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'Bazzle' Confounds Arbitration Agreements and Class Actions

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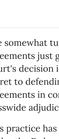

Aashish Y. Desai

Desai Law Firm PC
3200 Bristol Street #650
Costa Mesa , CA 92626

Phone: (949) 614-5830

Fax: (949) 271-4190

Email: aashish@desai-law.com

University of Houston Law Center; Houston TX

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Attachments

The somewhat turbulent relationship between class actions and arbitration agreements just got more complicated, 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 to defending class actions has centered on corporations' inserting arbitration agreements in consumer contracts to thwart class actions, by explicitly prohibiting classwide adjudications.

This practice has been endorsed by, and worked particularly well in, federal courts. Under the Federal Arbitration Act, federal courts routinely held that, unless an arbitration clause specifically provided for classwide arbitration, a judge had no authority to certify class arbitration, thereby leaving the class representative to litigate his or her individual action in arbitration. See *Gray v. Conseco Inc.*, 2001 WL 1081347 (C.D. Cal. Sept. 6, 2001) (absent express provision, no class arbitration allowed under the act); *Champ v. Siegel Trading Co.*, 55 F.3d 269 (7th Cir. 1995) (same); *Weyerhauser Co. v. Western Seas Shipping Co.*, 743 F.2d 635 (9th Cir. 1984) (same).

Of course, a class action is meant to redress only minimal claims that are not large enough to warrant individual litigation. Fully aware that few - if any - consumers would arbitrate these types of claims individually, the corporation, through its lawyers, created a virtual exemption from class or representative actions irrespective of their potential merit, while suffering no detriment to its own rights. Corporations generally do not sue their customers in class actions.

Seizing on such substantive unconscionability and using the Revised Uniform Arbitration Act (Code of Civil Procedure Section 1280, et seq.) as a hammer, however, a few California state courts have gone the other way when faced with an arbitration provision that was silent on the issue of classwide 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 classwide arbitration under state law); *Mandel v. Household Bank (Nev.)*, 129 Cal.Rptr.2d 380 (Cal. App. 2000) (same). But for class-action practitioners this dichotomy served only as an additional factor to consider when deciding which forum to file the complaint, that is, 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 and its lawyers, recognizing the death-knell effect, would do almost anything to remove the action to federal court. With *Bazzle*, the Supreme Court may have changed that strategy.

In a 5-4 decision, Justice Stephen Breyer announced the judgment of the court and delivered the opinion, holding that because the parties agreed to have all their disputes resolved by the arbitrator, the arbitrator would decide whether the arbitration could proceed on behalf of a class. This effectively muted the long line of cases stating that, without explicit language, the Federal Arbitration Act prohibited classwide arbitrations.

Now, the decision regarding the scope of the act arguably vests in the arbitrator, not the court. As a caveat, 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. Nevertheless, the opinion is significant for its practical, if not momentous, application.

Quite ironically, the corporation that drafted its arbitration agreement to avoid class actions may 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 (1992) (arbitration awards subject to very limited judicial review); *First Options of Chicago Inc. v. Kaplan*, 514 U.S. 938 (1995) (same for federal courts). Further, the only way to truly divest the authority of an arbitrator to certify a class in 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 recently was 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 in California, however, are seemingly split on the issue depending on 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); but see *Discover Bank v. Superior Court*, 105 Cal.App.4th 326 (2nd Dist. 2003), petition for review granted, 2003 DJDAR 3936 (contra).

Regardless of the outcome in state court, the federal court has spoken, such that the scope of a Federal Arbitration Act-governed arbitration agreement is within the control of the arbitrator. And given the 9th Circuit's ruling in *Ting*, a corporation's explicit ban on classwide arbitrations may render either that clause or the entire arbitration agreement unenforceable.

This comes as sobering news for the defense lawyer who devised the arbitration agreement merely to thwart class actions. In fact, many of the weapons used by corporations in the judicial system may well be lost in arbitration, that is, 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.

To be sure, the use of pre-dispute arbitration agreements is - and will continue to be - the subject of much debate by both the courts and academic scholars. But until now, the decisions in federal courts 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. In the end, the decisions striking arbitration agreements, almost to a one, have been grounded on the one-sided manner that favors the corporation at the expense of the consumer, that is, they provide for biased selection procedures, impose undue costs on 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 (N.D. Ill. 2002) (after extensive analysis of fees under the American Arbitration Association'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 the arbitrator's fee, should he or she lose).

But recently, corporations have used (or abused) arbitration clauses to blunt or eviscerate class actions by prohibiting classwide arbitration. What many of the topical cases are finding is that class actions are an important and necessary arsenal in our legal system to protect victims from unfair and illegal business practices. See *In re Vitamin Cases*, 107 Cal.App.4th 820 (2003). Indeed, contrary to conventional wisdom, a new study of class settlements concludes that neither client recoveries nor attorney fees have increased over the past 10 years when adjusted for inflation. See Theodore Eisenberg and Geoffrey P. Miller, Journal of Empirical Legal Studies (www.blackwell-synergy.com).

Perhaps the Supreme Court was reacting to the unparalleled swing of power in favor of arbitration when it issued its recent ruling in *Bazzle*, which injected another question mark into the impassioned debate: the availability of classwide arbitration proceedings.

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