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Feature

*36 CLASS ACTION ARBITRATION--THE CHICKENS COME HOME TO ROOST

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The world of class actions and arbitration agreements have come full-circle thanks in large part to the U.S. Supreme Court's decision in Green Tree Fin. Corp. v. Bazzle, 123 S.Ct. 2402 (2003). The dark secret of complex litigation has centered upon corporations inserting arbitration agreements in consumer contracts to thwart class actions by explicitly prohibiting class-wide adjudications. This has worked particularly well in federal courts. Under the Federal Arbitration Act (FAA), courts routinely held that unless an arbitration clause specifically provided for class-wide arbitration, a court had no authority to certify class arbitration, thereby leaving the class representative to litigate his or her individual action in arbitration. See, e.g., Gray v. Conseco Inc., 2001 WL 1081347, at *2-3 (C.D. Cal. Sept. 6, 2001) (absent express provision, no class arbitration allowed under FAA); Champ v. Siegel Trading Co., 55 F.3d 269, 275-77 (7th Cir. 1995) (same); Weyerhauser Co. v. Western Seas Shipping Co., 743 F.2d 635 (9th Cir. 1984) (same). Of course, by definition, a class action is meant to redress minimal claims not large enough to warrant individual litigation. Fully aware that few--if any--consumers would individually arbitrate these types of claims, the corporations created a virtual immunity from class or representative actions irrespective their potential merit, while suffering no detriment to its own rights. Corporations typically do not sue their customers in class action lawsuits.

Seizing upon such substantive unconscionability and utilizing the Revised Uniform Arbitration Act as a hammer, however, a few state courts in California have gone the other way when faced with an arbitration provision that was silent on the issue of class-wide arbitration. Keating v. Superior Court, 31 Cal.3d 584 (1982), rev'd on other grounds sub nom. Southland Corp. v. Keating, 465 U.S. 1 (1984) (allowing class-wide arbitration under state law); Mandel v. Household Bank (Nev.), 129 Cal.Rptr.2d 380 (Cal.Ct.App. 2000) (same). But for class action practitioners this dichotomy only served as an additional factor to consider when deciding which forum to file the complaint, i.e., federal or state court. Normally, if a class action is filed in state court in a case which is subject to an arbitration agreement, the corporation-- recognizing the death-knell effect--would do almost anything to remove the action to federal court. In Bazzle, the Supreme Court may have changed the landscape.

In a five to four decision, Justice Breyer announced the judgment of the Court and delivered the opinion which held that because the parties agreed to have all their disputes resolved by the arbitrator, it would be "up to the arbitrator" if the arbitration could proceed on behalf of a class. Bazzle, 123 S.Ct. at 2407-08. This effectively muted the long line of cases stating that without explicit language, the FAA prohibited class-wide arbitrations. Now the decision regarding the scope of the FAA arguably vests in the arbitrator, not the court. The courts may assume that the parties intended the courts, not arbitrators, to decide certain gateway matters, such as whether the parties have a valid arbitration agreement at all or whether a concededly binding arbitration clause applied to a certain type of controversy. Id. at 2407. The opinion is, nevertheless, significant for its practical, if not historic, application.

Quite ironically, the corporation which drafted its arbitration agreement to avoid class actions may now face an increased risk that its disputes will be subject to a forum with relatively few--if any real-- safeguards. Moncharsh v.

Heily & Blase, 3 Cal.4th 1, 9 (1992) (arbitration awards subject to very limited judicial review); First Options of Chicago Inc. v. Kaplan, 514 U.S. 938, 942 (1995) (same). Further, the only way to truly divest the authority of the arbitrator to rule in favor of class-wide arbitration is to insert an explicit clause forbidding such a result. But doing that may subject the corporation to a substantive unconscionability attack!

For example, a class action ban in a consumer telecommunications contract was recently held as unconscionable, making the entire arbitration agreement unenforceable. See Ting v. AT&T, 319 F.3d 1126 (9th Cir. 2003), cert. denied, 124 S.Ct. 53 (2003). Similarly, a district court in California invalidated an arbitration rider to a loan agreement because it banned class actions. Acorn v. Household International Inc., 211 F.Supp.2d 1160 (N.D.Cal. 2002). State courts, however, are split on the issue depending upon the district. Szetala v. Discover Bank, 97 Cal.App.4th 1094 (4th Dist. 2002), cert. denied, 123 S.Ct. 1258 (2003) (striking class action waiver in arbitration clause as unconscionable); compare with, Discover Bank v. Superior Court, 105 Cal.App.4th 326 (2nd Dist. 2003), petition for review granted, 2003 Daily Journal D.A.R. 3936 (contra).

Regardless of the outcome in state court, the federal court has spoken--the scope of an FAA governed arbitration agreement is within the control of the arbitrator. And given the Ninth Circuit's ruling in Ting, a corporation's explicit ban on class-wide arbitrations may render either that clause, or the entire arbitration agreement, unenforceable. Sobering news indeed for the defendant who devised the arbitration agreement merely to thwart class actions. In fact, many of the weapons utilized by corporations in the judicial system may well be lost in arbitration, i.e., pre-judgment writs of class certification rulings, time-consuming appeals of rulings on liability, and of course post-trial challenges to excessive damage and attorney fee awards.

The use of predispute arbitration agreements is the subject of much debate both by the courts and academic scholars. In federal courts, the decisions have been largely in favor of enforceability. The state courts--California excepted--generally have followed the lead of the federal court decisions, deferring to the emphatic yet unfounded policy "in favor of arbitral dispute resolution." The decisions striking arbitration agreements have been grounded in the one-sided manner which favor the corporation at the expense of the consumer, i.e., they provide for biased selection procedures, impose undue costs upon the inferior party, allow for hearings to be held in distant locations, shorten the statutes of limitations, waive punitive damages and impose limits on fee-shifting statutes. Armendariz v. Found. Health Psychcare Services, Inc., 24 Cal.4th 83 (2000) (outlining five factors to consider in invalidating arbitration clauses); Brennan v. Bally Total Fitness, 198 F.Supp.2d 377 (S.D.N.Y. 2002) (arbitration clause unconscionable because it allowed employer to unilaterally modify the contract at any time); Arnold v. Goldstar Fin. Sys., Inc., 2002 WL 1941546, at *11 (N.D. Ill. 2002) (after extensive analysis of fees under AAA's Commercial Rules, the court states that "plaintiffs have shown a genuine likelihood that they would incur prohibitive costs in arbitration"); Mercuro v. Superior Court, 96 Cal.App.4th 167 (2002) (giving no weight to company's offer to front arbitration costs because the individual could "wind up paying the entire cost of the arbitration, including *37 the arbitrator's fee, should he lose").

Recently, corporations have used arbitration clauses to blunt or eviscerate class actions by prohibiting class-wide arbitration. But class actions are an important and necessary arsenal in our legal system to protect victims from unfair and illegal business practices. Indeed, contrary to conventional wisdom, a new study of class action settlements concludes that neither client recoveries nor attorneys' fees have increased over the past 10 years when adjusted for inflation. See Profs. Theodore Eisenberg and Geoffrey P. Miller, Journal of Empirical Legal Studies (currently available on the Internet at www.blackwell-synergy.com).

Perhaps the Supreme Court was reacting to the unprecedented swing of power in favor of arbitration when it issued its recent ruling in Bazzle, which injected another issue into the debate: the availability of class-wide arbitration proceedings.

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