sup>179</sup> As discussed *infra* Part IV.B, it is not always beneficial to opt out of the arbitration agreement with the class arbitration waiver. There are certainly foreseeable situations in which the consumer has the advantage in pursuing individual claims with arbitration that is, in essence, free.

<sup>180</sup> A consumer very well may find the typical recovery in a class action completely worthless, as many class actions settle for nominal monetary value to the individual class member, and may only result in a coupon or voucher that the consumer finds of little to no value.

<sup>181</sup> For example, the AAA requires an arbitrator to render a decision for a case decided on the papers within fourteen days, unless the parties agree otherwise. American Arbitration Association, *supra* note 144, at C-7. Studies show that the typical arbitration process takes from four to six months from initiation to award. AMERICAN ARBITRATION ASSOCIATION, ANALYSIS OF THE AMERICAN ARBITRATION ASSOCIATION'S CONSUMER ARBITRATION CASELOAD (2007), <http://www.adr.org/si.asp?id=5027> (last visited Apr. 8, 2009).

Moreover, there is nothing to support the arbitration opponents' argument that individuals will be less likely to succeed in arbitration. To the contrary, preliminary studies show that at least in the employment context, plaintiffs are *more* likely to be victorious in arbitration than in court.<sup>182</sup> Thus, one must at least consider the idea that in some situations, individual arbitration fully compensated by the manufacturer/seller can result in a recovery that is more advantageous on an individual basis than would be the recovery per individual member of a class. And it is important to remember that for low-value claims that no consumer may wish to litigate, the state attorney general or appropriate administrative agency is still the main accessible resource for policing wrongful conduct to prevent corporations from escaping liability for low-value claims.<sup>183</sup>

Accepting this premise that consumers are sometimes, even often-times, better off arbitrating individual claims for which they may be entitled to full recovery, than maintaining the opportunity to participate in low-value claim class actions, some companies have adopted an adequate "incentivizing agreement" that would encourage meritorious, albeit low-value claims, on an individual basis. An example of this is the third-generation arbitration clause drafted by AT&T, formerly Cingular Wireless, which offers a significant "premium" for both the consumer and the attorney when the consumer recovers an amount in a low-value claim (\$10,000 or less)<sup>184</sup> that is greater than AT&T's last written settlement offer.<sup>185</sup> If the consumer does recover more than AT&T's last written settlement offer, in addition to having the arbitration fully subsidized by

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<sup>182</sup> Michael H. LeRoy & Peter Feuille, *Happily Never After: When Final and Binding Arbitration Has No Fairy Tale Ending*, 13 HARV. NEGOT. L. REV. 167, 184 (2008) (discussing a survey of employment arbitrations where "[e]mployees won more often in arbitration than similar plaintiffs in court").

<sup>183</sup> See, e.g., *Johnson v. W. Suburban Bank*, 225 F.3d 366, 375 (3d Cir. 2000) (discussing the availability of administrative enforcement mechanisms); *Francis v. AT&T Mobility LLC*, No. 07-CV-14921, 2009 WL 416063, at \*9 (E.D. Mich. Feb. 18, 2009) (recognizing that state attorney general provides additional avenue of consumer rights enforcement).

<sup>184</sup> Although this amount may be characterized as "low-value," for many consumer product claims, an individual recovery of an amount near \$10,000 is probably viewed by many (myself included) as significant.

<sup>185</sup> See *infra* note 186. AT&T's arbitration clause includes a nonseverable class arbitration waiver:

YOU AND AT&T AGREE THAT EACH MAY BRING CLAIMS AGAINST THE OTHER ONLY IN YOUR OR ITS INDIVIDUAL CAPACITY, AND NOT AS A PLAINTIFF OR CLASS MEMBER IN ANY PURPORTED CLASS OR REPRESENTATIVE PROCEEDING. Further, unless both you and AT&T agree otherwise, the arbitrator may not consolidate more than one person's claims, and may not otherwise preside over any form of a representative or class proceeding. If this specific provision is found to be unenforceable, then the entirety of this arbitration provision shall be null and void.

AT&T Wireless Service Agreement <http://www.wireless.att.com/learn/articles-resources/wireless-terms.jsp> (follow "Terms of Service" hyperlink) (last visited Apr. 8, 2009).

AT&T, AT&T pays the consumer the greater of the amount of the award or \$10,000.<sup>186</sup> By accepting this premium—or incentive—a consumer has the potential to turn a meritorious low-value claim (for example a claim of \$30) into a substantial recovery of at least \$10,000. Of course, AT&T can always avoid the premium by offering to settle with the consumer for the maximum amount the consumer could recover (this should include any statutory minimums or remedial damages to which the consumer is entitled by law). In our example, AT&T would be much better off by simply offering the consumer \$30 rather than risk paying the premium. But even in this scenario, the consumer is made whole before the formal arbitration process has begun.<sup>187</sup> If AT&T does not make an appropriate offer to avoid compelling the consumer to arbitration, and the claim is meritorious, the consumer is afforded a windfall. Thus, the provision replaces the class incentive by adding promises of substantial, cost-effective *individual* recovery in two ways: (1) it provides the opportunity for a significant windfall to the consumer forced into arbitration by AT&T's refusal to settle claims that are meritorious, and (2) it imposes significant incentives on AT&T to offer the consumer's demand pre-arbitration in cases in which there is a likelihood that the consumer may

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<sup>186</sup> The relevant language of AT&T's arbitration agreements is:

If, after finding in your favor in any respect on the merits of your claim, the arbitrator issues you an award that is greater than the value of AT&T's last written settlement offer made before an arbitrator was selected, then AT&T will:

- pay you the amount of the award or \$10,000 ("the alternative payment"), whichever is greater; and
- pay your attorney, if any, twice the amount of attorneys' fees, and reimburse any expenses (including expert witness fees and costs) that your attorney reasonably accrues for investigating, preparing, and pursuing your claim in arbitration ("the attorney premium").

If AT&T did not make a written offer to settle the dispute before an arbitrator was selected, you and your attorney will be entitled to receive the alternative payment and the attorney premium, respectively, if the arbitrator awards you any relief on the merits. The arbitrator may make rulings and resolve disputes as to the payment and reimbursement of fees, expenses, and the alternative payment and the attorney premium at any time during the proceeding and upon request from either party made within 14 days of the arbitrator's ruling on the merits.

*Id.* With respect to fully funding the arbitration fee, the arbitration clause states:

Except as otherwise provided for herein, AT&T will pay all AAA filing, administration, and arbitrator fees for any arbitration initiated in accordance with the notice requirements above. If, however, the arbitrator finds that either the substance of your claim or the relief sought in the Demand is frivolous or brought for an improper purpose (as measured by the standards set forth in Federal Rule of Civil Procedure 11(b)), then the payment of all such fees will be governed by the AAA Rules.

*Id.*

<sup>187</sup> As stated above, to protect itself from the premium by making an offer equal to or greater than the arbitrator's final award, AT&T must do so before an arbitrator is selected. *See id.*

win at arbitration in order to avoid paying the incentive fee.<sup>188</sup> The worst case scenario for the consumer is that his or her claim is unsuccessful at arbitration and AT&T made no written settlement offer. Even then, on an unsuccessful claim, the consumer has encumbered little to no financial investment (outside attorney's fees) because AT&T is still required to pay all costs of arbitration unless the claim is deemed frivolous under Rule 11 of the Federal Rules of Civil Procedure.<sup>189</sup> Thus, the consumer has an incentive to vindicate low-value claims at almost no cost to himself, outside of legal/expert preparation for the arbitration proceeding.

But the cost of legal assistance is a weighty consideration for most courts. Recognizing that the consumer-attorney market is unwilling to take low-value claims absent the class mechanism, even with the promise of reasonable attorney fees, some courts have held that the absence of legal representation prevents the consumer from vindicating statutory rights.<sup>190</sup> Thus, in addition to providing incentives for the consumer, the arbitration agreement must also provide incentives for the attorneys bringing the claim. The AT&T provision does this in a manner nearly identical to the consumer premium—by guaranteeing double attorney fees for any low-value claim in which the consumer receives an award

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<sup>188</sup> To date, at least two courts have addressed fairness challenges to the “incentivizing agreement.” In *Francis II v. AT&T Mobility LLC*, No. 07-CV-14921, 2009 WL 416063, at \*4–5 (E.D. Mich. Feb. 18, 2009), the court rejected the plaintiff's argument that his right to recover under the Michigan Consumer Protection Act was eviscerated by the class arbitration waiver. The court found that the possibility of recovering \$5,000 (then the minimal reimbursement amount provided in AT&T's Arbitration Agreement), plus double attorney's fees was “fair to the extent [the plaintiff] could effectively enforce his MCPA rights in AAA arbitration.” *Id.* at \*5. In rejecting the plaintiff's unconscionability argument, the court found that the incentive agreement, “provides a significant incentive for [the plaintiff] to pursue his \$1,143.00 MCPA claim in individual arbitration.” *Id.* at \*6. In response to the plaintiff's argument that AT&T's ability to avoid the incentive by offering an appropriate pre-settlement offer rendered the incentive illusory, the court found that he ignored “the goal of informally resolving billing disputes before they reach arbitration.” *Id.* at \*9.

The court in *Steiner v. Apple Computer, Inc.*, 556 F. Supp. 2d 1016, 1030 (N.D. Cal. 2008), reached the opposite conclusion. The *Steiner* court concluded that the incentive is illusory because AT&T need only settle in full before the consumer proceeds with arbitration. The Court reasoned that AT&T need only settle in full with a certain percentage of plaintiffs, when at some point, consumers would become convinced that the maximum recovery would be the damages amount, not the Premium. However, the *Steiner* court did not address the prospectively economical trade-off to the individual consumer at the time the sales agreement was made of having the opportunity to recover damages in whole with no arbitration costs. The court's analysis seems to suggest that the unconscionability test it invoked includes a focus on other putative members of a class, not the individual plaintiff's, incentive to recover for even low-value claims. *Steiner* is currently on appeal to the Ninth Circuit Court of Appeals. United States Court of Appeals Docket # 08-15612.

<sup>189</sup> See *supra* note 186 and accompanying text.

<sup>190</sup> See e.g., *Kristian v. Comcast Corp.*, 446 F.3d 25, 58 & n. 21 (1st Cir. 2006); *Ting v. AT&T*, 182 F. Supp. 2d 902, 918 (N.D. Cal. 2002), *rev'd on other grounds*, 319 F.3d 1126 (9th Cir. 2003); *Scott v. Cingular Wireless*, 161 P.3d 1000, 1007 (Wash. 2007).



more favorable than AT&T's last written offer, irrespective of whether the governing law requires attorney fees or not.<sup>191</sup> Thus, there is an opportunity for a cottage market of consumer attorneys to recover double fees by assisting consumers in bringing meritorious consumer products actions. Although each individual recovery would not come close to rivaling the enormous payoffs for bringing class-action claims, this incentive should develop a market for the enterprising consumer attorneys asserting relatively non-complex, meritorious consumer products claims. The withdrawal of confidentiality provisions from most consumer products arbitration provisions can aid in developing this market—consumer products attorneys can advertise recoveries, informally aggregate claims and discovery, and draw on past expertise to make arbitration of pattern consumer litigation more cost-effective. Given that many consumer claims are relatively simple proceedings decided solely on the papers,<sup>192</sup> a practice partially devoted to submitting consumer product arbitration claims of similar nature could prove quite lucrative even if only a percentage of the claims resulted in double recovery.

The one major drawback to this type of incentivizing arrangement is that it does not provide a guaranteed incentive to the attorney in cases of pre-arbitration settlement, unless the attorney would be guaranteed statutory fees.<sup>193</sup> However, AT&T could resolve this issue by offering to include a thirty percent premium within any settlement offer triggering the premium clause to afford the attorney a typical contingency fee without reducing the consumer's recovery.<sup>194</sup> In our prior example then, if the consumer's demand was \$30, AT&T could be required to offer at least \$40 to avoid the premium if the arbitration award is favorable to the consumer. Again, even in this scenario the total attorney payoff would

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<sup>191</sup> *Id.* The right to the attorney premium supplements existing law. Thus if the attorney would be entitled to a larger award under applicable law, the attorney premium does not replace it. However, AT&T does not permit duplicate awards, i.e., the attorney premium in addition to statutory awards. AT&T Wireless Service Agreement, *supra* note 186.

<sup>192</sup> Under the AAA rules, claims under \$10,000 are resolved upon submission of the documents, unless one party requests a hearing. American Arbitration Association, Consumer-Related Disputes Supplementary Procedures, at C-5, <http://www.adr.org/sp.asp?id=22014> (last visited Apr. 8, 2009).

<sup>193</sup> Although the arbitration clause is unclear as to whether the settlement offer triggering the premium clause would necessarily include statutorily required attorney fees, it seems that an arbitrator could conclude that an award of attorney's fees would be included in the offer amount if they are statutorily required.

<sup>194</sup> It appears that in fact, it is AT&T's practice to do just this. In *Steiner v. Apple Computer, Inc.*, 556 F. Supp. 2d 1016, 1031–32 (N.D. Cal. 2008), AT&T defended its attorney premium by arguing that “customers who are aided by counsel in pursuing their disputes are likely to receive *settlement offers* that include reasonable attorneys’ fees.” (quoting AT&T's Reply Br. at 7:7-8) (emphasis in published opinion). Because AT&T did not include data as to how many customers received attorney's fees, nor quantify “reasonable,” the court rejected this argument. A better practice of course, would be to include a guarantee of a quantifiable attorney fee in the settlement offer that the consumer is awarded if represented by an attorney.

offer significantly less financial payout to representative attorneys than the financial boon of the class action, but the trade would restore the payoff to the individual consumer, who at a minimum would receive full recovery for meritorious claims. This trade-off seems to be one with which the American public would be quite satisfied.<sup>195</sup>

### C. *Deterrence*

Even though the new optional “incentivizing” arbitration agreements do much to remove individual arbitration from the vindication-of-statutory-rights or unconscionability defenses, there is still one concern that may loom in the background of paternalistic courts—that of deterrence. If the class mechanism does nothing else, its mere presence as the public “watchdog” encourages corporations to toe the line, and provides a vehicle for penalizing the corporate wrongdoer—even if the monetary damage to each individual consumer is not significant. So how do we achieve deterrence through individual arbitration? Of course, the attorney general’s role in policing certain claims that individuals find too insignificant to pursue individually cannot be forgotten.<sup>196</sup> If a corporation is engaging in certain wrong-doing that is injurious to the public, even if the monetary damage is nominal, it is certainly within the attorney general’s responsibility to assert such claims on behalf of the public. Companies wishing to offer class arbitration waivers could also alleviate this public concern by agreeing to report settled claims and arbitral awards to the state attorney general’s office. Further, perhaps in the absence of numerous class actions, administrative agencies such as the Consumer Product Safety Commission would develop a more prominent role in safety control, but the idea that without the class action, all deterrence would be lost is certainly a misconception. If a company offering an incentivizing agreement paid \$10,000 several times for a low-value claim, certainly it would catch the corporate eye (or that of its shareholders), although not to the potentially crippling extent class action settlements may penalize. And, if sufficient numbers of consumers bring individual arbitration suits to recover valid claims, the expense of subsidizing arbitration, paying damages, and perhaps statutory damages or attorney fees will eventually cause a deterrent effect. This effect will be particularly apparent if the plaintiff consumer products bar adapts to the incentivizing agreements and initiates a pattern of individual arbitration in claims that are wide-spread. This sort of deterrence, in which companies are penalized only when individual consumers, as opposed to a

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<sup>195</sup> See generally Ware, *supra* note 54, at 255 (discussing the cost savings associated with consumer arbitration agreements and noting that the “[B]enefit to businesses is also a benefit to consumers.”).

<sup>196</sup> See *supra* note 183 and accompanying text.

small percentage of class representatives, feel sufficiently wronged to pursue a complaint, will likely approximate more precisely the kind of conduct the American public wishes to deter.<sup>197</sup>

#### CONCLUSION

The American public, through the courts, and corporate America have been engaging in a decade-long dialogue regarding the construction and implementation of binding individual arbitration. Although the second phase of arbitration agreements in which corporations agreed to subsidize much of the costs of arbitration, and removed unlawful liability limitations, were very favorable to consumers litigating individual claims in which the payoff was greater than the cost of arbitration, some courts have recently refused to enforce these arbitration agreements because they fail to provide consumers, and the attorneys who would represent them, with sufficient incentives to bring low-value claims. Corporations interested in binding arbitration have responded. New, third-generation arbitration clauses are ameliorating the sense of unconscionability attendant to binding individual arbitration by offering the consumer choice through the opt-out mechanism. And other agreements provide both consumers and attorneys incentives designed to encourage the consumer to bring meritorious low-value claims. These incentivizing optional agreements provide a fair vehicle for consumers who do not decide to opt out and preserve the class mechanism, because many individuals may view the trade-off of giving up low-value claims with little prospect of pay-off for the opportunity to inexpensively and expediently arbitrate claims that have more significant value as favorable. Even with this trade-off, the incentivizing agreements do provide lucrative opportunities for consumers that assert successful low-value claims, thereby preserving the consumer's opportunity to vindicate statutory rights and deter potential wrong-doing by corporations. This dialogue, via the courts, is the type of behavior that should be encouraged, and the new optional, incentivizing class arbitration waiver clauses demonstrate the evolution towards a type of consumer purchase or service agreement that may be more beneficial, at the time of the sales agreement, than the class action mechanism.

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<sup>197</sup> For example, the American public may not feel sufficiently rewarded by the coupon vouchers that some class members receive as settlement. There may be some economic conduct that is simply so insignificant that the public does not seek to deter it.