Vanderbilt Law Review

Volume 59 | Issue 5 Article 5

10-2006

# Beyond Unconscionability: Class Action Waivers and Mandatory Arbitration Agreements

J. Maria Glover

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## INTRODUCTION

We live in an age of convenience. From financial transactions to electronic correspondence, we frequently deal with large corporations that provide services in our daily lives. One of the prices we pay for the convenience of these transactions, however, is that our commercial relationships increasingly are based on standard form contracts written by large corporations. While these standard form contracts are necessary to an economically efficient society, the growing use of mandatory arbitration provisions and clauses that prohibit class actions in these contracts raises the spectre of corporate abuse.

This reality of modern commercial life brings into conflict two particular trends in the civil justice system: increased acceptance of mandatory arbitration clauses and more frequent use of the class action device as a means to vindicate individual claims.[1] Both the class action and the arbitration device are exceptions to more general rules: the arbitration device is an exception to the general rule that disputes between parties are resolved in courts of law, and the class action device is "an exception to the usual rule that litigation is conducted by and on behalf of the individual named parties only."[2]

Corporations faced with the prospect of an enormous number of claims arising out of their frequent transactions with consumers have increasingly sought to channel such claims to arbitration, while at the

1. As a preliminary matter, arbitration removes disputes from the judicial system and places them in a private system of justice that is paid for by the participants in the dispute. Provisions prohibiting class actions (referred to throughout as "class action waivers") work in conjunction with standard arbitration clauses to ensure that any claim brought against the drafter may only be asserted in a one-on-one, non-aggregated arbitral proceeding. Myriam Gilles, *Opting Out of Liability: The Forthcoming Near Total Demise of the Modern Class Action*, 104 MICH. L. REV. 373, 376 (2005).

2. Califano v. Yamasaki, 442 U.S. 682, 700-01 (1979).

same time denying claimants the right to proceed through class actions. The confluence of mandatory arbitration and class action waivers is particularly problematic for "negative-value claims"[3] where the expected recovery does not justify the cost of a stand-alone claim, and where, as a result, corporations have the greatest incentive to write class action waivers into mandatory arbitration provisions.[4] For example, imagine you are the victim of a fraudulent scheme by a credit-card company to charge fees that are higher than advertised. You suddenly discover that not only are you unable to bring your claims in court, but also your individual expected recovery (the difference between the advertised fee and the charged fee) is too low to justify an attorney's time and expense. Unless you can aggregate your claims with those of others, you may have no effective recourse to vindicate your claims.

Faced with problems such as this, plaintiffs' lawyers have raised various challenges to mandatory class action waivers. Prominent among these challenges is that class action waivers in contracts of adhesion are unenforceable under state-law doctrines of unconscionability. This strategy has met with some success, as a few state courts have used the unconscionability doctrine to solve the problem of class action waivers in adhesion contracts. On the whole, however, the unconscionability doctrine has had limited effectiveness in addressing the core problem created by class action waivers in adhesion contracts, namely, that there may be a sufficiently close nexus between the class action waiver and non-waivable substantive rights such that these waivers should not be left to private bargaining.

This Note urges a re-examination of the issue of class action waivers, and suggests that courts should take a new approach to the problem posed by such waivers. Rather than rely on a patchwork of state-law unconscionability doctrine, courts should adopt a federal standard under the Federal Arbitration Act ("FAA") that would guarantee that arbitration agreements do not thwart the vindication of substantive rights. Part I of this Note briefly outlines the rise of judicial acceptance of arbitration as a dispute resolution mechanism in general, and of adhesion contracts as a vehicle for requiring

3. A negative-value suit is one in which the total costs of pursuing the claim exceed the total expected recovery for that claim.

4. *See* Amchem Prods., Inc. v. Windsor, 521 U.S. 591, 617 (1997) ("The policy at the very core of the class action mechanism is to overcome the problem that small recoveries do not provide the incentive for any individual to bring a solo action prosecuting his or her rights. A class action solves this problem by aggregating the relatively paltry potential recoveries into something worth someone's (usually an attorney's) labor.") (quoting Mace v. Van Ru Credit Corp., 109 F.3d 338, 344 (7th Cir. 1997)).

arbitration in particular. Part I also surveys the principal criticisms of mandatory arbitration agreements. Part II discusses how companies have used class action waiver provisions in mandatory arbitration agreements in an effort to reduce or eliminate aggregated procedures. Part III discusses the effort by some litigants and courts to use the doctrine of unconscionability as a possible sword against these class action waivers. Part III contends, however, that the unconscionability doctrine is an imperfect tool for this task in that it fails to capture the core concerns attendant to class action waivers.

Finally, Part IV advocates a new approach. First, it examines the two fundamental premises underlying the FAA's pro-arbitration policy: the assumptions that (1) arbitration does not fundamentally thwart or alter substantive rights, but merely transfers dispute resolution to an alternative forum, and (2) arbitration allows parties to decide on mutually beneficial procedures for resolving disputes over those rights. Part IV argues that, in the context of mandatory arbitration, class action waivers in certain contexts (namely, negative-value suits) violate these assumptions in that they prevent plaintiffs from effectively vindicating their substantive rights. Picking up on the Supreme Court's dicta in *Mitsubishi Motors v. Soler Chrysler-Plymouth, Inc.*,[5] and its more recent decision in *Green Tree Financial Corp. v. Randolph*,[6] Part IV argues that the implicit assumptions underlying the FAA's liberal pro-arbitration policy warrant invalidation of class waivers in cases where they effectively preclude the vindication of these rights. Part IV concludes by proposing a two-step inquiry for determining whether or not a class action waiver should be enforced under this new federal standard.

## I. THE FAA'S POLICY FAVORING ARBITRATION: ORIGINS, PREMISES, AND IMPLICATIONS

Since the early part of the twentieth century, scholars, judges, attorneys, and litigants on both sides of the adversarial system have criticized the civil litigation process as unduly cumbersome, expensive, and time-consuming.[7] In response, many participants in the litigation

5. 473 U.S. 614 (1985).

6. 531 U.S. 79 (2000).

7. *See, e.g.*, Sec. Indus. Ass'n v. Connolly, 883 F.2d 1114, 1118-19 (1st Cir. 1989) (stating that many critics of civil litigation appeals favor arbitration as an alternative); C. Evan Stewart, *Securities Arbitration Appeal: An Oxymoron No Longer?*, 79 KY. L.J. 347, 347 n.3 (1991) (noting that many view the civil litigation system as "too cumbersome, burdensome, time-consuming, formalistic, and expensive" and promote arbitration as an alternative); Warren E. Burger, *Isn't there a Better Way?*, *reprinted in* LEONARD L. RISKIN & JAMES E. WESTBROOK, DISPUTE RESOLUTION AND LAWYERS 13-15 (2d ed. 1997) (describing the adversarial system as expensive

process have viewed alternative dispute resolutions, such as private arbitration, as an efficient, cost-effective, and specialized alternative to formal, public litigation. Arbitration in particular is viewed as having a number of advantages. Because arbitration allows the parties to develop flexible procedures,[8] it often moves more swiftly than civil litigation actions. In addition, since arbitrators rarely publish their opinions, the time between hearing and result is shorter in arbitration than in standard litigation.[9] Further, many scholars extol arbitration as a desirable alternative to litigation because it allows disputants to select a decision maker with particular expertise and to design a dispute resolution process that is best suited to the parties' needs.[10]

Despite these perceived benefits, arbitration agreements initially received a hostile reception from most federal courts.[11] In 1925, Congress passed the FAA to reverse this "hostility to arbitration."[12] Section 2 of the FAA ensures that parties' agreements to arbitration will be enforced in federal court, stating that written 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."[13]

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and time-consuming; asserting that "[w]e need to consider moving some cases from the adversary system to administrative processes . . . especially arbitration"); Katherine Van Wezel Stone, *Rustic Justice: Community and Coercion Under the Federal Arbitration Act*, 77 N.C. L. REV. 931, 934 (1999) (noting that the growth of consumer arbitration stemmed largely from "widespread dissatisfaction with the civil justice system").

8. Sarah Rudolph Cole, *Arbitration and State Action*, 2005 BYU L. REV. 1, 40 (2005). For example, arbitration proceedings need not follow the rules of evidence, and many arbitrators limit or even eliminate discovery. *Id.*

9. *Id.* at 41.

10. Jean R. Sternlight, *As Mandatory Binding Arbitration Meets the Class Action, Will the Class Action Survive?*, 42 WM. & MARY L. REV. 1, 22 (2000); *see also* STEPHEN B. GOLDBERT ET AL., DISPUTE RESOLUTION: NEGOTIATION, MEDIATION AND OTHER PROCESSES 234 (3d ed. 1999) (noting the theoretical advantages of arbitration); Warren E. Burger, *Using Arbitration to Achieve Justice*, ARB. J., Dec. 1985, at 3, 6 ("[I]n terms of cost, time and human wear and tear, arbitration is vastly better than conventional litigation for many kinds of cases."); Dwight Golann, *Developments in Consumer Financial Services Litigation*, 32 BUS. LAW. 1081, 1091 (1988) (contending that arbitration is potentially quicker, less expensive, and more private for all parties).

11. Kulukundis Shipping Co. v. Amtorg Trading Corp., 126 F.2d 978, 981-84 (2d Cir. 1942) (holding that mandatory arbitration agreement was revocable at the will of either party); U.S. Asphalt Ref. Co. v. Trinidad Lake Petroleum Co., 222 F. 1006, 1008 (S.D.N.Y. 1915) (same).

12. Keith N. Hylton, *Agreements to Waive or to Arbitrate Legal Claims: An Economic Analysis*, 8 SUP. CT. ECON. REV. 209, 214 (2000).

13. 9 U.S.C. § 2 (1994).

### *A. The Rise of Mandatory[14] Arbitration Agreements*

At the time of the passage of the FAA, U.S. businesses typically did not use arbitration agreements to require consumers, employees, franchisees, or other parties in weaker bargaining positions to resolve disputes through private arbitration.[15] Instead, the early use of arbitration was generally limited to contracts between businesses or between management and unions.[16] In fact, when the FAA was debated in Congress, one Senator expressed concern that arbitration contracts might be "offered on a take-it-or-leave-it basis to captive customers or employees," but was assured by the bill's supporters that they did not intend the FAA to cover such situations.[17] Early Supreme Court jurisprudence also seemed to assuage fears that it would enforce adhesive arbitration agreements against consumers. For example, in its 1953 decision in *Wilko v. Swan*,[18] the Supreme Court refused to apply an arbitration clause to claims of securities fraud, interpreting the Securities Act of 1933 to prohibit the use of such a provision and emphasizing that the FAA "was drafted with an eye to the disadvantages under which buyers labor."[19]

In the 1980s, however, the Court's view towards commercial arbitration changed dramatically. In 1983, the Court first articulated its oft-cited holding that the FAA evidences a "liberal federal policy favoring arbitration agreements, notwithstanding any state substantive or procedural policies to the contrary."[20] Six years later, in 1989, the Supreme Court reversed its prior decision in *Wilko* and required courts to enforce arbitration agreements written by securities brokerage houses against investors.[21] In 1991, the Court in *Gilmer v. Interstate/Johnson Lane Corp.*[22] held that a securities broker could be

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14. When this paper uses the term "mandatory" it refers only to the former meaning, which equates "mandatory" arbitration agreements with those found in contracts of adhesion; that is, standard form contracts offered to individuals on a "take it or leave it" basis.

15. *See* IAN R. MACNEIL, AMERICAN ARBITRATION LAW: REFORMATION, NATIONALIZATION, INTERNATIONALIZATION 7, 19 (1992).

16. *See* Jean R. Sternlight, *Creeping Mandatory Arbitration: Is It Just?*, 57 STAN. L. REV. 1631, 1636 (2005).

17. *See* Prima Paint Corp. v. Flood & Conklin Mfg. Co., 388 U.S. 395, 414 (1967) (Black, J., dissenting) (citing *Hearing on S. 4213 and S. 4214 Before the Subcomm. of the S. Comm. on the Judiciary*, 67th Cong. 9-11 (1923)).

18. 346 U.S. 427 (1953).

19. *Id.* at 435, 436 (noting that arbitration does not offer the same remedies as litigation; pointing out that arbitrators may make awards "without explanation of their reasons and without a complete record of their proceedings").

20. Moses H. Cone Mem'l Hosp. v. Mercury Constr. Co., 460 U.S. 1, 24-25 (1983).

21. Rodriguez de Quijas v. Shearson/Am. Express, Inc. 490 U.S. 477, 481 (1989).

22. 500 U.S. 20, 29 (1991).

forced to arbitrate his federal age discrimination claims against his employer.[23]

As judicial support of arbitration as a means of commercial dispute resolution grew, U.S. businesses quickly began imposing arbitration in contexts previously thought to prohibit the use of such a method of dispute resolution. U.S. corporations increasingly used form contracts, mail inserts, shrink-wrap licenses,[24] and the like[25] to require consumers, employees, patients, and others to resolve future claims through arbitration rather than through the courts.[26] Numerous reported cases evidence the increased use of mandatory arbitration by entities including financial institutions,[27] retailers,[28] service providers,[29] and even McDonald's restaurants in their promotional games.[30]

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23. *Id.*

24. *See, e.g.*, Hill v. Gateway 2000, 105 F.3d 1147, 1148 (7th Cir. 1997).

25. The actual form of arbitration clauses also has changed substantially during the last twenty years. While the FAA mandates that arbitration agreements be written, it does not require that they be signed to be enforceable. *See* Linda J. Demaine & Deborah R. Hensler, *"Volunteering" to Arbitrate Through Predispute Arbitration Clauses: The Average Consumer's Experience*, LAW & CONTEMP. PROBS., Winter/Spring 2004, at 55 (focusing on industries that provided what the authors deemed "important purchases" (e.g. transactions that were expensive, such as automobile purchases), ongoing (e.g. long distance telephone service), or that had potentially large social impacts (e.g. health care services) and noting that, unsurprisingly, tbese industries began including arbitration agreements in documents that, while sent to consumers, were not of the types usually read or signed). U.S. businesses have included arbitration agreements in small print notices sent to consumers already bound to contracts, in envelope stuffers, *see, e.g.*, Ting v. AT&T, 319 F.3d 1126, 1149 (9th Cir. 2003) (finding unconscionable an arbitration clause imposed on telephone consumers via envelope stuffers), in warranties contained in boxes, *see Hill*, 105 F.3d at 1151 (upholding an arbitration clause imposed upon consumers via a warranty brochure in the computer box), on Web sites, *see, e.g.*, Dell Inc., Dell's Online Policies: U.S. Terms & Conditions of Sale, *at* http://www.dell.com/content/topics/global.aspx/policy/en/policy?c=us&l=en&s=gen&~section=012 (last visited Sept. 2, 2006); Gateway, Inc., Gateway Consumer Service Plans, *at* http://content.gateway.com/www.gateway.com/about/legal/warranties/8510306ConVAS88757B_306.pdf (last visited Sept. 2, 2006), and in e-mail communications, *see, e.g.*, Campbell v. Gen. Dynamics Gov't Sys. Corp., 321 F. Supp. 2d 142, 149 (D. Mass. 2004) (finding e-mail notification insufficient to require employee to resolve disputes in binding arbitration).

26. *See* Sternlight, *supra* note 16, at 1631 (noting that the U.S. Supreme Court has approved and even encouraged U.S. companies to use various forms of contracts to bind consumers and the like to binding arbitration).

27. *See, e.g.*, Wash. Mut. Fin. Group v. Bailey, 364 F.3d 260, 266 (5th Cir. 2004) (upholding an arbitration clause imposed on illiterate consumer borrower); McKenzie Check Advance of Miss. v. Hardy, 866 So. 2d 446, 455 (Miss. 2004) (upholding arbitration clause imposed on payday-loan borrowers).

28. *See, e.g.*, *Hill*, 105 F.3d at 1151 (upholding arbitration clause imposed on computer purchasers by including arbitration provision in warranty brochure in computer box); Cavalier Mfg., Inc. v. Clarke, 862 So. 2d 634, 636-37 (Ala. 2003) (upbolding arbitration clause imposed on mobile home purchasers).

29. *See, e.g.*, Allied-Bruce Terminix Cos. v. Dobson, 513 U.S. 265, 282 (1995) (upholding arbitration clause imposed on consumer purcbasing termite extermination services); Carbajal v.

U.S. companies not only increased their usage of arbitration agreements to compel arbitration, but they also began using these agreements to dictate various characteristics of the arbitration process. For example, businesses have used arbitration agreements in an effort—sometimes successfully—to shorten statutes of limitations,[31] restrict or eliminate discovery,[32] require a claimant to file in a particular and perhaps distant forum,[33] bar consumers or employees from recovering particular forms of relief,[34] and, through the use of class action waivers, prohibit consumers, employees, or other plaintiffs from joining together in a class action.[35]

### *B. A Critique of Mandatory Arbitration Agreements*

The emergence of mandatory arbitration clauses in contracts of adhesion is subject to significant criticism. Many critics of mandatory arbitration agreements assert that such clauses are inherently "unfair" to individuals for the simple reason that the party upon whom an arbitration clause is imposed is

> unwilling or unable to resist. . . . In some cases this will stem from lack of knowledge of what is happening until it is too late. But in most cases it will also be a function of the market power of the stronger party, imposing its will on the weaker one: an ordinary

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H&R Block Tax Servs., Inc. 372 F.3d 903, 905-06 (7th Cir. 2004) (upholding arbitration clause imposed on person who obtained tax preparation services, noting that unconscionability arguments are inappropriate where arbitration is selected "voluntarily").

30. Popovich v. McDonald's Corp., 189 F. Supp. 2d 772, 777-78 (N.D. Ill. 2002).

31. *See, e.g.*, Circuit City Stores, Inc. v. Adams, 279 F.3d 889, 894 (9th Cir. 2002) (invaliding an employment clause that imposed a shortened statue of limitations on employees); Stirlen v. Supercuts, Inc., 60 Cal. Rptr. 2d 138, 152 (Cal. Ct. App. 1997) (holding shortened time limit unconscionable).

32. Generally, arbitration clauses leave discovery to the arbitrator's discretion, but it is well-recognized that discovery is less available in arbitration than in litigation. Sternlight, *supra* note 16, at 1641 n.51. A few courts have held unenforceable arbitration clauses that *unduly* limit access to essential documents and witnesses. *See, e.g.*, Armendariz v. Found. Health Psychcare Servs., Inc., 6 P.3d 669, 684 (Cal. 2000).

33. *See, e.g.*, Patterson v. ITT Consumer Fin. Corp., 18 Cal. Rptr. 2d 563, 565-66 (Cal. Ct. App. 1993) (refusing to enforce an arbitration clause imposed by a financing organization upon California consumers that required arbitration to be heard in Minneapolis, noting that, though such a procedure might be fair if applied to a business entity, it was not necessarily just when applied to consumers); Brower v. Gateway 2000, Inc., 676 N.Y.S.2d 569, 571-75 (N.Y. App. Div. 1998) (finding unconscionable an arbitration agreement that required nationwide consumers to arbitrate claims in Chicago).

34. *See, e.g.*, *Circuit City*, 279 F.3d at 893 (finding unconscionable an arbitration provision imposed on employees in part because it limited the amount of damages and front and back pay); *Ex parte* Thicklin, 824 So. 2d 723, 733 (Ala. 2002) (holding an arbitration clause unconscionable to the extent it prevented consumers' right to recover punitive damages).

35. *See, e.g.*, Discover Bank v. Superior Court (*Discover Bank*), 113 P.3d 1100, 1103 (Cal. 2005); Szetela v. Discover Bank, 118 Cal. Rptr. 2d 862, 864 (Cal. Ct. App. 2002).

employee, a health-care patient, a consumer of goods or services, a small business dealing with a large one.[36]

As one scholar has written, "Under the law written by the Court, birds of prey will sup on workers, consumers, shippers, passengers and franchisees."[37]

Critics further argue that mandatory arbitration agreements are manifestly "unfair" because businesses frequently use them to dictate particular details of potential arbitral disputes.[38] In the context of adhesive contracts, the parties have not genuinely bargained for these details; rather, the drafter often has imposed its choices upon the party with weaker bargaining power, the individual consumer or employee. Not surprisingly, these "detail" clauses are typically drafted in a one-sided manner favoring the drafter—usually a corporation or union—without any input or negotiation by the individual consumers or employees. The typical one-sidedness of these "detail" provisions is especially troublesome in light of one of the primary arguments articulated in favor of private arbitration: it allows parties to tailor the arbitration proceedings to the individual needs and wants of each party. Further, many argue that these "detail" provisions limit or eliminate individuals' procedural and substantive rights. For example, because state and federal courts have reached differing results regarding the enforceability of class action waivers, various detail provisions, such as choice-of-law or choice-of-forum provisions, can affect, among other things, an individual's ability to take advantage of aggregation procedures.[39] Other procedural aspects of mandatory arbitration have also generated criticism. For example, arbitration does not typically provide a right to appeal, and review of arbitral awards by courts is limited under the FAA to grounds of corruption, fraud, "evident partiality," misconduct, and actions that are *ultra vires*.[40]

Consumer and employee advocates in particular have launched specific criticisms of mandatory arbitration agreements. Both contend that arbitration, though lauded as more cost-effective than standard

36. Charles L. Knapp, *Taking Contracts Private: The Quiet Revolution in Contract Law*, 71 FORDHAM L. REV. 761, 788 (2002).

37. Paul D. Carrington & Paul H. Haagen, *Contract and Jurisdiction*, 1996 SUP. CT. REV. 331, 401.

38. Examples of such "detail" clauses include, but are not limited to, those ordering the use of a particular arbitrator, those limiting or restricting discovery, those requiring a claimant to file in a particular—and perhaps distant—forum, those setting forth the substantive law to be employed, and those barring individuals from joining together in a class action.

39. *See, e.g.*, Discover Bank v. Superior Court (*Discover Bank Remand*), 36 Cal. Rptr. 3d 456, 457 (Cal. Ct. App. 2005).

40. *See* 9 U.S.C. § 10 (1994).

litigation, is in truth unavailable to many individuals because its initial costs are prohibitively high.[41] Criticizing the enforcement of arbitration clauses in employment contracts, the Equal Employment Opportunity Commission ("EEOC") announced in a policy statement that agreements requiring employees to agree to binding arbitration of discrimination claims as a condition of employment are "contrary to fundamental principles" of American employment discrimination laws.[42] These criticisms of mandatory arbitration agreements are especially relevant to the analysis of class action waivers because many employment claims—particularly those alleging patterns or practices of discrimination and requesting primarily injunctive relief—are most effectively brought as class actions.

Despite these criticisms, mandatory arbitration agreements also have their supporters. Many assert that binding arbitration provides a better alternative for consumers than does standard litigation.[43] These supporters contend that arbitration provisions help consumers and employees by giving them a forum that is at least

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41. Mark E. Budnitz, *The High Cost of Mandatory Arbitration*, 67 LAW & CONTEMP. PROBS. 133, 133 (2004). Unlike litigation, parties to arbitration must pay the fees of the arbitrator and of the administering institution. *See* David S. Schwartz, *Enforcing Small Print to Protect Big Business: Employee and Consumer Rights Claims in an Age of Compelled Arbitration*, 1997 WIS. L. REV. 33, 61 (1997) (stating that "[h]igher threshold costs to plaintiff" is a reason "why corporate defendants like arbitration"). In addition, a party who brings a claim in arbitration must pay an up-front fee that typically exceeds the filing fee required to proceed in court. *See* Frederick L. Miller, *Arbitration Clauses in Consumer Contracts: Building Barriers to Consumer Protection*, 78 MICH. B.J. 302, 303 (1999) (discussing various fees associated with arbitral proceedings). It is worth noting, however, that up-front arbitration fees are often tempered by low-cost consumer arbitration, *see* Christopher R. Drahozal, *"Unfair" Arbitration Clauses*, 2001 U. ILL. L. REV. 695, 713 n.141, and the willingness of some arbitral institutions to waive or reduce fees for indigent claimants. *See* NATIONAL ARBITRATION FORUM, CODE OF PROCEDURE RULE 45, *available at* http://www.adrforum.com/users/naf/resources/20060501CodeOfProcedure07216.pdf (last visited Sept. 2, 2006) (waiver of fees for indigent party). In fact, various courts have recognized that the costs of arbitration can indeed prevent consumers from using the very forum that an arbitration agreement has made the exclusive means of resolving their claims. *See, e.g.*, Ting v. AT&T, 319 F.3d 1126, 1151 (9th Cir. 2003) (recognizing that consumer complainants would face insurmountable arbitration costs if forced to bring their small claims individually); Mendez v. Palm Harbor Homes, Inc., 45 P.3d 594, 605 (Wash. Ct. App. 2002) (holding that prohibitive costs may "render the arbitral forum inaccessible"); Brower v. Gateway 2000, Inc., 676 N.Y.S.2d 569, 573 (N.Y. App. Div. 1998) (finding unconscionable a provision requiring arbitration of consumer disputes over computer purchases because the chosen arbitral forum–the International Chamber of Commerce–had a minimum up-front fee of $4000 for small claims, stating that excessive costs "deter consumers from invoking arbitration").

42. EEOC Notice No. 915.002 (July 10, 1997).

43. *See* Sternlight, *supra* note 16, at 1633; *see also* David Sherwyn et al., *In Defense of Mandatory Arbitration in Employment Disputes: Saving the Baby, Tossing Out the Bathwater, and Constructing a New Sink in the Process*, 2 U. PA. J. LAB. & EMP. L. 73, 147 (1999) (stating that whatever disadvantages involved with mandatory arbitration, they are minimal compared to those involved in litigation).

arguably less expensive and usually more efficient and accessible.[44] Indeed, supporters of mandatory arbitration agreements, though acknowledging their imperfections, argue that as long as certain procedural guarantees are provided, these agreements "level the playing field" because they provide an adjudicatory process for plaintiffs who likely would—in the context of standard litigation—be forced to settle for paltry sums or receive no relief whatsoever.[45] Further, many argue that because arbitration often reduces the drafter's own dispute resolution costs, market forces ensure that these savings are passed to consumers in the form of lower prices and to employees in the form of higher wages.[46] As a fundamental matter, some supporters of binding arbitration insist that voiding these contracts would effectively deny consumers and employees their freedom of contract.[47]

## II. CLASS ACTION WAIVERS IN MANDATORY ARBITRATION AGREEMENTS

The problem of possible unfairness caused by mandatory arbitration clauses has been exacerbated by another recent trend: the increasing use by many U.S. businesses of mandatory arbitration provisions that prohibit class-wide proceedings, referred to throughout this Note as "class action waivers." This Section provides a brief overview of class action waivers and the current judicial stance toward them.

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44. *See, e.g.*, Charles B. Craver, *The Use of Non-Judicial Procedures to Resolve Employment Discrimination Claims*, 11 KAN. J.L. & PUB. POL'Y 141, 158 (2001) ("Fair arbitral procedures can provide a more expeditious and less expensive alternative that may benefit workers more than judicial proceedings."); Samuel Estreicher, *Saturns for Rickshaws: The Stakes in the Debate over Predispute Employment Arbitration Agreements*, 16 OH. ST. J. ON DISP. RESOL. 559, 563 (2001) ("In a world without employment arbitration . . . we would essentially have a 'cadillac' system for the few and a 'rickshaw' system for the many.").

45. *See* David Sherwyn et al., *supra* note 43, at 147.

46. *See* Sternlight, *supra* note 16, at 1634; *see also* Stephen J. Ware, *Paying the Price of Process: Judicial Regulation of Consumer Arbitration Agreements*, 2001 J. DISP. RESOL. 89, 90-93 (arguing that mandatory arbitration lowers consumer prices because competition forces businesses to pass cost savings on to consumers). *But see* Jean R. Sternlight & Elizabeth J. Jensen, *Mandatory Arbitration: Using Arbitration to Eliminate Consumer Class Actions: Efficient Business Practice or Unconscionable Abuse?*, LAW & CONTEMP. PROBS., Winter/Spring 2004, at 75, 93 (suggesting that Ware's argument that companies pass on all savings to consumers is based upon "oversimplified" economic assumptions).

47. *See, e.g.*, Stephen J. Ware, *Arbitration Under Assault: Trial Lawyers Lead the Charge*, POL'Y ANALYSIS, Apr. 18, 2002, at 8, *available at* http://www.cato.org/pubs/pas/pa433.pdf (last visited Sept. 2, 2006) ("What opponents of so-called mandatory arbitration really oppose is freedom of contract.").

### *A. Debate Over Class Action Waivers*

Though many courts have emphasized that class action proceedings are important for helping make possible suits that would otherwise be logistically or economically impossible,[48] credit card companies, banks, health care providers, and other corporate defendants usually dislike class actions. Many of these corporations have found ways to avoid class actions through the use of mandatory arbitration agreements[49] and, more recently, through class action waivers.[50] Class action waivers began to emerge in the late 1990s, when trade-journal articles first started encouraging corporations to consider including class action prohibitions in arbitration agreements.[51] Companies now frequently use arbitration clauses in their agreements with customers or other counterparties to manage class action risks.[52]

Companies' use of class action waivers is motivated by the view that plaintiffs exploit the class action procedure in order to wrest large and unfair settlements from defendants.[53] This view is particularly prominent with respect to defendants involved with mass tort claims, securities fraud claims, and consumer claims, especially under federal laws that provide for statutory and/or treble damages, attorney's fees, and costs.[54] Class action waivers are viewed by these companies as a way "to defend themselves" from consumers who are "ganging up on" companies through the leverage inherent in the aggregation of large numbers of claims.[55] In further support of these waivers, corporations argue that the many (perceived) advantages of arbitration to a

48. *See, e.g.*, Amchem Prods., Inc. v. Windsor, 521 U.S. 591, 617 (1997).

49. *See, e.g.*, Edward Wood Dunham, *The Arbitration Clause as Class Action Shield*, 16 FRANCHISE L.J. 141, 142 (1997) (encouraging franchisors to make use of mandatory arbitration provisions); Michael R. Pennington, *Every Health Insurer's Litigation Nightmare: A Case Study of How One Class Action Affected the Business of One Insurer*, THE BRIEF, Summer 1999, at 47, 52 (noting that Alabama insurance companies are using binding arbitration clauses in an "effort to limit litigation exposure in general, and exposure to class actions in particular"); J.T. Westermeir, *How Arbitration Clauses Can Help Avoid Class Action Damages*, 14 COMPUTER L. STRATEGIST, Sept. 1997, at 1 (discussing computer manufacturers' use of arbitration clauses).

50. *See* Sternlight, *supra* note 10, at 6 n.5 (citing various arbitration clauses prohibiting class actions including clauses used by MBNA, American Express, J.C. Penney & Monogram Credit Card Bank of Georgia, and H&R Block).

51. Gilles, *supra* note 1, at 396.

52. *See* Dunham, *supra* note 49, at 141.

53. *See* Sternlight, *supra* note 10, at 5.

54. *See, e.g.*, 15 U.S.C. § 1681n (2006) (provision of the Fair Credit Reporting Act providing for statutory damages, attorney's fees, costs, and punitive damages for "willful" violations of the Act).

55. Alan S. Kaplinsky & Mark J. Levin, *Excuse Me, But Who's the Predator? Banks Can Use Arbitration Clauses as a Defense*, BUS. L. TODAY, May-June 1998, at 24.

plaintiff make up for any disadvantages or inconveniences that the plaintiff may incur by sacrificing the ability to be part of a class action.

Predictably, both consumer and employee advocates have expressed strong opposition to corporations' use of class action waivers.[56] Opponents of class action waivers contend that the ability to aggregate claims is crucial to protect the rights of those individuals—employees, consumers, minorities, medical patients, and the like—who do not have the resources to litigate individual claims.[57] Further, many individual claims are *only* viable if brought on a class-wide basis.[58] Indeed, by prohibiting class actions in the context of "negative-value" lawsuits, where the expected recovery is dwarfed by the cost of litigating or arbitrating the claim, individuals are effectively prevented from pursuing their claims. As a result, businesses are able to engage in unchecked market misbehavior that results in small and seemingly insignificant consequences upon individuals, but which leads to sizeable windfalls for the particular corporation in the aggregate.[59]

### *B. Current Judicial Stance Toward Class Action Waivers*

Despite this opposition, class action waivers are increasingly common, as illustrated by a number of recent cases.[60] For example, in *Discover Bank v. Superior Court,*[61] consumers challenged the lawfulness of Discover's payment schedule whereby, unknown to

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56. This opposition is especially unsurprising in the context of consumer cases, since no other area of law besides securities cases generates more class actions. Gilles, *supra* note 1, at 414.

57. *See* Sternlight, *supra* note 10, at 12.

58. *See, e.g.*, Med Ctr. Cars, Inc. v. Smith, 727 So. 2d 9, 19-20 (Ala. 1998) (plaintiffs argued that individual damages were too small for individuals to warrant the payment of a $500 arbitration fee).

59. *See* Samuel Issacharoff & Erin F. Delaney, *Credit Card Accountability*, 73 U. CHI. L. REV. (forthcoming 2006), *available at* http://ssrn.com/abstract =789704 (last visited Sept. 2, 2006).

60. *See, e.g.*, Tsadilas v. Providian Nat'l Bank, 786 N.Y.S.2d 478, 480 (N.Y. App. Div. 2004); Johnson v. Chase Manhattan Bank USA, N.A., No. 603101/02, 2004 WL 413213, at *4-8 (N.Y. Sup. Ct. Feb. 27, 2004); Ranieri v.Bell Atl. Mobile, Inc., 759 N.Y.S.2d 448, 449 (N.Y. App Div. 2003). Courts in Utah similarly favor agreements to arbitrate. *See, e.g.*, Cent. Fla. Invs., Inc. v. Parkwest Assocs., 40 P.3d 599, 606 (Utah 2002); Chandler v. Blue Cross Blue Shield, 833 P.2d 356, 358 (Utah 1992). Federal courts have also not hesitated to enforce arbitration agreements that precluded class action relief. *See, e.g.*, Jenkins v. First Am. Cash Advance of Ga., LLC, 400 F.3d 868, 877 (11th Cir. 2005); Randolph v. Green Tree Fin. Corp.-Ala., 244 F.3d 814, 819 (11th Cir. 2001); *In re* Currency Conversion Fee Antitrust Litig., 265 F. Supp. 2d 385, 400 (S.D.N.Y. 2003).

61. 113 P.3d 1100 (Cal. 2005).

consumers, payments not credited by 1 p.m. on the bill's due date were considered late and subjected to a $29.00 late fee plus finance charges.[62] However, because amendment provisions in the card member agreements both required all claims to be arbitrated and prohibited consumers from proceeding on a class wide basis,[63] Discover customers were all but prevented from bringing their claims since, individually, the $29.00 amount in controversy would likely not justify the expense of arbitration.

Employers are also increasingly using class action waivers in the context of discrimination and disability claims. Title VII cases have long "typified the sort of civil rights action that courts and commentators describe as uniquely suited to resolution by class action litigation."[64] Such claims have long been subject to mandatory arbitration agreements.[65] More recently, employers have begun incorporating class action waivers into these arbitration clauses to try to shield themselves from aggregated claims. For example, Circuit City has imposed class action waivers on its employees to minimize its exposure to discrimination and other types of employment-related claims.[66]

While the potential reach of these class action waivers is uncertain, at least one leading scholar predicts that these waivers have the potential effectively to eliminate class actions brought under consumer and employment statutes.[67] Regardless of whether this prediction proves true, it is not farfetched to suggest that these provisions will appear in more and more contracts, in light of a judicial climate largely favorable toward arbitration in general and class action waivers in particular. Indeed, such a result seems especially likely in light of recent articles in trade journals advising

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62. *Id.* at 1104.

63. Bellavia v. First USA Bank, No. 02 C 3971, 2003 U.S. Dist. LEXIS 18907, at *2-3 (N.D. Ill. Oct. 22, 2003).

64. Melissa Hart, *Will Employment Discrimination Class Actions Survive?*, 37 AKRON L. REV. 813, 813-14 (2004).

65. *See, e.g.*, Fletcher v. Kidder, Peabody & Co., 601 N.Y.S.2d 686, 694 (N.Y. App. Div. 1993) (compelling arbitration of race and gender discrimination claims brought against a brokerage firm).

66. Gentry v. Superior Court, 37 Cal. Rptr. 3d 790, 791-92 (Cal. Ct. App. 2006), *petition for review granted*, 135 P.3d 1 (Cal. 2006).

67. Gilles, *supra* note 1, at 413; *see also* Demaine & Hensler, *supra* note 25, at 56 ("Arbitration is no longer the province of sophisticated participants. Instead, individuals pursuing long-established statutory claims, such as those brought under the federal securities and antitrust laws, and newer but long-sought civil rights claims, including race, sex, age, and disability discrimination, may now be forced to arbitrate if the parties are deemed to have assented to a pre-dispute arbitration clause.").

companies to include class action waivers in arbitration agreements.[68] Further, even companies that have already formed contracts with consumers are perfectly able to include modifications to those contracts, including class action waiver provisions, in mail inserts and the like. Thus, in the absence of significant practical restraints, companies predictably will continue to seek to use class action waivers in their contractual relationships with consumers, employees, and other counterparties that they interact with on an aggregate basis.

## III. UNCONSCIONABILITY AS A SOLUTION TO THE PROBLEM OF CLASS ACTION WAIVERS

In an effort to protect consumers, employees, and other groups from the potential unfairness of class action waivers in mandatory arbitration agreements, certain courts have looked to state-law doctrines of unconscionability. After providing a brief overview of the doctrine of unconscionability, this Part assesses the viability of that doctrine as a cure for the problems posed by mandatory class action waivers and concludes that the doctrine fails to capture the most pertinent objections to class action waivers.

### *A. Judicial Efforts to Use Unconscionability to Prevent Class Action Waivers*

#### 1. Overview of the Unconscionability Doctrine

The doctrine of unconscionability is a defense to the enforceability of contracts at common law that exists in all American state and territorial jurisdictions.[69] Traditionally, to determine whether or not a contract provision is unconscionable, courts test the provision at issue for both procedural and substantive unconscionability.[70] Typically, a contract provision must fail *both* prongs of this test to be found unconscionable.[71] When policing a

68. *See, e.g.*, Hilary B. Miller, *Drafting a Bulletproof Arbitration Agreement (and Donning Your Flak Jacket)*, 1362 PLI/CORP 159, 163 (Mar.–May 2003) (detailing how lawyers can use arbitration clauses as "front-line defense[s] against class actions").

69. *See, e.g.*, RESTATEMENT (SECOND) OF CONTRACTS § 208 cmt. b (1981).

70. *See, e.g.*, Armendariz v. Found. Health Psychcare Servs., Inc., 6 P.3d 669, 690 (Cal. 2000) ("[U]nconscionability has both a procedural and suhstantive element, the former focusing on oppression or surprise due to unequal bargaining power, the latter on overly harsh or one-sided results.").

71. *See id.* ("The prevailing view is that procedural and substantive unconscionability must both be present in order for a court to exercise its discretion to refuse to enforce a contract or clause under the doctrine of unconscionability."). Occasionally, a contract provision has been

contract provision for procedural unconscionability, courts focus on the bargaining conditions under which the contract was made.[72] Most often, problems with the bargaining process are found when the contract at issue is one of adhesion—that is, one offered on a "take-it-or-leave it" basis. If the terms of that adhesive contract, however, are substantively fair, courts generally tolerate a fair amount of procedural unconscionability.[73] Courts consider many factors when evaluating procedural unconscionability, including the clarity with which the terms are set forth,[74] the clarity with which the effect of those terms is explained,[75] and the equality (or lack thereof) of the bargaining power between the contracting parties.[76]

When evaluating a contract provision for substantive unconscionability, courts typically focus on the "oppressiveness" or "gross one-sidedness" of the contract terms. A contract term is often considered "oppressive" if it unfairly allocates risk to one party or if the contents of the term could not be said to fall within one party's reasonable expectations. Courts also look at "the commercial reasonableness of the contract term [and] the purpose and effect of the

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found unconscionable after failing only one prong of the test. *See, e.g.*, Ball v. SFX Broad., 165 F. Supp. 2d 230, 240 (N.D.N.Y. 2001) (holding that an arbitration clause providing for a forum with excessively high fees is impermissible in a consumer transaction with a relatively small amount in issue); Brower v. Gateway 2000, 676 N.Y.S.2d 569, 574 (N.Y. App. Div. 1998) (same); Sho-Pro of Ind., Inc. v. Brown, 585 N.E.2d 1357, 1361 (Ind. Ct. App. 1992) (holding that gross excessiveness of price—"oppressive" as a matter of substantive unconscionability—is itself unconscionable); Ahern v. Knecht, 563 N.E.2d 787, 792 (Ill. App. Ct. 1990) (same); *see also* Margaret M. Harding, *The Redefinition of Arbitration by Those with Superior Bargaining Power*, 1999 UTAH L. REV. 857, 934 (1999) ("[C]ourts have suggested . . . a large amount of one type of unconscionability can make up for only a small amount of the other.").

72. Joshua S. Lipshutz, *The Court's Implicit Roadmap: Charting the Prudent Course at the Juncture of Mandatory Arbitration Agreements and Class Action Lawsuits*, 57 STAN. L. REV. 1677, 1694 (2005).

73. *See* Jonathan E. Breckenridge, *Bargaining Unfairness and Agreements to Arbitrate: Judicial and Legislative Application of Contract Defenses to Arbitration Agreements*, 1991 ANN. SURV. AM. L. 925, 979 (1993).

74. *See, e.g.*, Bell v. Cong. Mortgage Co., 30 Cal. Rptr. 2d 205, 210 (Cal. Ct. App. 1994) (holding that arbitration clauses in adhesion contracts are unenforceable unless they "appear in clear and unmistakable form by highlighting, bold type, or with an opportunity for specific acknowledgment by initialing"), *depublished by* S040252, 1994 Cal. LEXIS 4258, at *1 (Cal. July 28, 1994).

75. *See* Mark E. Budnitz, *Arbitration of Disputes Between Consumers and Financial Institutions: A Serious Threat to Consumer Protection*, 10 OHIO ST. J. ON DISP. RESOL. 267, 304 (1995) ("Even if arbitration contracts are in bold-faced type, they may be vulnerable to a procedural unconscionability attack on the grounds that the contract fails to adequately explain the arbitration procedure and what the consumer is surrendering.").

76. *See, e.g.*, RESTATEMENT (SECOND) OF CONTRACTS § 208 cmt. d (1981) ("[G]ross inequality of bargaining power, together with terms unreasonably favorable to the stronger party, may confirm indications that the transaction involved elements of deception or compulsion, or may show that the weaker party had no meaningful choice, no real alternative, or did not in fact assent or appear to assent to the unfair terms.").

terms."[77] For better or worse,[78] the vagueness of this two-prong standard provides courts with a fair amount of leeway in making unconscionability determinations in particular circumstances.

As mentioned in Part I above, FAA § 2 requires courts to enforce arbitration agreements "save upon such grounds as exist at law or in equity for the revocation of any contract."[79] The Supreme Court has specifically held that this "saving clause" means that "generally applicable contract defenses, such as . . . unconscionability, may be applied to invalidate arbitration agreements without contravening" the FAA.[80] In other words, due to this "saving clause," federal law favors enforcement of agreements according to their terms insofar as—but only insofar as—those terms are enforceable as a matter of generally applicable state contract law. States may not single out arbitration provisions for suspect status, but must place such provisions "upon the same footing as other contracts."[81] Because most other defenses to contract enforcement (fraud, duress) are rarely pertinent, the "saving clause" of the FAA means that the unconscionability doctrine—and little else—remains a potential sword with which to attack class action waivers.

### 2. Unconscionability Doctrine and Class Action Waivers

The majority of courts faced with class action waivers have upheld their validity against claims that they are unconscionable. The U.S. Courts of Appeals for the Third,[82] Fourth,[83] Fifth,[84] and Seventh[85]

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77. NEC Tech., Inc. v. Nelson, 478 S.E.2d 769, 772 (Ga. 1996).

78. Some scholars have suggested that unconscionability is simply so flexible a concept that it permits too much post-hoc judicial interference with contracts. *See, e.g.*, Arthur A. Leff, *Unconscionabilty and the Crowd—Consumers and the Common Law Tradition*, 31 U. PITT. L. REV. 349, 353 (1970) (arguing that the unconscionability doctrine should not be used as an ad-hoc judicial remedy but may be effective as a regulatory mechanism imposed by legislatures or administrative agencies). *But sce generally* M.P. Ellinghaus, *In Defense of Unconscionability*, 78 YALE L.J. 757 (1969).

79. 9 U.S.C. § 2 (1994).

80. Doctor's Assocs., Inc. v. Casarotto, 517 U.S. 681, 687 (1996); *see also* Allied-Bruce Terminix Cos. v. Dobson, 513 U.S. 265, 281 (1995); Rodriguez de Quijas v. Shearson/Am. Express, Inc., 490 U.S. 477, 483-484 (1989); Shearson/Am. Express Inc. v. McMahon, 482 U.S. 220, 226 (1987).

81. Scherk v. Alberto-Culver Co., 417 U.S. 506, 511 (1974).

82. *See* Lloyd v. MBNA Am. Bank, N.A., 27 F. App'x. 82, 84 (3d. Cir. 2002) (stating that because "the right to a class action . . . is 'merely procedural' and 'may be waived,' an arbitration agreement barring class wide relief for claims brought under the TILA is not unconscionable").

83. *See* Snowden v. CheckPoint Check Cashing, Inc., 290 F.3d 631, 638 (4th Cir. 2002) ("We also reject Snowden's argument that the arbitration agreement is unconscionable because without the class action vehicle, she will be unable to maintain her legal representation given the small amount of her individual damages.").

84. Iberia Credit Bureau, Inc. v. Cingular Wireless LLC, 379 F.3d 159, 176 (5th Cir. 2004).

Circuits all have enforced class action waivers in consumer contracts. Many district courts have also upheld the validity of these class action waivers,[86] rejecting plaintiffs' claims that such provisions are unconscionable or contrary to public policy. Notwithstanding the majority view, however, certain courts—including state courts in California and Illinois, as well as the Ninth Circuit—have refused to enforce class action waivers, finding them unconscionable.[87]

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85. *See* Livingston v. Assocs. Fin., Inc., 339 F.3d 553, 559 (7th Cir. 2003) ("The arbitration agreement . . . explicitly precludes . . . class claims or . . . 'class action arbitration,' so we are therefore 'obliged to enforce the type of arbitration to which these parties agreed, which does not include arbitration on a class basis.'" (citation omitted)).

86. *See, e.g.*, Schiefley v. Discover Bank, No. CV 03-2801 RBL, slip op. at 4 (W.D. Wash. June 25, 2004) (enforcing a class action waiver, stating that, pursuant to a choice-of-law provision in the contract, "Delaware has clearly and recently determined that the inclusion of a class action prohibition is not unconscionable, and is enforceable"); Gipson v. Cross Country Bank, 294 F. Supp. 2d 1251, 1262-63 (M.D. Ala. 2003) (rejecting plaintiffs' argument that a class action waiver was unconscionable, noting that under the Fair Credit Billing Act—the statute under which plaintiffs' cause of action arose—the bank would be liable to pay plaintiffs' attorney's fees and costs if plaintiffs prevailed in arbitration, and, thus, plaintiffs and counsel had incentive to proceed on an individual basis despite the small monetary value of individual claim); Tsadilas v. Providian Nat'l Bank, 786 N.Y.S.2d 478, 480 (N.Y. App. Div. 2004) (affirming lower court's holding that a contractual waiver of the right to pursue a class action is not unconscionable); Rosen v. SCIL, LLC, 799 N.E.2d 488, 494, 496 (Ill. App. Ct. 2003) (reversing the trial court's finding that a class action waiver was unconscionable, reasoning that, even though plaintiff's individual claims were small, the plaintiff's arbitration fee ($125) was not unreasonable, that there was no limitation on his ability to vindicate substantive statutory rights under the Illinois Consumer Fraud and Deceptive Business Practices Act (including recovery of punitive damages and attorneys' fees) should he prevail, and that, since the arbitration agreement was added to the credit card agreement through change of terms procedures, "[i]f plaintiff did not wish to agree to the new terms . . . he simply should have stopped using the card").

87. *See, e.g.*, Ingle v. Circuit City Stores, 328 F.3d 1165, 1176 (9th Cir. 2003) ("Under California law, provision of arbitration agreement prohibiting consolidation of employee claims and generally prohibiting class-action arbitrations was substantively unconscionable, inasmuch as provision operated solely to advantage of employer."); Szetela v. Discover Bank, 118 Cal. Rptr. 2d 862, 867 (Cal. Ct. App. 2002) (holding that a class action prohibition in a credit card consumer contract was both procedurally and substantively unconscionable, emphasizing the "manifest one-sidedness" of the provision and noting that the clause was intended to preclude customers with small claims from obtaining relief, thereby providing Discover with "virtual immunity" from class actions); *see also* ACORN v. Household Int'l, Inc., 211 F. Supp. 2d 1160, 1170-71 (N.D. Cal. 2002) (holding a class action prohibition unconscionable on the same grounds set forth in *Szetela* and rejecting defendants' argument that *Szetela* only applies in jurisdictions that accept arbitral class actions); Comb v. Paypal, Inc., 218 F. Supp. 2d 1165, 1175-76 (N.D. Cal. 2002) (finding a class action waiver unconscionable and rejecting defendants' argument that the FAA preempted the court's unconscionability finding); Ting v. AT&T, 182 F. Supp. 2d 902, 918 (N.D. Cal. 2002) (holding particular provisions of an arbitration agreement unconscionable, including a clause prohibiting class actions, noting that "[i]t would not have been economically feasible to pursue the claims in these cases on an individual basis, whether . . . in court or in arbitration," and that "the lawyers who represented the plaintiffs in these cases [would not] have taken them if the only claim they could have pursued was the claim of the individual plaintiff"); State *ex rel.* Dunlap v. Berer, 567 S.E.2d 265, 278 (W. Va. 2002) (finding a class action waiver unconscionable in a contract for jewelry insurance, reasoning that the waiver effectively gave companies

The Illinois Appellate Court's decision in *Kinkel v. Cingular Wireless, LLC*[88] is one of the most recent to apply the doctrine of unconscionability to a class action waiver and is a good illustration of the reasoning of similar cases. In *Kinkel*, the court declared a class action waiver provision in a wireless telephone arbitration agreement both procedurally and substantively unconscionable.[89] The court based its holding of procedural unconscionability on the grounds that the provision was written in extremely small type, was contained in a contract of adhesion, and was "hidden" in the middle of an extensive "terms and conditions" page.[90] As a matter of substantive unconscionability, the court stated that the cost of filing either in court or before an arbitral body, combined with costs incurred in presenting the claim (including lost wages) would offset a "significant portion" of the plaintiff's maximum recovery (here, a $150.00 cancellation fee).[91] Significantly, the court in *Kinkel* rejected defendant's argument that a class action proceeding would undermine or eliminate the benefits of streamlined arbitration, noting that it would be more efficient to proceed with a class arbitration than to decide the plaintiff's claim among thousands of other duplicative claims.[92] In sum, the court in *Kinkel* refused to enforce the class action waiver on the ground that such waivers (1) would effectively prevent plaintiffs with low-value claims from bringing those claims and (2) would provide defendants with virtual immunity from liability, class-wide or otherwise.[93]

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immunity to commit illegal acts when the $8.46 added to plaintiff's jewelry purchase was "precisely the sort of small-dollar/high volume (alleged) illegality that class action claims and remedies are effective at addressing"); Kinkel v. Cingular Wireless, LLC, 828 N.E.2d 812, 819-21 (Ill. App. Ct. 2005) (denying Cingular's motion to compel arbitration, finding unconscionable a class action waiver because it effectively prevented plaintiffs from bringing claims regarding early termination fees and because it rendered the contract unreasonably one-sided); Powertel, Inc. v. Bexley, 743 So. 2d 570, 576 (Bankr. Fla. Dist. Ct. App. 1999) (finding a class action waiver unconscionable, reasoning that class litigation provided the most economically feasible remedy for the kind of claim asserted; namely, one involving relatively small sums of money on an individual basis).

88. 828 N.E.2d 812.

89. *Id.* at 819-21.

90. *Id.* at 819.

91. *Id.* at 820. Significantly, the court first distinguished *Hutcherson v. Sears Roebuck & Co.*, 793 N.E.2d 886 (Ill. App. Ct. 2003), noting that in the latter, the arbitration clause provided that the creditor would advance any arbitration fees the consumer had to pay. *Kinkel*, 828 N.E.2d at 820. The court also distinguished *Rosen*, 799 N.E.2d 488, stating that, in *Rosen*, the arbitration clause provided that the creditor would advance the amount of any arbitration fees to the consumer that exceeded what he would have to pay for court fees. *Kinkel*, 828 N.E.2d at 822-23.

92. *Kinkel*, 828 N.E.2d at 820.

93. *Id.* at 820-821 (citing Szetela v. Discover Bank, 118 Cal. Rptr. 2d 862, 867 (Cal. Ct. App. 2002)).

Notwithstanding the fact that the majority of courts uphold class action waivers against a claim of unconscionability, these minority decisions are of considerable practical significance insofar as they permit class proceedings on behalf of a nationwide class of consumers or employees to take place in the minority forum, or insofar as they enable, at the very least, consumers in larger states (*e.g.*, California, Illinois, and Florida) to sue rather than arbitrate.[94] Indeed, the dissent in the California Supreme Court's decision in *Discover Bank* expressed concern that California would become a "magnet" jurisdiction for plaintiffs' lawyers.[95] Thus, even these minority decisions have, for practical purposes, meant that class action waivers are susceptible to invalidation under state-law unconscionability doctrine.

### *B. Efforts to Avoid the Effect of the Unconscionability Doctrine*

Because some courts have found class action waivers unconscionable, defendants have adopted a variety of legal strategies designed to circumvent such results. In particular, defendants have attempted to use choice-of-law and forum-selection clauses and to invoke FAA preemption as means of preserving class action waivers. None of these strategies, however, has offered a guaranteed way to avoid the minority view that class action waivers in arbitration clauses are invalid under state unconscionability doctrine.

#### 1. Choice-of-Law and Forum-Selection Clauses

Defendants have attempted to avoid unfavorable unconscionability findings by including choice-of-law and forum-selection clauses in their arbitration agreements. Such measures have met with mixed success. For example, on remand from the California Supreme Court in *Discover Bank*, the California Court of Appeals for the Second District enforced a Delaware choice-of-law provision in the arbitration agreement, reasoning that California's policy interest in

94. *See* Samuel Isaacharoff & Catherine Sharkey, *Backdoor Federalization: Grappling with the "Risk to the Rest of the Country"*, 53 UCLA L. REV. 1353 (2006) (addressing the question of what happens when an aberrant state's "experimentation" poses a "risk to the rest of the country").

95. Discover Bank v. Superior Court *(Discover Bank)*, 113 P.3d 1100, 1118 (Cal. 2005) (Baxter, J., concurring in part and dissenting in part) ("[I]f California courts must, or may, dishonor class action waivers that are perfectly valid under the governing law selected by the parties themselves, California – which now takes a minority position on this issue – might well become the magnet for countless nationwide consumer class action lawsuits that could not be maintained elsewhere.").

striking down certain class action waivers as unconscionable did not outweigh the state of Delaware's interest in the application of its policies, which did not consider class action waivers unconscionable.[96] In contrast, however, the California Appeals Court in another case, *Szetela v. Discover Bank*,[97] found unconscionable a class action waiver notwithstanding the presence of a choice-of-law provision, stating that Discover had failed to establish that the law of Delaware should apply in that case.[98] As these decisions make clear, including a choice-of-law provision does not guarantee that a defendant can entirely avoid the application of an expansive unconscionability doctrine under state law.

Though one might believe a simple response to this problem would be to insert a forum-selection clause in addition to a choice-of-law provision, this strategy, too, is far from foolproof. For example, in *America Online, Inc. v. Superior Court*,[99] a California appellate court permitted class proceedings brought under the California Consumers Legal Remedies Act ("CLRA"), despite the presence of both forum-selection and choice-of-law provisions designating Virginia as providing the governing law and chosen forum.[100] The court reasoned that both the forum-selection and the choice-of-law clauses were unenforceable because to hold otherwise "would necessitate a waiver of the statutory remedies of the CLRA, in violation of that law's anti-waiver provision and California public policy."[101] Significantly, the court noted that "[t]he unavailability of class action relief in this context [was] sufficient in and of itself to preclude enforcement of the forum-selection clause."[102] Thus, while including such provisions in arbitration agreements certainly increases the chance that the chosen law and forum will apply, courts have deemed such clauses to be unenforceable precisely because they are designed to circumvent the minority of cases holding that class action waivers are unconscionable due to the fact that they effectively prevent plaintiffs from pursuing their claims.

96. Discover Bank v. Superior Court (*Discover Bank Remand*), 36 Cal. Rptr. 3d 456, 461-62 (Cal. Ct. App. 2005).

97. *Szctela*, 118 Cal. Rptr. 2d at 866 n.3.

98. *Id.*

99. 108 Cal. Rptr. 2d 699, 701-02 (Cal. Ct. App. 2001).

100. *Id.* at 701.

101. *Id.*

102. *Id.*

### 2. FAA Preemption Arguments

In addition to choice-of-forum and choice-of-law clauses, defendants have used preemption under the FAA as an argument against the use of the unconscionability doctrine to invalidate class action waivers. As noted earlier, FAA § 2 requires courts to enforce arbitration agreements "save upon such grounds as exist at law or in equity for the revocation of any contract."[103] Specifically, the Supreme Court in *Doctor's Associates Inc. v. Casarotto*[104] explained that "generally applicable contract defenses, such as fraud, duress, or unconscionability, may be applied to invalidate arbitration agreements without contravening [FAA] § 2. . . ."[105] Defendants have argued, however, that the invalidation of class action waivers under state unconscionability law crosses the line between the application of "ordinary principles of unconscionability" and implementing substantive state policies in order to attack specifically arbitration clauses.[106] When courts are faced with a policy decision between class action litigation or individual arbitration of claims, these proponents contend, the FAA explicitly sets forth that arbitration should presumptively prevail as long as the parties actually chose to submit to arbitration.[107] Proponents of FAA preemption thus argue that courts have impermissibly used the "unconscionability label"[108] not as a means of policing the bona fides of the parties' voluntary agreement, but rather to enforce substantive state policies of "discouraging unfair and unlawful business practices," "creating a mechanism for a representative to seek relief on behalf of the general public," and "promot[ing] judicial economy and streamlin[ing] the litigation process in appropriate cases."[109]

Nevertheless, FAA preemption is not a foolproof argument, as cases such as *Discover Bank* have held, citing FAA § 2, that the FAA

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103. 9 U.S.C. § 2 (1994).

104. 517 U.S. 681 (1996).

105. *Id.* at 686-87.

106. Alan S. Kaplinsky & Mark J. Levin, *The Gold Rush of 2002: California Courts Lure Plaintiffs' Lawyers (But Undermine the Federal Arbitration Act) By Refusing to Enforce "No-Class Action" Clauses in Consumer Arbitration Agreements*, 58 BUS. LAW 1289, 1294-95 (2003).

107. *Id.* at 1296; *see also* STEPHEN J. WARE, ALTERNATIVE DISPUTE RESOLUTION 58 (2001) ("[T]he United States Supreme Court surely would review state courts' unconscionability rulings to the extent necessary to prevent the unconscionability doctrine from effectively nullifying the FAA with respect to a huge class of contracts. Indeed, the Court has twice stated that state courts may not 'rely on the uniqueness of an agreement to arbitrate as a basis for a state-law holding that enforcement would be unconscionable, for this would enable the court to effect what . . . the state legislature cannot.'" (citing *Casarotto*, 517 U.S. at 687 n.3)).

108. Kaplinsky & Levin, *supra* note 106, at 1295.

109. *Id.*

does not federalize the law of unconscionability and thus leaves states free to apply that doctrine to invalidate arbitration agreements as they would any other contract.[110] The Ninth Circuit and various other federal courts have also rejected the argument that California's application of the unconscionability doctrine to invalidate class action waivers is preempted by the FAA.[111] Thus, the preemptive force of the FAA does not preclude the minority view that class action waivers are unconscionable from having important practical effects.

### *C. Evaluating Unconscionability as a Mechanism for Policing Class Action Waivers*

As discussed above, a minority of courts have—with important practical effects—used state-law unconscionability doctrine as a weapon against class action waivers. These courts have resorted to the unconscionability doctrine primarily due to the fact that § 2 of the FAA expressly preserves state law defenses to contract enforcement. Nevertheless, state-law unconscionability doctrine is a highly imperfect and conceptually unsatisfactory antidote to the problem posed by class action waivers. Ultimately, the unconscionability doctrine simply does not capture fully the problems raised by class action waivers because of its singular focus on the "fairness" of the bargain to individual claimants.

In order to evaluate the unconscionability doctrine as a defense against class action waivers, it is important to recall the two primary rationales underlying those decisions which have held class action waivers unconscionable. As discussed above, the doctrine focuses on two types of "unfairness": procedural unfairness in the bargaining process and substantive unfairness in the terms of the resulting contract. A contract may be deemed "oppressive" if it is "grossly one-sided" both in the bargaining power of the respective parties and in the benefits and burdens allocated to each party by the agreement.

This question of "oppressive in relation to whom" is important in evaluating whether the unconscionability doctrine is an effective means for getting at the concerns underlying class action waivers. At its core, the unconscionability doctrine is concerned with individual

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110. *See* Discover Bank v. Superior Court (*Discover Bank*), 113 P.3d 1100, 1112 (Cal. 2005) (holding that nothing in the FAA "prohibit[s] a California court from refusing to enforce a class action waiver that is unconscionable. . . .").

111. *See* Ingle v. Circuit City Stores, Inc., 328 F.3d 1165, 1176 n.15 (2003); *see also* Janda v. T-Mobile USA, No. C 05-03729 JSW, 2006 WL 708936, at *7 (N.D. Cal. Mar. 17, 2006) (following *Ingle*); Laster v. T-Mobile USA, 407 F. Supp. 2d 1181, 1192 (S.D. Cal. 2005) ("[T]he holding of Discover Bank is not preempted by § 2 of the FAA.").

bargains and individual contracts. However, this focus on unfairness to individuals does not adequately reflect concerns about class action waivers, especially in the most problematic context—namely, negative-value suits. Indeed, when claims are of minimal value, even a contract that prospectively waives the right to pursue such claims altogether is difficult to describe as "oppressive" to each individual claimant.

Moreover, when claims are of minimal importance to each individual, alternative enforcement mechanisms may be sufficient to alleviate unfairness. In the context of employment contracts, for example, even if an individual is, in all practicality, economically prevented from pursuing her claim herself, the prospect of agency enforcement is often available. For example, employees with discrimination claims may file charges with the Equal Employment Opportunity Commission ("EEOC") and other enforcement agencies, even if they have signed predispute arbitration agreements.[112] If the claimant seeks equitable relief, the EEOC is at least theoretically a viable option, and this prospect—as imperfect as it is—could be said to counter the "oppressiveness" of relinquishing an individual claim for minimal damages.

Largely because many individual claims (especially in the context of consumer contracts) are worth so little money, it is simply not the case that the courts' *sole* concern is that each and every potential claimant receives his or her own meager recovery. Rather, as the district court in *Johnson v. West Suburban Bank*[113] asserted, an additional and essential reason for skepticism of class action waivers is that "the class action device is necessary to ensure meaningful deterrence to creditors who might violate the acts."[114] This articulates courts' equally important concern with class action waivers: the inability of a large group of plaintiffs to pursue their claims will effectively give defendants immunity from liability under the law, thus allowing these defendants to continue their (allegedly) illegal conduct unchecked. With no check on the actions of corporations, many worry that these defendants will have the ability to cause arguably "slight" harm to countless individuals, to cause massive harm in the aggregate, and sometimes to get quite rich in the process.[115] Viewed with a focus on the result of the imposition of

112. Samuel Estreicher, *Predispute Agreements to Arbitrate Statutory Employment Claims*, 72 N.Y.U. L. REV. 1344, 1373 (1997).

113. 82 F. Supp. 2d 264 (D. Del. 1999), *rev'd*, 225 F.3d 366 (3d Cir. 2000).

114. *West Suburban Bank*, 225 F.3d at 368-69 (involving a class action waiver in an action brought under the Truth in Lending Act).

115. *See, e.g.*, Gilles, *supra* note 1, at 430.

numerous class action waivers, these provisions lead to one-sided results favoring defendants, but they probably do not rise to an unconscionable level of "oppressiveness" with regard to any particular individual. A defendant cannot gain large wealth because *one* individual was prevented from bringing claims; similarly, a defendant cannot enjoy "immunity" from discrimination claims, for example, by including a class action waiver in *one* employment contract. Rather, these waivers only seem to cause "oppressive," "one-sided" results *in the aggregate*. As a preliminary observation, the unconscionability doctrine seems largely inadequate to address this concern about class action waivers.

Indeed, focusing on the results of class action waivers in the aggregate presents at least two problems for an unconscionability analysis. First, application of the unconscionability doctrine involves an assessment of an individual contract *ex ante*, not *ex post*.[116] The concern about corporate misbehavior shifts the doctrinal focus from "oppressiveness" at the time of the contract's formation (*ex ante*) to "oppressiveness" in the form of unchecked corporate misbehavior *as an effect or result of* individual parties' practical inability to bring claims (*ex post*). This reveals that the concern about corporate deterrence is mismatched with the primary concern of oppressiveness—namely, the perceived harm to individual consumers.

Second, and perhaps more troubling for one attempting to characterize a class action waiver as "oppressive" and therefore unreasonably "one-sided," is the notion that much of the havoc wreaked by these provisions occurs not at an individual level, but rather, in the aggregate. Indeed, if the concern of courts is the unjust enrichment and immunity gained by defendant corporations, such gains only occur, to any significant degree, *in the aggregate*. As an illustration, if only one or two (or even ten or twenty) individuals are prevented from bringing claims, the amount of money gained and the amount of litigation avoided by corporations likely will be as negligible as the value of the low-yield claims. Thus, as to each individual contract, a class action waiver is not unfairly "one-sided" in favor of the corporation, since the corporation gains very little in such a case. The corporation only receives monetary gains if it successfully imposes

116. RESTATEMENT (SECOND) OF CONTRACTS § 208 (1981) ("If a contract or term thereof is unconscionable at the time the contract is made a court may refuse to enforce the contract, or may enforce the remainder of the contract without the unconscionable term, or may so limit the application of any unconscionable term as to avoid any unconscionable result."); U.C.C. § 2-302(1) (1998) ("If the court as a matter of law finds the contract or any clause of the contract to have been unconscionable at the time it was made . . . ."); *id.* cmt. 1 ("The basic test [for unconscionability] is whether . . . the clauses involved are so one-sided as to be unconscionable under the circumstances existing at the time of the making of the contract.").

class action waivers on a large majority of its customers; similarly, the corporation only attains large-scale immunity if it imposes these provisions on a majority of its consumers or its employees. Thus, if the class action waiver is only unfairly one-sided *in the aggregate*, it can only be challenged, to any meaningful degree, *in the aggregate*. Viewed this way, unconscionability, as a doctrine that evaluates an individual contract's fairness *ex ante*, is an inadequate tool with which to deal with this concern.

## IV. BEYOND UNCONSCIONABILITY: CLASS ACTION WAIVERS, MANDATORY ARBITRATION AGREEMENTS, AND THE VINDICATION OF SUBSTANTIVE RIGHTS

As discussed above, unconscionability is not the most appropriate doctrinal basis for ensuring the availability of aggregate procedures. It is far from apparent that the concern about defendants' unjust enrichment and immunity from civil law enforcement constitutes the type of gross "one-sidedness" that the doctrine of unconscionability is designed to remedy. Accordingly, only a few courts have held that class action waivers are so "oppressive" as to be considered unconscionable. At bottom, the unconscionability doctrine seems wholly inapt to address the fundamental concerns about these class action waivers. The real question is not whether class action waivers are the product of unfairly lopsided bargaining in each individual arbitration agreement. Rather, the core concern about class action waivers is whether there is a sufficiently close nexus between the class action waiver and non-waivable substantive rights such that these waivers should not be left to private bargaining. This Section directly addresses this question and argues that the implicit assumptions underlying the FAA's liberal pro-arbitration policy warrant invalidation of class action waivers in cases where they effectively preclude the vindication of substantive rights.

### *A. Key Assumptions Behind the FAA's "Liberal Policy" in Favor of Arbitration*

In its decision in *Moses H. Cone Memorial Hospital*, the Supreme Court established that the FAA created a "liberal federal policy favoring arbitration agreements, notwithstanding any state substantive or procedural policies to the contrary."[117] Invoking this

117. Moses H. Cone Mem'l Hosp. v. Mercury Constr. Corp., 460 U.S. 1, 24 (1983).

"liberal policy," courts have tended to uphold class action waivers in mandatory arbitration agreements.[118] These courts have largely failed to recognize, however, that this "liberal policy" favoring arbitration rests on two important assumptions that are essential to its justification: (1) mandatory arbitration agreements merely move dispute resolution between private parties from a judicial to an arbitral forum, and (2) arbitration confers benefits to both parties to a dispute in the form of more efficient and cost-effective procedures. Class action waivers undermine these central assumptions—and should therefore not be subject to the generous federal policy toward arbitration agreements—in situations where they abridge plaintiffs' ability to pursue their claims in any meaningful way.

### 1. Assumption # 1: Mandatory Arbitration Agreements Merely Move Dispute Resolution From a Judicial Forum to an Arbitral Forum

While recognizing that the FAA creates a "liberal federal policy favoring arbitration agreements," the Supreme Court has nonetheless repeatedly stressed in cases beginning with *Mitsubishi Motors v. Soler Chrysler-Plymouth, Inc.*[119] that "[b]y 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."[120] This has been a central assumption in the Supreme Court's arbitration jurisprudence at least since the Court abandoned the "old judicial hostility" toward arbitration agreements that was expressed in prior decisions such as *Wilko*.[121] Under the Court's current pro-arbitration policy, while arbitration provides an alternative means of resolving disputes,[122] the switch from courtroom litigation to private arbitration presumptively does not abridge the statutorily conferred private rights of consumers, employees, and other plaintiffs. As the Court stated in *Rodriguez de Quijas v. Shearson/American Express, Inc.*,[123] "[t]o the extent that *Wilko* rested

118. *See, e.g.*, *West Suburban Bank*, 225 F.3d at 366.

119. 473 U.S. 614 (1985).

120. *Mitsubishi*, 473 U.S. at 628; *see also* Circuit City Stores, Inc. v. Adams, 532 U.S. 105, 123 (2001); Gilmer v. Interstate/Johnson Lane Corp., 500 U.S. 20, 25 (1991); Rodriguez de Quijas v. Shearson/Am. Express, Inc., 490 U.S. 477, 481 (1989). *See also* Taylor v. Progress Energy, Inc., 415 F.3d 364, 372 (4th Cir. 2005) ("An agreement to arbitrate preserves the claim; the agreement simply shifts the forum for resolving the claim from a court to an arbitration setting.").

121. *Shearson/Am. Express, Inc.*, 490 U.S. at 480 (quoting Kulukundis Shipping Co. v. Amtorg Trading Corp., 126 F.2d 978, 985 (2d Cir. 1942)).

122. *See Moses H. Cone Mem'l Hosp.*, 460 U.S. at 20 ("While arbitration focuses on specific disputes between the parties involved, so does judicial resolution of claims. . . .").

123. 490 U.S. 477.

on suspicion of arbitration as a method of weakening the protections afforded in the substantive law to would-be complainants, it has fallen far out of step with our current strong endorsement of the federal statutes favoring this method of resolving disputes."[124]

The Supreme Court's presumption that arbitration does not fundamentally abridge the remedies available under applicable law is constrained, however, by practical realities. Although federal law creates a *presumption* that arbitration does not constitute a "method of weakening the protections afforded in the substantive law to would-be complainants,"[125] even the Court recognized in *Shearson/American Express* that the enforceability of an arbitration agreement that abolished "essential features" of the remedial regime would be subject to serious doubt.[126] Indeed, the Court in *Shearson/American Express* reassured itself, citing Justice Frankfurter's dissent in *Wilko*, that "[t]here [wa]s nothing in the record before us, nor in the facts of which we can take judicial notice, to indicate that the arbitral system . . . would not afford the plaintiff the rights to which he is entitled."[127]

In upholding arbitration clauses in other contexts, lower courts have also reassured themselves that the arbitral process is sufficient to vindicate private rights.[128] While courts should not assume that every deviation from the normal procedures of civil litigation is fundamental, the implication of the Supreme Court's *Mitsubishi* assumption is that corporations and other entities should not be able to use a procedural vehicle, no matter how otherwise favored, to obliterate a party's ability to pursue the resolution of his claims altogether. Because a key justification for mandatory arbitration is that the switch from a courtroom to an arbitral forum still leaves intact an effective alternative means of enforcing private rights, a provision—such as a class action waiver—that completely eliminates any effective means of relief, leaving in place a system in which the *only viable* enforcement mechanism remaining is a public one, violates the Court's *Mitsubishi* assumption and thus falls outside the Court's pro-arbitration policy.

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124. *Id.* at 481.

125. *Id.*

126. *Id.* ("[T]he right to select the judicial forum and the wider choice of courts are not such essential features of the Securities Act that § 14 is properly construed to bar any waiver of these provisions.").

127. *Id.* at 483.

128. *See, e.g.*, Garrett v. Circuit City Stores, Inc., 449 F.3d 672, 681 (5th Cir. 2006) (noting that the purposes of the Uniformed Services Employment and Reemployment Rights Act "can be fully realized through arbitration").

### 2. Assumption # 2: Arbitration Confers Benefits on Plaintiffs and Defendants

Another related assumption behind the "liberal policy" favoring arbitration is that the arbitral forum provides some benefit to *both* parties, not merely in the form of cost savings, but also in the form of a more efficient, knowledgeable, and private decisionmaking process for pursuing their claims.[129] Supreme Court precedent is rife with references to the "advantages of arbitration" in the form of a more streamlined, less cumbersome, and less costly process for resolving private disputes.[130] As the Supreme Court stated in *Circuit City Stores, Inc. v. Adams*,[131] in which the FAA's pro-arbitration policy was extended to employment contracts, "[a]rbitration agreements allow parties to avoid the costs of litigation, a benefit that may be of particular importance in employment litigation, which often involves smaller sums of money than disputes concerning commercial contracts."[132] The premise behind the Supreme Court's view of arbitration as "beneficial" is that the arbitral process is an efficacious method of resolving disputes and generates efficiencies and cost savings (as compared to the litigation process) that redound to the benefit of both parties.

This assumption behind the favorable policy toward mandatory arbitration is undermined entirely, however, when a mandatory arbitration provision is combined with a class action waiver that renders parties unable, in practicality, from bringing claims at all. In such situations, a plaintiff never benefits from any arguable cost savings or efficiencies of arbitration. Indeed, a plaintiff, because of the class action waiver, cannot effectively bring his claim in *either* dispute resolution forum. Further, any non-monetary benefits derived from pursuing claims in the arbitral forum (for example, efficiency, expertise, or privacy) are not actually realized by those individuals who cannot bring claims. Thus, while such "benefits" provide a key rationale for permitting mandatory arbitration, this rationale crumbles in the presence of a class action waiver that prevents parties from bringing claims.

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129. *See generally* Stephen J. Ware, *The Case for Enforcing Adhesive Arbitration Agreements*, 5 J. AM. ARB. 251 (2006) (contending that the benefits of arbitration outweigh the burdens of class action waivers).

130. Circuit City Stores, Inc. v. Adams, 532 U.S. 105, 123 (2001).

131. 532 U.S. 105.

132. *Id.* at 132; *see also* Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc., 473 U.S. 614, 634 (1985) (noting the "strong belief in the efficacy of arbitral procedures for the resolution of international disputes").

### *B. Toward a New Federal Policy on Class Action Waivers That Compromise Substantive Rights*

At bottom, the core concern with class action waivers in the context of mandatory arbitration is that class action waivers prevent certain plaintiffs—namely, those with claims that are not economically viable on an individual basis—from "effectively vindicating" their statutory rights. This core concern finds support in the Supreme Court's decision in *Mitsubishi*, in which the Court expressed the view that federal statutory claims may only be arbitrated if "the prospective litigant effectively may vindicate his or her statutory cause in the arbitral forum."[133] It also accords with Supreme Court precedent holding that federal statutory rights, such as those under Title VII, cannot prospectively be waived.[134] The rationale behind the *Mitsubishi* standard is that arbitration provisions that effectively prevent a plaintiff from bringing his claims are, for practical purposes, no different from a waiver of otherwise unwaivable rights that should not be permitted even as a matter of private bargaining.

Lower courts have repeatedly applied the *Mitsubishi* standard in assessing the enforceability of particular arbitration agreements. In *Cole v. Burns International Security Services*,[135] for example, the D.C. Circuit applied *Mitsubishi* and held that an employee could be compelled to arbitrate his Title VII claim because the arbitration agreement in that case:

> (1) provides for neutral arbitrators, (2) provides for more than minimal discovery, (3) requires a written award, (4) provides for all types of relief that would otherwise be available in court, and (5) does not require to pay either unreasonable costs or any arbitrators' fees or expenses as a condition of access to the arbitration forum.136

Likewise, the Sixth Circuit, sitting en banc, held in *Morrison v. Circuit City Stores, Inc.*[137] that "[t]he Supreme Court has made clear that statutory rights . . . may be subject to mandatory arbitration only if the arbitral forum permits the effective vindication of those rights."[138]

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133. Green Tree Fin. Corp.-Ala v. Randolph, 531 U.S. 79, 90 (2000) (quoting *Mitsubishi Motors Corp.*, 473 U.S. at 635); *see also* Gilmer v. Interstate/Johnson Lane Corp., 500 U.S. 20, 28 (1991) (same); Shearson/Am. Express Inc. v. McMahon, 482 U.S. 220, 240 (1987) (same).

134. Alexander v. Gardner-Denver Co., 415 U.S. 36, 51 (1974).

135. 105 F.3d 1465, 1479-83 (D.C. Cir. 1997).

136. *Id.* at 1482.

137. 317 F.3d 646 (6th Cir. 2003) (en banc).

138. *Id.* at 658.

The Supreme Court has only once elaborated on the standard for assessing whether a particular arbitration provision prevents a plaintiff from "effectively vindicating" her statutory rights. In *Green Tree Financial Corp. v. Randolph*,[139] the Court stated that an arbitration agreement might pose such an obstacle if it forces the plaintiff to assume financial burdens so prohibitive as to "deter the bringing of claims."[140] The Court stated that "[i]t 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."[141] The Court refused to invalidate the arbitration agreement on that basis, however, because the record did not establish that the plaintiff would "bear such costs if she goes to arbitration."[142] Nevertheless, the Court in *Randolph* firmly established the proposition that a plaintiff *may* successfully challenge the enforceability of an arbitration agreement if it can bear "the burden of showing the likelihood of incurring such costs" that would make arbitration "prohibitively expensive."[143]

The *Randolph* holding has significant implications for the future treatment of class action waivers. Indeed, the crux of the problem with class action waivers in the context of negative-value claims is that proceeding with an individual arbitration is "prohibitively expensive" in light of the small value of the claim. Only through aggregate procedures can a plaintiff "effectively vindicate" her individual rights. Indeed, as the Supreme Court stated in *Amchem Products, Inc. v. Windsor*,[144] "The policy at the very core of the class action mechanism is to overcome the problem that small recoveries do not provide the incentive for any individual to bring a solo action prosecuting his or her rights."[145] Thus, under *Randolph*, a plaintiff should be able to defeat a class action waiver (even if he concedes that the ability to engage in a class action is a procedural and waivable right) by arguing that the waiver of that right in a particular case prohibits him as a practical and economical matter from being able to vindicate a substantive federal statutory right.[146]

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139. 531 U.S. 79 (2000).

140. *Id.* at 90.

141. *Id.*

142. *Id.*

143. *Id.*

144. 521 U.S. 591 (1997).

145. *Id.* at 617 (quoting Mace v. Van Ru Credit Corp., 109 F.3d 338, 344 (7th Cir. 1997)).

146. Gilles, *supra* note 1, at 406; *see also* Roger J. Perlstadt, *The Timing of Institutional Bias Challenges to Arbitration*, 69 U. CHI. L. REV. 1983, 1995 (2002) ("The treatment of statutory rights is different because of the public interest in the resolution of disputes over statutory rights – an interest that is separate from private parties' interest in resolving a dispute between

Whether this argument against class action waivers will find traction in federal courts remains an open question. The initial reception by the lower courts was muted.[147] A recent First Circuit case suggests, however, that courts may ultimately be receptive to invalidating class action waivers on these grounds. In *Kristian v. Comcast, Inc.*,[148] the First Circuit was faced with an arbitration agreement in a cable television subscription agreement that barred Boston-area cable subscribers from bringing any form of class-wide arbitration (in that case, alleging antitrust violations and other anticompetitive practices). The court of appeals first noted that under its prior precedents interpreting *Mitsubishi*, "the legitimacy of the arbitral forum rests on 'the presumption that arbitration provides a fair and adequate mechanism for enforcing statutory rights.' "[149] Although it noted that the class action device is "a procedure for redressing claims—and not a substantive or statutory right in and of itself," it nevertheless refused to "ignore the substantive implications of this procedural mechanism."[150] Rather, it credited expert evidence presented by plaintiffs that, due especially to the expense and complexity of antitrust litigation, "without some form of class mechanism—be it class action or class arbitration—a consumer antitrust plaintiff will not sue at all."[151] In light of this reality, the court struck down the class arbitration waiver, on the grounds that "Comcast [would] be essentially shielded from private consumer antitrust enforcement liability, even in cases where it has violated the law"; "Plaintiffs [would] be unable to vindicate their statutory rights"; and "the social goals of federal and state antitrust laws [would] be

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themselves. In order for these rights to be submitted to arbitration, the arbitration must allow effective vindication of them. Any arbitration of a statutory claim that did not allow for effective vindication of rights would 'conflict[ ] with the statute's purpose of both providing individual relief and generally deterring unlawful conduct through the enforcement of its provisions.'" (alteration in original) (citations omitted)).

147. In the immediate aftermath of *Randolph*, a line of lower court cases upheld the enforceability of arbitration clauses under the Truth in Lending Act (TILA) despite the fact that they precluded class wide relief. *See* Livingston v. Assocs. Fin., Inc., 339 F.3d 553, 559 (7th Cir. 2003); Snowden v. CheckPoint Check Cashing, 290 F.3d 631, 638 (4th Cir. 2002); Randolph v. Green Tree Fin. Corp.-Ala., 244 F.3d 814, 819 (11th Cir. 2001); Johnson v. West Suburban Bank, 225 F.3d 366, 374 (3d Cir. 2000).

148. 446 F.3d 25 (1st Cir. 2006).

149. *Id.* at 54 (quoting Rosenberg v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 170 F.3d 1, 14 (1st Cir. 1999)).

150. *Kristian*, 446 F.3d at 54.

151. *Id.* at 58; *see also id.* at 54-55 ("The class mechanism ban – 'particularly its implicit ban on spreading across multiple plaintiffs the costs of experts, depositions, neutrals' fees, and other disbursements' – forces the putative class member 'to assume financial burdens so prohibitive as to deter the bringing of claims. . . . And these costs . . . will exceed the value of the recovery she is seeking.'" (quoting Gilles, *supra* note 1, at 407)).

frustrated because of the 'enforcement gap' created by the de facto liability shield."[152] Although it remains relatively untested, the First Circuit's rationale in *Kristian* is a far more promising—and doctrinally appropriate—tool against class action waivers in the context of negative-value claims than the unconscionability arguments adopted by other courts.[153]

### *C. Which Rights?: Refining the Scope of the Mitsubishi Standard*

One critical question remains. In its evolving jurisprudence on the enforceability of arbitration clauses, the Supreme Court has always been particularly concerned about arbitration agreements that affect claims arising under federal law. Indeed, in each case that it has expressed a concern about the "effective vindication" of rights through arbitration, the Supreme Court was faced with claims arising under federal statutes.[154] Moreover, even those justices who have dissented from the Court's broad application of the liberal policy favoring arbitration have focused on a "distinction between statutory rights and contractual rights."[155] Even under the most expansive reading of *Mitsubishi* and *Randolph*, the Supreme Court's concern appears to be limited to the effective vindication of federal statutory rights.

In light of the core concern regarding class action waivers, as well as the assumptions underlying the "liberal policy" favoring arbitration, any rigid, categorical distinction among types of claims is misplaced. As discussed above, the core concern with class action

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152. *Kristian*, 446 F.3d at 61. The court also distinguished the Third Circuit's decision in *Johnson* as well as its progeny, which had rejected the assertion that class-wide proceedings are necessary for the effective vindication of rights under the TILA. Antitrust claims, the court noted, are far more costly and complicated to litigate than relatively straightforward claims about a particular financial transaction. *Id.* at 57-58.

153. Another case soon to test this theory is currently underway in New York, in which various small retailers seek class treatment for antitrust claims against American Express, arguing that the cost of proving liability will run well into the hundreds of thousands of dollars, while the median small merchant stands to gain, at most, $5,200. *See* Plaintiffs' Memorandum of Law in Opposition to Motion to Compel Arbitration at 14, *In re* Am. Express Merchants' Litig., No. 03 Civ. 9592 (GBD) (S.D.N.Y. Dec. 23, 2003) (arguing that "expert witness fess and other out-of-pocket costs that are necessarily incurred in a case of this nature, exclusive of class related expenses, are at least $1 million," while the median "small merchant plaintiff incurred $1,751 in actual damages during the four year statutory period, or $5,252 in treble damages").

154. *See* Green Tree Fin. Corp.-Ala. v. Randolph, 531 U.S. 79, 90 (2000) (considering the Truth in Lending Act (TILA) and Equal Credit Opportunity Act (ECOA)); Gilmer v. Interstate/Johnson Lane Corp., 500 U.S. 20, 28 (1991) (considering the Age Discrimination in Employment Act); Shearson/Am. Express Inc. v. McMahon, 482 U.S. 220, 240 (1987) (considering the Securities Exchange Act and RICO); Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc., 473 U.S. 614, 635 (1985) (considering the Sherman Act).

155. *Mitsubishi*, 473 U.S. at 647 (Stevens, J., dissenting).

waivers is that in a certain set of cases, the inability to proceed on a class-wide basis would both deprive individual plaintiffs of their right to recovery and allow defendants to engage in illegal activities unchecked. Moreover, a fundamental assumption of the courts' pro-arbitration gloss on the FAA is that the referral of a claim to arbitration does not effectively deprive the plaintiff of a meaningful ability to pursue her claims. Neither of these justifications depends fundamentally on the substantive or jurisdictional nature of the claims that the plaintiff seeks to pursue. Whether the claim arises under federal or state law, or sounds in contract or tort, the basic and correct insight behind *Mitsubishi* and *Randolph* is that class action waivers ought not to be enforceable if class-wide proceedings are necessary to the effective vindication of individual claims under applicable law.

As the First Circuit properly recognized in *Kristian*, whether a class action waiver should be enforced under the FAA depends critically on whether individual claims would be economically and practically feasible in the absence of a class action mechanism. This requires a basic two-step inquiry. First, as a threshold matter, courts should ask whether the claims at issue are amenable to class treatment. Indeed, the class action device is only a suitable means for aggregating claims if they meet the requirements of numerosity, commonality, typicality, and adequate representation under Rule 23, given the particular facts and legal issues presented in the case.[156] With regard to employment discrimination, for example, in 1977 the Supreme Court recognized that "suits alleging racial or ethnic discrimination are often by their nature class suits, involving class-wide wrongs."[157] If, however, the class certification claim is weak—for example, because individual issues predominate over common ones—then presumptively a waiver of the right to proceed via class-wide litigation is not seriously prejudicial to the plaintiffs. Similarly, if the particular state or federal statute that gives rise to the claim contains a specific restriction on the availability of class-based relief in the first instance, then the class waiver may not represent the curtailment of a significant right.[158]

156. FED. R. CIV. P. 23(a).

157. E. Tex. Motor Freight Sys., Inc. v. Rodriguez, 431 U.S. 395, 405 (1977).

158. *See, e.g.*, Johnson v. West Suburban Bank, 225 F.3d 366, 374 (3d. Cir. 2000) ("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 available under TILA's statutory cap on class recoveries is spread over the entire class.").

Second, and more crucially, courts should inquire whether the prospective individual recovery is sufficiently large in light of the totality of the costs of litigation to incentivize plaintiffs and plaintiffs' attorneys to bring an individual action. In other words, would an individual claim realistically be brought in the absence of a class action mechanism? The cost of pursuing different types of claims will vary widely depending on how fact-intensive and legally complex they are.[159] Statutory provisions providing for costs, attorneys' fees, and statutory damages may offset the otherwise applicable costs of litigation, but the inherent uncertainty of success means that such recovery will never in itself be sufficient incentive for lawyers to pursue such claims.[160] Simply put, in most cases an individual claim will not be brought even with such provisions if the value of the claim is minimal.[161] If, after this two-step inquiry, a court concludes that an arbitration provision prohibiting a class proceeding would cause a potential plaintiff not to pursue even the most clearly meritorious of claims, the appropriate application of the *Mitsubishi* and *Randolph* standards would be to preclude the enforcement of that provision under the FAA.

## CONCLUSION

As commercial relationships become more and more complex, corporations increasingly incorporate class action waivers and mandatory arbitration agreements into their contracts with consumers, employees, and others. Given the frequency of these commercial interactions, and the bargaining power of corporations, these provisions usually are included in contracts of adhesion. Courts have thus far struggled to develop an appropriate doctrinal basis to grapple with the problem caused by these provisions. Arguments rooted in state law unconscionability have largely been unsuccessful and even where they have been adopted, have proven conceptually inapt. Rather, the central question of whether to enforce these waivers raises fundamental inquiries about just how closely the class action device is intertwined with substantive rights. In order to address the concerns articulated by many courts in response to class action waivers—namely, concerns for the protection of individual claimants and for the deterrence of corporate wrongdoing—arbitration

159. *See* Kristian v. Comcast Corp., 446 F.3d 25, 58 (1st Cir. 2006).

160. *See id.* at 59 n.21.

161. *See, e.g.*, Carnegie v. Household Int'l, Inc., 376 F.3d 656, 661 (7th Cir. 2004) ("The realistic alternative to a class action is not 17,000,000 individual suits, but zero individual suits, as only a lunatic or a fanatic sues for $30.00.").

provisions that effectively compromise substantive rights should not be enforceable under the FAA. The Supreme Court's decisions in *Mitsubishi* and *Randolph* should therefore be adopted to preclude enforcement of class action waivers where such waivers have the practical effect of extinguishing individual claims.

*J. Maria Glover*[*]

* I am grateful to Professor Richard Nagareda for his guidance in the development of this Note topic. I also wish to thank Professor Nagareda, Steve Benz, Professor Myriam Gilles, and Derek Ho for insightful comments on earlier drafts of this Note. Finally, I would like to thank Scott Atkinson, Joseph Chase, Alexandra Hui, Jessica Lyons, and Catherine Tennant for their helpful editing of this Note.