CHALLENGING CLASS ACTION BANS IN MANDATORY ARBITRATION CLAUSES

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While pre-dispute mandatory arbitration is debated as a matter of policy in legal academia,[2] and even in Congress,[3] consumer and employee plaintiffs continue to litigate the enforceability of particular binding arbitration clauses (or, more commonly, the en-

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[2] *Compare, e.g.*, David S. Schwartz, *If You Love Arbitration, Set It Free: How "Mandatory" Undermines "Arbitration,"* 8 NEV. L.J. 400 (2007) [hereinafter Schwartz, *If You Love Arbitration*] *and* Jean R. Sternlight, *In Defense of Mandatory Binding Arbitration (If Imposed on the Company)*, 8 NEV. L.J. 82 (2007), *with, e.g.*, Peter B. Rutledge, *Who Can Be Against Fairness? The Case Against the Arbitration Fairness Act*, 9 CARDOZO J. CONFLICT RESOL. 267 (2008). The policy debate has become so heated that normally staid academics have at times resorted to extreme insults directed against those on the other side of the issue. *See, e.g.*, Thomas E. Carbonneau, "Arbitracide:" The Story of Anti-Arbitration Sentiment in the U.S. Congress 30 (2008) (unpublished manuscript, on file with the author) (accusing lawyers who advocate for "adversarial justice" of "greed and perverse ambition" and describing them as "no better than pedophiles who masquerade as priests").

[3] Several bills introduced in the 110th Congress would have limited stronger parties' ability to impose pre-dispute, mandatory arbitration on weaker parties in consumer, employment, franchise, nursing home, and automobile purchase contracts. *See* Arbitration Fairness Act, S. 1782/H.R. 3010, 110th Cong. (2007) (prohibiting enforcement of pre-dispute arbitration clauses in consumer, employment, and franchise contracts); Fairness in Nursing Home Arbitration Act, S. 2838/H.R. 6126, 110th Cong. (2008); Automobile Arbitration Fairness Act of 2008, H.R. 5312, 110th Cong. (2008). Similar reform efforts are likely to be made in the next Congress.

These bills followed a path first cleared by business interests. In 2002, car dealerships succeeded in passing a bill that prohibited pre-dispute arbitration agreements in dealership contracts with manufacturers, importers, and distributors, suggesting that even corporate entities oppose pre-dispute arbitration when it is imposed against them. *See* 21st Century Dep't of Justice Appropriations Authorization Act, Pub. L. No. 107-273, §11028, 116 Stat. 1758, 1835–36 (2002) (codified at 15 U.S.C. §1226); *see also* Pub. Citizen, "Auto Dealers and Consumers Agree: Mandatory Arbitration Is Unfair," http://www.citizen.org/congress/civjus/arbitration/articles.cfm ?ID=650 (gathering statements made by car dealer advocates regarding the unfair nature of pre-dispute mandatory arbitration).

Efforts at arbitration reform in the 110th Congress—together with other pro-consumer initiatives—provoked a strident response from anti-regulation activists. Representatives Boehner, Blunt, and Smith of Texas introduced the "Stop Trial Lawyer Pork Act," H.R. 7080, which described a series of consumer and environmental protection measures as "trial lawyer pork" and excoriated the "scandal-plagued American trial lawyer industry." The bill would have attempted to make several categories of legislation unenforceable, even if enacted after the Act, including sunshine laws, bills to limit federal preemption in the medical liability field, and bills limiting the enforceability of pre-dispute arbitration agreements. The Stop Trial Laywer Pork Act died in committee without a hearing.

forceability of extraneous provisions that corporations embed within arbitration clauses) on an almost daily basis in courts across the country. Plaintiffs have had success in recent years in challenging arbitration clauses that purport to insulate corporate defendants from class proceedings against them; a growing number of courts have held that class action bans are unconscionable, void as against public policy, or otherwise unenforceable when they effectively exculpate corporate defendants from any meaningful liability for their alleged misconduct.[4] At the same time, because a class action ban is often the most valuable provision in an arbitration clause from a company's perspective, corporate defendants have strongly resisted this trend in case law, and the legality of class action bans remains one of the most hotly contested issues in consumer and employee litigation.

After a brief summary of relevant Supreme Court doctrine, this article sets out the argument that exculpatory class action bans violate many states' generally applicable contract law and responds to several common corporate defenses offered in support of such bans.

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[4] *See, e.g.*, Lowden v. T-Mobile USA, Inc., 512 F.3d 1213, 1219 (9th Cir. 2008) (Washington law); Dale v. Comcast Corp., 498 F.3d 1216, 1224 (11th Cir. 2007) (Georgia law); Kristian v. Comcast Corp., 446 F.3d 25, 60 (1st Cir. 2006) (federal and Massachusetts antitrust law); Ingle v. Circuit City Stores, Inc., 328 F.3d 1165, 1176 (9th Cir. 2003) (California law); Ting v. AT&T, 319 F.3d 1126, 1150 (9th Cir. 2003) (California law); Creighton v. Blockbuster Inc., 2007 WL 1560626, at *3 (D. Or. May 25, 2007) (Oregon law); Cooper v. QC Fin. Servs., Inc., 503 F. Supp. 2d 1266, 1290 (D. Ariz. 2007) (Arizona law); Wong v. T-Mobile USA., Inc., 2006 WL 2042512, at *5 (E.D. Mich. July 20, 2006) (Michigan law); Lozada v. Dale Baker Oldsmobile, Inc., 91 F. Supp. 2d 1087, 1105 (W.D. Mich. 2000) (Michigan law); Leonard v. Terminix Int'l Co., L.P., 854 So.2d 529, 539 (Ala. 2002); Discover Bank v. Super. Ct., 113 P.3d 1100, 1110 (Cal. 2005); S.D.S. Autos, Inc. v. Chrzanowski, 976 So.2d 600, 611 (Fla. Dist. Ct. App. 2007); Powertel, Inc. v. Bexley, 743 So.2d 570, 576 (Fla. Dist. Ct. App. 1999); Kinkel v. Cingular Wireless LLC, 857 N.E.2d 250, 274 (Ill. 2006); Whitney v. Alltel Comm'n, Inc., 173 S.W.3d 300, 314 (Mo. Ct. App. 2005); Muhammad v. County Bank of Rehoboth Beach, Del., 912 A.2d 88, 100–01 (N.J. 2006); Fiser v. Dell Computer Corp., 188 P.3d 1215, 1221 (N.M. 2008); Tillman v. Commercial Credit Loans, Inc., 655 S.E.2d 362, 373 (N.C. 2008); Schwartz v. Alltel Corp., 2006 WL 2243649, at *5 (Ohio Ct. App. June 29, 2006); Eagle v. Fred Martin Motor Co., 809 N.E.2d 1161, 1183 (Ohio Ct. App. 2004); Vasquez-Lopez v. Beneficial Or., Inc., 152 P.3d 940, 949–50 (Or. Ct. App. 2007); Thibodeau v. Comcast Corp., 912 A.2d 874, 886 (Pa. Super. Ct. 2006); Scott v. Cingular Wireless, 161 P.3d 1000, 1006, 1008 (Wash. 2007); State ex rel. Dunlap v. Berger, 567 S.E.2d 265, 280 (W. Va. 2002); Coady v. Cross Country Bank, 729 N.W.2d 732, 748 (Wis. Ct. App. 2007); *cf.* Skirchak v. Dynamics Research Corp., 508 F.3d 49, 59–63 (1st Cir. 2007) (class action waiver unenforceable because not knowing and voluntary); Rollins, Inc. v. Garrett, 176 F. App'x 968, 968–69, 2006 WL 1024166 (11th Cir. Apr. 19, 2006) (per curiam) (illustrating that arbitrators did not exceed their authority by allowing class-wide arbitration because arbitration clause prohibiting class proceedings would have been unconscionable under Florida law).

I. Supreme Court Doctrine

Most arbitration clauses in corporate contracts are governed by the Federal Arbitration Act ("FAA").[5] The FAA has been held to create a federal substantive law of arbitration,[6] but it also preserves the States' role in regulating arbitration agreements.[7] Arbitration clauses may be unenforceable under FAA § 2 if they violate applicable principles of state contract law,[8] and the Supreme Court has explained that state law is not preempted by the FAA if it "arose to govern issues concerning the validity, revocability, and enforceability of contracts generally."[9] These rules are what allow courts to strike down arbitration clauses containing class action bans pursuant to traditional contract defenses such as unconscionability or void as against public policy.

A. The FAA's Federal-State Partnership

Section 2 of the FAA provides that arbitration agreements are generally "valid, irrevocable, and enforceable . . . ."[10] In a series of decisions beginning with *Moses H. Cone Memorial Hospital v. Mercury Construction Corp.*,[11] the Supreme Court has held that Section 2 declares "a liberal federal policy favoring arbitration agreements," that it creates federal substantive law applicable in state courts, and that a presumption of arbitrability requires courts to resolve "any doubts concerning the scope of arbitrable issues . . . in favor of arbitration."[12] Although it is not clear that Congress

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5 9 U.S.C. §§ 1–16 (1925). The FAA applies to any "contract evidencing a transaction involving commerce." *Id*. § 2. The Supreme Court has interpreted "involving commerce" as reaching to the full extent of Congress' Commerce Clause power. *See* Allied-Bruce Terminix Cos., Inc. v. Dobson, 513 U.S. 265, 273–75 (1995).

6 Southland Corp. v. Keating, 465 U.S. 1, 11–16 (1984); Moses H. Cone Mem'l Hosp. v. Mercury Constr. Corp., 460 U.S. 1, 24 (1983).

7 *See* FAA § 2, 9 U.S.C. § 2.

8 *Id.*

9 Doctor's Assocs., Inc. v. Casarotto, 517 U.S. 681, 685 (1996) (quoting Perry v. Thomas, 482 U.S. 483, 492 n.9 (1987)).

10 9 U.S.C. § 2 (2009).

11 460 U.S. 1, 24 (1983).

12 *Id*. at 25. Professor Katherine Van Wezel Stone has made the point that the Supreme Court drew its presumption of arbitrability, as well as several other pro-arbitration doctrines, from case law interpreting and applying collective bargaining agreements under §301 of the Labor Management Relations Act, 29 U.S.C. §185(a), rather than under the FAA. The Court first articulated the presumption of arbitrability in a labor case, *United Steelworkers of Am. v. War-*

ever intended the FAA to apply outside the context of disputes between relatively equal commercial parties,[13] the Court has applied the statute—and the "liberal . . . policy favoring arbitration"—to disputes between corporate defendants and consumer and employee plaintiffs.[14]

In addition to creating federal substantive law, FAA § 2 also preserves the States' role in regulating arbitration clauses. Arbitration agreements are enforceable "save upon such grounds as exist at law or in equity for the revocation of any contract."[15] Citing this language, the Supreme Court has explained that state law serves an important function in protecting consumers and employees from abusive arbitration provisions.[16] The Court has also subjected arbitration agreements to state common-law rules of contract interpretation, including the rule that a contract must be construed against its drafter when necessary to avoid an unintended or unfair result.[17]

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rior & Gulf Navigation Co., 363 U.S. 574 (1960), in which it also made a point of distinguishing labor-management disputes from commercial ones. *See* Katherine V.W. Stone, *The Steelworkers Trilogy and the Evolution of Labor Arbitration* 38-40 (Univ. of Cal., Los Angeles School of Law Pub. Law & Legal Theory Research Paper Series, Research Paper No. 04-29, 2004), *available at* http://ssrn.com/abstract=631343; Katherine Van Wezel Stone, *Rustic Justice: Community and Coercion under the Federal Arbitration Act*, 77 N.C. L. REV. 931, 1008–14 (1999) [hereinafter Stone, *Rustic Justice*]. In an interesting development, arguments regarding arbitration have now come full circle, with companies' preference for individual arbitration, and the Supreme Court's FAA jurisprudence, threatening to invade the sphere of labor-management relations. See 114 Penn Plaza LLC v. Pyett, — S.Ct. —, 2009 WL 838159 (April 1, 2009).

13 *See, e.g.*, 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, 75–78 (1997) (discussing the FAA's legislative history) [hereinafter Schwartz, *Enforcing Small Print*]; Jean R. Sternlight, *Creeping Mandatory Arbitration: Is It Just?*, 57 STAN. L. REV. 1631, 1636 (2005) (same) [hereinafter Sternlight, *Creeping Mandatory Arbitration*]; *see also* Schwartz, *If You Love Arbitration*, *supra* note 2, at 403 ("[a]s a historical reality, the primary model of arbitration—and the primary impetus behind the FAA—was a mechanism to resolve disputes within communities of merchants"); Stone, *Rustic Justice*, *supra* note 12, at 936, 969–1029 (explaining that within merchant communities, arbitration furthered a vision of "voluntarism, delegation, and self-regulation" that is not served by arbitration in the consumer context); *cf.* Amy J. Schmitz, *Consideration of "Contracting Culture" in Enforcing Arbitration Provisions*, 81 ST. JOHN'S L. REV. 123, 145–53 (2007) (discussing the different role arbitration plays in "intra communal" disputes between members of the same community, versus "extra communal" disputes between insiders (*e.g.*, corporations) and outsiders (*e.g.*, their customers)) [hereinafter Schmitz, *Contracting Culture*].

14 *See, e.g.*, Buckeye Check Cashing, Inc. v. Cardegna, 546 U.S. 440 (2006); Gilmer v. Interstate/Johnson Lane Corp., 500 U.S. 20 (1991).

15 9 U.S.C. § 2.

16 Allied-Bruce Terminix, 513 U.S. at 281.

17 Mastrobuono v. Shearson Lehman Hutton, Inc., 514 U.S. 52, 62 (1995).

This preserved role of state law is consistent with the FAA's purpose, which was to put arbitration agreements on the "same footing" as other contracts, not on a better footing.[18] Nothing requires the States to apply their generally applicable law with any greater solicitude for arbitration agreements than for any other contracts.

B. FAA Preemption

Perhaps not surprisingly, the federal-state partnership created by the FAA has given rise to a series of complex preemption questions. The FAA does not include an express preemption provision and is not an example of field preemption.[19] The only theory of preemption available under the statute is implied conflict preemption, which applies, *inter alia*, to state provisions that stand "as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress."[20]

The Supreme Court has applied conflict preemption doctrine to hold that state law is preempted by the FAA when it explicitly targets arbitration clauses for disfavored treatment in a manner that would prevent their enforcement,[21] or when it does not mention arbitration but, as applied, would require a judicial forum for an entire subject-matter category of contracts (*e.g.*, all franchise

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18 Volt Info. Sciences, Inc. v. Bd. of Trustees of the Leland Stanford Junior Univ., 489 U.S. 468, 474 (1989) (quoting Scherk v. Alberto-Culver Co., 417 U.S. 506, 511 (1974) (quoting H.R. REP. NO. 96, at 1, 2 (1924)).

19 *Id*. at 477.

20 *Id*. (quoting Hines v. Davidowitz, 312 U.S. 52, 67 (1941)). Another type of implied conflict preemption "arises when compliance with both federal and state regulations is a physical impossibility." Hillsborough County, Fla. v. Automated Med. Labs., Inc., 471 U.S. 707, 713 (1985) (internal quotation marks omitted). This type of "impossibility" conflict is not at issue in most FAA preemption cases.

21 *E.g.*, Doctor's Assocs., Inc. v. Casarotto, 517 U.S. 681 (1996) (Montana state law that required arbitration clause to be printed in underlined capital letters on contract's first page held preempted). In finding preemption in *Doctor's Associates*, the Court was careful to distinguish its decision in *Volt*, which had held that a California statute permitting a stay of arbitration pending litigation was not preempted—even though the statute was targeted explicitly at arbitration agreements. *Doctor's Associates* explained that the statute at issue in *Volt* was different because it "determined only the efficient order of proceedings; it did not affect the enforceability of the arbitration agreement itself." *Id*. at 688. Applying Montana's statute, by contrast, "would not enforce the arbitration clause . . .; instead, Montana's first-page notice requirement would invalidate the clause." *Id*.

agreements).[22] The Court has also emphasized that state law is *not* preempted "*if* that law arose to govern issues concerning the validity, revocability, and enforceability of contracts generally."[23] Under this rule, "[g]enerally applicable contract defenses, such as fraud, duress, or unconscionability, may be applied to invalidate arbitration agreements without contravening § 2."[24]

II. Proving that a Class Action Ban Violates State Law

A growing number of courts—particularly state courts—have held that class action bans embedded in arbitration clauses are unconscionable or violate public policy when they act as exculpatory clauses, *i.e.*, when they effectively immunize corporate defendants from any meaningful liability.[25] The best legal framework to use in challenging an exculpatory class action ban may vary from state to state, but several key facts and arguments are likely to be important in almost every case. Several of these arguments are discussed in Part B; likely corporate counter-arguments are addressed in Section III.

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22 *See* Southland Corp. v. Keating, 465 U.S. 1 (1984) (anti-waiver provision in California Franchise Investment Law held preempted when interpreted by the California Supreme Court to require a judicial forum for claims under the statute).

The boundaries and underlying principles of the Supreme Court's FAA preemption doctrine can be difficult to discern, and they have come in for significant criticism—in large part because the Court's various attempts to describe the second type of preempted state statute (*i.e.*, one that does not mention arbitration but would prohibit it for an entire subject-matter category) have led to some loose language that appears at times to be internally inconsistent and to contradict other Supreme Court holdings. *See* David S. Schwartz, *The Federal Arbitration Act and the Power of Congress over State Courts*, 83 Or. L. Rev. 541, 554–62 (2004).

23 *E.g.*, Doctor's Assocs., 517 U.S. at 685 (quoting Perry v. Thomas, 482 U.S. 483, 492 n.9 (1987)).

24 *Id*. at 687.

25 *See* cases cited *supra* note 4. The citations in note 4 are not intended to suggest that the case law in this area is entirely in consumers' and employees' favor. There is a trend against class action bans, but there are also cases enforcing them. *See generally* Pamela McLean, *Class Action Waivers Hit a Wall*, Nat'l L.J. Aug. 27, 2007 (noting the "definite trend" of courts striking class action bans as unconscionable). For additional case citations, *see* Nat'l Consumer Law Center, Consumer Arbitration Agreements: Enforceability & Other Topics § 6.5.5 (5th ed. 2007).

A. Legal Framework

Many states have a well-developed body of statutory or common law that deals explicitly with "exculpatory" agreements. In California, the state's policy against exculpatory contracts is made clear in Civil Code § 1668, which provides that "[a]ll contracts which have for their object, directly or indirectly, to exempt anyone from responsibility for his own fraud, or willful injury to the person or property of another, or violation of law, whether willful or negligent, are against the policy of the law." Similarly, Washington state case law has articulated a policy against exculpatory contracts.[26] In states like these, where the statutory or common law embodies a clear policy against exculpatory contracts, courts may be able to cite that policy in support of a straightforward holding that the company's class action ban is unenforceable as exculpatory because it effectively immunizes defendants from liability for relatively modest consumer and employee claims that could not practically be litigated on an individual basis.[27]

In other states, that type of holding may be more difficult, either because the case law regarding exculpatory contracts is underdeveloped or because the state's policy regarding such contracts is not helpful for the plaintiff's argument.[28] Even in such states, however, many plaintiff-side arguments can still be persuasive within a slightly different legal framework. Rather than focusing on case law that deals explicitly with exculpatory agreements, some courts find that class action bans violate public policy by preventing plaintiffs from effectively vindicating rights under state law.[29] Other courts have applied unconscionability doctrine, holding that class

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[26] In Scott v. Cingular Wireless, 161 P.3d 1000 (Wash. 2007), the Washington Supreme Court cited precedent for the related propositions that an agreement violates public policy if it has a "tendency to be against the public good" and that "[c]ontract provisions that exculpate the author for wrongdoing, especially intentional wrongdoing, undermine the public good." *Id*. at 1005–06.

[27] *E.g.*, *id*. at 1006–08.

[28] If the case law is underdeveloped, the Second Restatement of Contracts may be helpful depending on the particular facts. The Restatement provides that contract terms intended to exempt a party from liability for intentional or reckless conduct are generally unenforceable, that exculpatory contract terms are unenforceable in certain types of negligence cases, and that a term is unenforceable if intended to "unreasonably" exempt a party from the consequences of its own misrepresentation. RESTATEMENT (SECOND) OF CONTRACTS §§ 195, 196.

[29] *See, e.g.*, S.D.S. Autos, Inc. v. Chrzanowski, 976 So.2d 600, 606 (Fla. Dist. Ct. App. 2007); Eagle v. Fred Martin Motor Co., 809 N.E.2d 1161, 1183 (Ohio Ct. App. 2004); *cf*. Gentry v. Super. Ct., 165 P.3d 556, 42 Cal.4th 443, 455–63 (Cal. 2007) (similar analysis but remanding case for further consideration).

action bans are substantively unfair because they limit liability to such a significant degree.[30]

Ultimately, each of these different legal frameworks may lead to the same result, and the cases applying them may even focus on similar facts and policy arguments, as discussed in Part IIB, *infra*. The point is that different courts have approached this issue in slightly different ways, and that the best line of case law to cite may vary to some extent from state to state.

B. Proving that the Class Action Ban Is Effectively Exculpatory

Regardless of whether a class action ban is challenged within an unconscionability framework or on public policy grounds, the key to a successful attack will almost always be the same: a well-developed argument that the ban at issue effectively immunizes the corporate defendant from any meaningful liability for its alleged wrongdoing.[31] Each of the following points provides support for such an argument.

1. Class Actions Are Necessary for Modest Claims

Successful plaintiffs usually begin by explaining that the relatively modest size of their claims makes individual litigation im-

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[30] *See, e.g.*, Discover Bank v. Super. Ct., 113 P.3d 1100, 1108–10 (Cal. 2005); Powertel, Inc. v. Bexley, 743 So. 2d 570, 574–76 (Fla. Dist. Ct. App. 1999); State *ex rel*. Dunlap v. Berger, 567 S.E.2d 265, 280 (W. Va. 2002).

In some cases, courts have held that class action bans are unconscionable not because they are exculpatory but because they are unfairly one-sided. *See, e.g.*, Ting v. AT&T, 319 F.3d 1126, 1150 (9th Cir. 2003); Tillman v. Commercial Credit Loans, Inc., 655 S.E.2d 362, 373 (N.C. 2008); Vasquez-Lopez v. Beneficial Or., Inc., 152 P.3d 940, 949-50 (Or. Ct. App. 2007)

> We are reminded of the observation by a character in an Anatole France novel that 'the majestic equality of the laws * * * forbid[s] rich and poor alike to sleep under the bridges, to beg in the streets, and to steal their bread.' Although the arbitration rider with majestic equality forbids lenders as well as borrowers from bringing class actions, the likelihood of the lender seeking to do so against its own customers is as likely as the rich seeking to sleep under bridges. (alterations in original, citation omitted).

This is another argument plaintiff and employee consumers can make in challenging a class action. One downside to the unconscionability argument is that in many states, a contract is only unconscionable if there is some evidence of both procedural and substantive unfairness. Because the requirement that plaintiffs prove some procedural unconscionability (*e.g.*, in the negotiation process) can be a significant obstacle, it may be easier to succeed with a public policy challenge where that theory is available.

[31] *See* Jean R. Sternlight & Elizabeth J. Jensen, *Using Arbitration to Eliminate Class Actions: Efficient Business Practice of Unconscionable Abuse?*, 67 LAW & CONTEMP. PROBS. 75, 85–92 (2004).

practical and a class action necessary. Depending on the facts in any given case, building a record on this point can be relatively easy. In many cases, the size of the plaintiffs' claims are evident on the face of their complaint. Putative class representatives can also establish the size of their claims in declarations or affidavits. Leading attorneys in the area can testify that they would not take the class' claims on an individualized basis. Discovery obtained from the defendant can add further support if it shows that very few individual lawsuits or arbitrations have been filed for similar claims. In a variety of different factual contexts, many courts have concluded that class members' claims are likely to go un-remedied without the benefit of class proceedings—allowing the defendant to avoid any meaningful liability.[32]

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[32] *See, e.g.*, Fiser v. Dell Computer Corp., 188 P.3d 1215, 1219–21 (N.M. 2008) ("By preventing customers with small claims from attempting class relief and thereby circumscribing their only economically efficient means for redress, Defendant's class action ban exculpates the company from wrongdoing."); Vasquez-Lopez v. Beneficial Or., Inc., 152 P.3d 940, 951 (Or. Ct. App. 2007) (explaining that a class action ban gave defendant "a virtual license to commit, with impunity, millions of dollars' worth of small-scale fraud"); Scott v. Cingular Wireless, 161 P.3d 1000, 1003–04, 1007 (Wash. 2007) (citing declaration of consumer lawyer explaining that he would be unwilling to take on the plaintiffs' claims individually, and that other lawyers would likely reach the same conclusion, because of their claims' small value and complexity; also citing evidence that no individual arbitrations had been filed against the defendant in Washington in the previous six years); Coady v. Cross Country Bank, 729 N.W.2d 732, 747 (Wis. Ct. App. 2007) (stating that where "the damages involved are comparatively small for each individual consumer," class actions are "often the only means of vindicating consumer rights"); *see also, e.g.*, Shroyer v. New Cingular Wireless Services, Inc., 498 F.3d 976, 984 (9th Cir. 2007) (holding a class arbitration waiver unconscionable because the plaintiffs would not be able to effectively bring individual claims for "damages in the hundreds of dollars"); Discover Bank v. Super. Ct., 113 P.3d 1100, 1110 (Cal. 2005) (holding unconscionable a class action waiver because it "deliberately cheat[ed] large numbers of consumers out of individually small sums of money"); Powertel, Inc. v. Bexley, 743 So. 2d 570, 576 (noting that a corporate defendant's class action ban "precluded the possibility that a group of its customers might join together to seek relief that would be impractical for any of them to obtain alone."); Reuter v. Davis, 2006 WL 3743016, *4 (Fla. Cir. Ct. Dec. 12, 2006) (finding the defendant's class action ban to be unconscionable because "it would be virtually impossible for Ms. Reuter, or anyone in a similar position, to obtain competent individual representation"); Kinkel v. Cingular Wireless LLC, 857 N.E.2d 250, 275 (Ill. 2006) (noting that the defendant's class action ban created "a situation where the cost of vindicating the claim is so high that the plaintiff's only reasonable, cost-effective means of obtaining a complete remedy is as either the representative or member of a class."); Whitney v. Alltel Communications, Inc., 173 S.W.3d 300, 309 (Mo. Ct. App. 2005) (striking a class action ban as unconscionable because the individual claims "would not be economically feasible to prosecute" and the class action ban "would leave consumers with relatively small claims without a practical remedy"); Thibodeau v. Comcast Corp., 912 A.2d 874, 886 (Pa. Super. Ct. 2006) (finding the defendant's arbitration clause unconscionable, because, if enforced, the defendant would be "immunized from the challenges brought by . . . [the plaintiff], brought by any class member, or effectively from any minor consumer claims.").

Even without this sort of evidence, there is strong support in Supreme Court case law for the idea that class actions are needed to ensure an adequate remedy for modest claims.[33] Some courts have also relied on arbitration advocates' own rhetoric, which often confirms that corporate defendants value class action bans because of their exculpatory effect. In one frequently quoted "Practice Tips" column, a corporate defense lawyer wrote that

> the franchisor with an arbitration clause should be able to require each franchisee in the potential class to pursue individual claims in a separate arbitration. Since many (and perhaps most) of the putative class members may never do that, . . . strict enforcement of an arbitration clause should enable the franchisor to dramatically reduce its aggregate exposure.[34]

Citation to language like this makes a powerful case when paired with data showing that only a small percentage of consumers or employees have actually filed individual claims.[35]

2. Class Actions Serve a Deterrent Purpose

In addition to emphasizing the importance of class actions for small-value claims, plaintiffs have also pointed out that class actions serve an important deterrent function. Many courts recognize that their state's consumer- and employee-protection statutes

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33 One familiar articulation of this point is found in *Amchem Products, Inc. v. Windsor*, 521 U.S. 591 (1997), which recognized that "small recoveries do not provide the incentive for any individual to bring a solo action" and that "[a] class action solves this problem by aggregating the relatively paltry potential recoveries into something worth someone's (usually an attorney's) labor." *Id*. at 617 (quoting Mace v. Van Ru Credit Corp., 109 F.3d 338, 344 (7th Cir. 1997)); *see also* Deposit Guar. Nat'l Bank v. Roper, 445 U.S. 326, 338 n.9 (1980); Eisen v. Carlisle & Jacquelin, 417 U.S. 156, 161 (1974) ("A critical fact . . . is that petitioner's individual stake . . . is only $70. No competent attorney would undertake this complex antitrust action to recover so inconsequential an amount. Economic reality dictates that petitioner's suit proceed as a class action or not at all."); Carnegie v. Household Int'l, Inc., 376 F.3d 656, 661 (7th Cir. 2004) ("The *realistic* alternative to a class action is not 17 million individual suits, but zero individual suits, as only a lunatic or a fanatic sues for $30.").

34 Edward Wood Dunham, *The Arbitration Clause as a Class Action Shield*, 16 FRANCHISE L.J. 141, 141 (1997); *see also* Cooper v. QC Fin. Serv., Inc., 503 F. Supp. 2d 1266, 1287–88 (D. Ariz. 2007) (quoting from Myriam Gilles, *Opting Out of Liability: The Forthcoming, Near-Total Demise of the Modern Class Action*, 104 MICH. L. REV. 373, 396–397 (2005), which in turn quoted from the Dunham piece); Jean R. Sternlight, *As Mandatory Binding Arbitration Meets the Class Action, Will the Class Action Survive?*, 42 WM. & MARY L. REV. 1, 5 n.2 (2000) (citing the Dunham article and several others) [hereinafter Sternlight, *Mandatory Binding Arbitration Meets the Class Action*].

35 In one recent case, a Florida trial court also found it significant that payday lending companies like the defendant had "a reputation for being uncollectible, meaning that even the possibility of a fee award on an individual claim is insufficient to entice competent counsel." *See* Reuter, 2006 WL 3743016, at *5.

are intended to serve a deterrent purpose, not just a compensatory one, and corporate defendants' arguments tend to ignore that purpose by focusing on the remote possibility that one or two class members may decide to pursue individual claims.

The reality is that even if one or two plaintiffs do manage to file for individual relief, a statute's deterrent purpose is not served if a company obtains millions in profit from its illegal activity and balances that profit against only one or two awards of a few thousand dollars. Plaintiffs can demonstrate this discrepancy by comparing the value of their individual claims with defendant's profit from the alleged misconduct (if they can obtain such information in discovery). They can also make the same point by citing the California Supreme Court's analysis in *Gentry v. Superior Court*,[36] which explained that:

> [w]hile employees may succeed under favorable circumstances in recovering unpaid overtime through a lawsuit or a wage claim filed with the California Labor Commissioner, a class action may still be justified if these alternatives offer no more than the prospect of random and fragmentary enforcement of the employer's legal obligation to pay overtime. By preventing a failure of justice in the judicial system, the class action not only benefits the individual litigant but serves the public interest in the enforcement of legal rights and statutory sanctions. In other words, absent effective enforcement, the employer's cost of paying occasional judgments and fines may be significantly outweighed by the cost savings of not paying overtime.[37]

Finally, plaintiffs can point out that class actions provide the opportunity for far-reaching equitable relief, which furthers a remedial statute's purpose and serves as a significant deterrent.[38]

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36 165 P.3d 556, 42 Cal. 4th 443 (Cal. 2007).

37 *Id*. at 462 (internal quotation marks and citations omitted); *see also* Stone, *Rustic Justice*, *supra* note 12, at 1034–35 (explaining that if "the primary role of tort litigation" is not only "compensation to the individual plaintiff but deterrence to others," then small awards in confidential arbitrations fail to achieve this goal); Katherine Van Wezel Stone, *Mandatory Arbitration of Individual Employment Rights: The Yellow Dog Contract of the 1990s*, 73 DENV. U. L. REV. 1017, 1047 (1996) (citing testimony of Marsha Berzon, before her appointment to the Ninth Circuit Court of Appeals, to the effect that "mandatory ADR to resolve statutory disputes would circumvent the deterrent effects of litigation—large verdicts and unfavorable publicity—which are so important in enforcing employment legislation").

38 *See, e.g.*, Scott v. Cingular Wireless, 161 P.3d 1000, 1006 (Wash. 2007) (citing the public good served by equitable relief in private attorney general actions); Sternlight & Jensen, *supra* note 31, at 90–91 (same).

3. Without a Class Action, Many Absent Class Members Would Not Discover Their Claims

In cases involving fraud, misleading statements, or complex corporate practices, absent class members are unlikely to discover the factual basis for their claims without the assistance of a class action. This contributes to the exculpatory nature of many corporate class action bans.

Consumer advocates refer to "hidden" fees for a reason: it can be difficult for consumers and employees to identify wrongdoing in the cryptic language of their monthly statements or checks, and it should come as no surprise that widespread corporate misconduct is often discoverable only with the help of additional documents or data. If sophisticated investors and regulators could not uncover Bernard Madoff's $50 billion Ponzi scheme, despite significant signs of wrongdoing,[39] courts should not expect individual consumers and employees to discover fraudulent schemes buried in misleading corporate disclosures.

Indeed, even for those class members who may be able to discover the facts underlying their potential claims, it can be difficult to match those facts with a viable legal theory. If a legal claim is particularly complex, and if experienced lawyers are unwilling to take claims on an individualized basis, plaintiffs have little chance of securing meaningful relief, as several courts have recognized.[40] In *Scott v. Cingular Wireless*, the Washington Supreme Court explained that "[w]ithout [a class action], many consumers may not even realize that they have a claim."[41] The Court made this point in support of its holding that Cingular's class action ban was exculpatory and therefore unenforceable.[42]

4. Retaliation and Other Barriers

The difficulty of discovery cited in *Scott* is far from individual claimants' only hurdle. Several additional barriers can make indi-

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[39] *See* Gregory Zuckerman, *Chasing Bernard Madoff*, WALL ST. J., ,Dec. 18, 2008, at A1.

[40] *See, e.g.*, Gentry v. Super. Ct., 165 P.3d 556, 42 Cal. 4th 443, 461 (Cal. 2007) ("[S]ome individual employees may not sue because they are unaware that their legal rights have been violated."); Muhammad v. County Bank of Rehoboth Beach, Del., 912 A.2d 88, 100 (N.J. 2006) ("[O]ften consumers do not know that a potential defendant's conduct is illegal. When they are being charged an excessive interest rate or a penalty for check bouncing, for example, few know or even sense that their rights are being violated.") (quoting Sternlight & Jensen, *supra* note 31, at 88); Scott v. Cingular Wireless, 161 P.3d 1000, 1007 (Wash. 2007).

[41] *Scott*, 161 P.3d at 1007.

[42] *Id.* at 1008.

vidual arbitrations or lawsuits unlikely and can reinforce class action bans' exculpatory effect.

In some cases, absent class members may have legitimate reason to fear retaliation if they are identified by name in an individual proceeding. This fear could be a significant inhibitory factor for current employees, for undocumented workers, and even for some categories of consumers.[43] The prospect of retaliation played a significant role in the California Supreme Court's decision in *Gentry v. Superior Court*,[44] which discussed a variety of factors that may contribute to a class action ban's unenforceability and cited federal and state authority for the proposition that feared retaliation is an important justification for class suits in employment cases.[45]

Although feared retaliation will not be available as an argument in every case, behavioral economists and other experts have identified a series of additional barriers that are likely to inhibit individual claims. Several commentators have explained that consumers and employees tend to approach transactions with an optimistic bias that can interfere with their ability to anticipate or identify wrongdoing.[46] Most prefer to maintain the status quo[47] and to avoid injecting conflict into an ongoing relationship.[48] Consumers and employees are also likely to be fully occupied with everyday tasks and are unfamiliar with the arbitration process. Unsure about how to proceed,[49] and suspicious of arbitration[50] and

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43 *See* S. REP. NO. 110-518, pt. B(2) (2008) (report accompanying the Fairness in Nursing Home Arbitration Act, explaining that residents may fear retaliation for failing to agree to mandatory arbitration); *see also* Shmuel I. Becher, *Asymmetric Information in Consumer Contracts: The Challenge That Is Yet to Be Met*, 45 AM. BUS. L.J. 723, 744 (2008) (discussing "[c]onsumers' fear to be categorized as 'troublemakers.'").

44 165 P.3d 556, 42 Cal. 4th 443 (Cal. 2007).

45 *Id*. at 459–60.

46 *See* RICHARD H. THALER & CASS R. SUNSTEIN, NUDGE: IMPROVING DECISIONS ABOUT HEALTH, WEALTH AND HAPPINESS 31-33 (2008) (discussing the optimism bias); Amy J. Schmitz, *Dangers of Deference to Form Arbitration Provisions*, 8 NEV. L.J. 37, 45 (2007); Sternlight & Jensen, *supra* note 31 at 96–97; Sarah Rudolph Cole, *Incentives and Arbitration: The Case Against Enforcement of Executory Arbitration Agreements between Employers and Employees*, 64 UMKC L. REV. 449, 453 (1996).

47 *See* THALER & SUNSTEIN, *supra* note 46, at 8, 34–35 (discussing status quo bias); Schmitz, *Contracting Culture*, *supra* note 13, at 160 (referring to "[i]ndividuals' preference for inaction").

48 *See* Becher, *supra* note 43, at 744.

49 Schmitz, *Contracting Culture*, *supra* note 13, at 160 (stating consumers often lack "understanding or experience with arbitration" and "generally lack resources to research and use these mandatory arbitration schemes."); Sternlight & Jensen, *supra* note 31, at 89:

> Consumers may well be unsure how to file an individual claim in either litigation or arbitration. . . . Moreover, to the extent that a consumer realizes that she is required

its ability to provide meaningful relief,[51] they often make the reasonable decision that pursuing an individual claim is not worth any investment of time or money.

The ultimate effect of these many barriers to individual action is that a provision banning class proceedings is unlikely to lead to a class-sized army of individual claimants.[52] Companies understand this, as should courts, and it helps to explain why so many corporate defendants favor class action bans in the first place.[53]

III. Responding to Corporate Counter-Arguments

Corporate defendants have responded to the trend of courts striking down class action bans with a series of counter-arguments and contract terms intended to overcome traditional contract law objections. Common responses include choice-of-law clauses, opt-out provisions, and revived FAA preemption theories, as well as arguments that fee-shifting provisions provide sufficient incentive for individual claims and that regulatory enforcement makes class actions unnecessary.[54] Consumer and employee plaintiffs have strong answers to each of these defenses.

> to bring her claim in arbitration, lack of understanding or even misunderstandings of that process may deter her from filing a claim.

Sternlight & Jensen, *Id.*

50 Sternlight & Jensen, *supra* note 31, at 89 n.98:

> Most citizens are aware that the courts provide an impartial tribunal for resolution of legal matters and a jury of one's peers. To the extent that they have heard anything about arbitration, it may be negative, casting doubts upon it as the best vehicle for an individual to vindicate rights against large corporations or institutions.

Id. (quoting the affidavit of Prof. Edward F. Sherman in *Sullivan v. QC Fin. Servs. Inc.*, (No. 82D03-0003-CP-738) (Vanderburgh Super. Ct., Ind.)).

51 Consumers report feelings of powerlessness in their dealings with companies, and many have had difficulty even reaching a customer service representative to discuss a problem—let alone reaching a representative with the willingness and actual authority to resolve the issue. *See* Schmitz, *Dangers of Deference*, *supra* note 46, at 47. Given these experiences, consumers might be pessimistic about their chances in arbitration.

52 *See* Sternlight, *Mandatory Binding Arbitration Meets the Class Action*, *supra* note 34, at 353 ("where a class action is excluded from arbitration, it is likely that many if not most of the claimants will not be able to arbitrate their claims.").; *cf.* Becher, *supra* note 43, at 748 (citing "empirical data that suggest that standardized exculpatory terms may undermine consumers' motivation to insist upon their rights and seek compensation.").

53 *Cf.* Jon D. Hanson & Douglas A. Kysar, *Taking Behavioralism Seriously: The Problem of Market Manipulation*, 74 N.Y.U. L. Rev. 630, 724–26 (1999) (arguing that in a competitive environment, companies will act strategically to take advantage of consumers' cognitive biases).

54 This is not an exhaustive list of corporate counter-arguments. Some defendants have also argued that their own consumer or employee complaint procedures make class actions (or, presumably, any litigation) unnecessary. This argument is usually unsuccessful, and several com-

A. Choice-of-Law Clauses

In recent years, several corporate defendants have inserted choice-of-law clauses in their standard-form contracts that call for the application of state law favorable to class bans, such as the law of Texas or Utah. Some courts have enforced these clauses,[55] but several recent decisions have held them unenforceable under traditional choice-of-law principles.[56]

Choice-of-law analysis varies to some extent from state to state. In several states, a contractual choice-of-law clause will not be enforced if application of the chosen state's law would violate the forum's fundamental public policy.[57] When this is the only test, the key question is whether the forum state has a fundamental policy against exculpatory class action waivers and is instead in favor of ensuring plaintiffs a viable method for dispute resolution. For example, in *Fiser v. Dell*, the New Mexico Supreme Court held that a Texas choice-of-law clause could not be applied because Texas

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mentators have criticized the notion that a company's concerns about its reputation might motivate it to address consumer concerns. *See* Becher, *supra* note 43, at 750–52 (explaining why companies' "reputational" concerns may not provide them with sufficient motivation to correct abusive practices); Todd D. Rakoff, *The Law and Sociology of Boilerplate*, 104 MICH. L. REV. 1235, 1236 (2006) (criticizing the argument that some judicial enforcement, together with firms' reputational concerns, will produce systematically desirable results).

Other arguments have included policy-based attacks on the class-action device, often paired with theoretical assertions about corporate savings from class action bans that are passed along to consumers. For a decision rejecting this approach, see Ting v. AT&T, 182 F. Supp. 2d 902 (N.D. Cal. 2002), *reversed in part but affirmed as to unconscionability*, 319 F.3d 1126 (9th Cir. 2003), which viewed the company's assertions as speculative and explained that "the notion that it is to the public's advantage that companies be relieved of legal liability for their wrongdoing so that they can lower their cost of doing business is contrary to a century of consumer protection laws." *Id*. at 931 n.16.

Some companies have also inserted language in their arbitration clauses that is intended to make unconscionability an issue for the arbitrator. Several California appellate courts have refused to enforce such language. *See* Ontiveros v. DHL Express (USA), Inc., 79 Cal. Rptr. 3d 471 (Cal. Ct. App. 2008); Bruni v. Didion, 73 Cal. Rptr. 3d 395 (Cal. Ct. App. 2008); Murphy v. Check 'N Go of California, Inc., 67 Cal. Rptr. 3d 120 (Cal. Ct. App. 2007).

55 *E.g.*, Omstead v. Dell, Inc., 533 F. Supp. 2d 1012, 1036 (N.D. Cal. 2008) (on appeal to the Ninth Circuit); Eaves-Leanos v. Assurant, Inc., 2008 WL 114889, *6 (W.D. Ky. Jan. 8, 2008).

56 *See* Homa v. Am. Express Co., 558 F.3d 225 (3d Cir. 2009); Tamayo v. Brainstorm USA, 154 Fed. Appx. 564, 566 (9th Cir. Sept. 21, 2005); Oestreicher v. Alienware Corp., 2007 WL 2302490, *4–*6 (N.D. Cal. Aug. 10, 2007); Brazil v. Dell Inc., 2007 WL 2255296, *7 (N.D. Cal. Aug. 3, 2007); Doerhoff v. Gen. Growth Props., Inc., 2006 WL 3210502, *6 (W.D. Mo. Nov. 6, 2006); Klussman v. Cross Country Bank, 36 Cal. Rptr. 3d 728, 734–41 (Cal. Ct. App. 2005); Wigginton v. Dell, Inc., 890 N.E.2d 541, 549 (Ill. Ct. App. 2008); Fiser v. Dell Computer Corp., 188 P.3d 1215, 1220–21 (N.M. 2008); McKee v. AT&T Corp., 191 P.3d 845, 851–52 (Wash. 2008); Coady v. Cross Country Bank, 729 N.W.2d 732, 737–38 (Wis. Ct. App. 2007).

57 *See, e.g.*, *Wigginton*, 890 N.E.2d at 547; *Fiser,* 188 P.3d at 1218.

law would allow enforcement of the defendant's class action ban, contrary to New Mexico's "fundamental public policy" that "consumers with small claims [must] have a mechanism for dispute resolution via the class action."[58]

In some cases where enforcement of a choice-of-law clause has come down to the issue of public policy, defendants have argued that because the forum state might enforce a class action ban in a different context—*e.g.*, if the ban were not exculpatory—the state cannot have a "fundamental" policy against class action bans *per se*. The flaw in this argument is that a state may have a fundamental policy against *exculpatory* class action bans and in favor of viable dispute resolution even if it does not have a fundamental policy against *all* class action bans. Courts in Illinois, New Mexico and Washington have rejected choice-of-law clauses as inconsistent with state policy even though those states have not held class action bans unconscionable *per se*.[59]

Some states' choice-of-law analysis looks to more than just public policy. In California, for example, courts consider whether the forum state or the contractually chosen state has a materially greater interest in the parties' dispute.[60] California has the greater interest if the putative class members are all California consumers or employees,[61] although this is by no means required.[62] Given California's strong interest in protecting consumers and in regulating in-state companies, any choice-of-law clause that would exculpate a California defendant may well be unenforceable.[63]

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58 *Fiser*, 188 P.3d at 1220–21.

59 *Wigginton*, 890 N.E.2d at 547–49; *Fiser*, 188 P.3d at 1218–21; *McKee*, 191 P.3d at 851–52.

60 Wash. Mut. Bank, FA v. Super. Ct., 15 P.3d 1071, 1078 (2001); Nedloyd Lines B.V. v. Super. Ct., 834 P.2d 1148, 1152 (1992).

61 *See, e.g.*, Davis v. Chase Bank USA, NA, 2008 WL 4832998, at *1 (9th Cir. Nov. 3, 2008) (illustrating California had a materially greater interest in a case involving a California class, California claims, and transactions that took place in California); *Oestreicher*, 502 F. Supp. 2d 1068–69 (stating California had materially greater interest in case involving California class, California claims, and products shipped into California); *Klussman*, 134 Cal. App. 4th at 1299 (stating that California had materially greater interest in case involving, *inter alia*, California class, "primarily" California claims, contract made in California).

62 Courts have found that California had the materially greater interest in cases not limited to a statewide class. *See, e.g.*, Douglas v. U.S. Dist. Ct., 495 F.3d 1062, 1067 n.2 (9th Cir. 2007) (per curiam); Van Slyke v. Capital One Bank, 503 F. Supp. 2d 1353 (N.D. Cal. 2007).

63 *See* Murphy v. DirecTV, Inc., No. 2:07-cv-06465-FMC-VBKx, slip op. at 6–11 (C.D. Cal. May 9, 2008) (applying California law, notwithstanding choice-of-law clause, in case involving putative class representative from Georgia but California defendants and claims under California law); Masters v. DirecTV, Inc., No. 2:08-cv-00906-FMC-VBKx, slip op. at 6–10 (C.D. Cal. May 9, 2008) (applying California law applied, notwithstanding choice-of-law clause, in case in-

In addition to the "materially greater interest" test, some states also consider whether the forum state's law would apply absent any contractual choice.[64] This third element is included in the choice-of-law test outlined in the Second Restatement of Conflict of Laws,[65] but courts often spend little time analyzing this issue, even in states that have adopted the Restatement's test. Recently, *McKee v. AT&T Corp.* did discuss the issue, holding that absent any contractual choice Washington law would have applied to a putative class action with a Washington class representative who had purchased long-distance telephone service from an out-of-state defendant.[66]

Section 188 of the Restatement lists several factors to consider in identifying the default law that would apply, including the place of contracting, place of negotiation, place of performance, and location of the subject matter, as well as the domicile, residence, nationality, place of incorporation, and place of business of the parties.[67] These factors are to be "evaluated according to their relative importance with respect to the particular issue" in dispute,[68] and several of the factors will often be irrelevant in context.[69] Comments to section 188 provide some guidance with respect to the application of these factors, as does the forum state's contract law. All of the factors are to be considered within the broad framework of determining which state "has the most significant relationship to the transaction and the parties,"[70] and it will benefit consumers and employees in most cases to keep this framework foremost in the court's mind.

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volving putative class representative from Montana but California defendants and claims under California law).

64 *E.g.*, McKee v. AT&T Corp., 191 P.3d 845, 851–52 (Wash. 2008).

65 RESTATEMENT (SECOND) OF CONFLICT OF LAWS § 187 (1971).

66 *See McKee*, 191 P.3d at 851–52.

67 RESTATEMENT (SECOND) OF CONFLICT OF LAWS § 188(2) (1971).

68 *Id*.

69 For example, the place of contracting and the place of negotiation are unimportant if the parties' dispute is not focused on contract formation and if no real negotiation has taken place, although it may benefit the plaintiff to cite the place-of-contracting factor if the forum's law provides that a contract is made where the last act occurred that was necessary to give the contract effect. *Id*. cmt. e.

70 RESTATEMENT (SECOND) OF CONFLICT OF LAWS § 188(1) (1971).

B. Opt-Out Clauses

As a second line of defense for class action bans, several corporations have inserted "opt-out" language in their standard-form contracts that purports to give consumers or employees the right to reject pre-dispute arbitration. This language is most likely to become an issue in states that consider class action bans within an unconscionability framework and that require some evidence of both procedural and substantive unfairness.[71] Corporate defendants cite opt-out language in support of an argument that the right to opt out makes plaintiffs' agreement to arbitrate "voluntary" and prevents any finding of procedural unconscionability.

Some courts have accepted this argument,[72] but others have not,[73] and there are several potential responses available to consumer and employee plaintiffs. First, an increasing number of courts have held that procedural unconscionability is not required if a contract's terms are substantively unconscionable.[74] Second, as discussed *supra* Part IIA, unconscionability is not the only theory that can be used to challenge class action bans, and procedural un-

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71 Procedural unconscionability looks to the nature of the parties' negotiation and the disclosure of arbitration terms. Substantive unconscionability looks to the fairness of the terms themselves. *See, e.g.*, Discover Bank v. Super. Ct., 113 P.3d 1100, 1108 (Cal. 2005).

72 *E.g.*, Circuit City Stores, Inc. v. Najd, 294 F.3d 1104, 1108 (9th Cir. 2002).

73 *E.g.*, Gentry v. Super. Ct., 165 P.3d 556, 42 Cal. 4th 443, 470–72 (Cal. 2007).

74 *See* Dale v. Comcast Corp., 498 F.3d 1216, 1220 n.5 (11th Cir. 2007) ("The subscribers also argue on appeal that the class action waiver is procedurally unconscionable. We do not address this argument since we conclude *infra* that the clause is substantively unconscionable and thus unenforceable as a matter of law."); March v. Tysinger Motor Co., Inc., 2007 WL 4358339, at *4 n.5 (E.D. Va. Dec. 12, 2007) ("Nor has Virginia adopted the position of some courts that an agreement must be procedurally and substantially flawed to be unconscionable."); Batory v. Sears, Roebuck & Co., 456 F. Supp. 2d 1137, 1140 (D. Ariz. 2006) (illustrating that substantive unconscionability alone is enough to strike a provision); Wigginton v. Dell, Inc., 890 N.E.2d 541, 544 (Ill. App. Ct. 2008); Covenant Health Rehab. of Picayune, L.P. v. Brown, 949 So. 2d 732, 737, 739 (Miss. 2007) (stating that even though an arbitration agreement is not procedurally unconscionable, a provision banning punitive damages and waiving liability for criminal acts of individuals is unconscionable and stricken); Fiser v. Dell Computer Corp., 188 P.3d 1215, 1221 (N.M. 2008) ("While we agree that Defendant's 'terms and conditions' may not rise to the level of an adhesive contract, we nevertheless conclude that the terms are unenforceable because there has been such an overwhelming showing of substantive unconscionability."); Vasquez-Lopez v. Beneficial Or., Inc., 152 P.3d 940, 948 (Or. Ct. App. 2007) ("[B]oth procedural and substantive unconscionability are relevant, although only substantive unconscionability is absolutely necessary."); Scott v. Cingular Wireless, 161 P.3d 1000, 1006 n.4 (Wash. 2007) (ruling it "unnecessary to address plaintiffs' claims of procedural unconscionability" after holding class action ban substantively unconscionable); *cf.* Hialeah Automotive, LLC v. Basulto, 2008 WL 4568067, at *5 n.5 (Fla. Dist. Ct. App. 2008) (stating opinion of one member of the panel that earlier Florida case should be reconsidered as illogical and inconsistent with other case law).

conscionability is not required to prove that a ban is exculpatory, violates public policy, or prevents effective vindication of statutory rights.

The opt-out argument also faces the problem that its theory—*i.e.*, that opt-out language ensures a voluntary choice—is not borne out by reality. Burying an opt-out clause in a fine-print contract does not mean that every consumer or employee who fails to opt out has chosen arbitration voluntarily. To the contrary, companies have been willing to adopt opt-out language as a strategy because they know that very few potential class members read standard-form contracts, understand them, understand the differences between arbitration and litigation, are able to assess those differences, and have time to reject the default arbitration option by exercising any opt-out right.

Commentators have explained why this is so: optimism bias means that potential plaintiffs will underestimate the risk of a future dispute and undervalue their right to proceed in court;[75] status quo bias encourages the default option and makes opt outs unlikely;[76] many consumers and employees will not read a standard-form agreement, let alone understand it;[77] contracts are often confusingly written, as readability experts can explain in a particular case;[78] consumers and employees often face a paralyzing information overload;[79] opting out always involves transaction costs;[80] and

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75 *See* THALER & SUNSTEIN, *supra* note 46, at 31–33 ("People are unrealistically optimistic even when the stakes are high . . . . When they overestimate their personal immunity from harm, people may fail to take sensible preventive steps."); *see also* Schmitz, *Dangers of Deference*, *supra* note 46, at 45 (explaining parties "usually enter transactions with optimism that no disputes will arise and do not expend resources considering or discussing the likely impacts of breach."); Schmitz, *Contracting Culture*, *supra* note 13, at 160 (referring to individuals' "under estimation of litigation risks"); Schwartz, *Enforcing Small Print*, *supra* note 13, at 57 ("the adherent [to a standard-form contract] is most likely to undervalue the right to a judicial forum.").

76 *See, e.g.*, THALER & SUNSTEIN, *supra* note 46, at 34–35 (asserting that due to status quo bias, "if an option is designated as the 'default,' it will attract a large market share"); *see also* Schmitz, *Dangers of Deference*, *supra* note 46, at 46 ("Negotiators also accept form terms without question due to contracting inertia and general preference for provisions that operate without requiring action.").

77 *See* Becher, *supra* note 43, at 730–31, 757 (stating "empirical evidence shows that most consumers do not read [standard form contracts]"); Russell D. Feingold, *Mandatory Arbitration: What Process Is Due?*, 39 HARV. J. ON LEGIS. 281, 296 (2002) (citing case where "bank knew that no more than four percent of card holders would read bill stuffers."); Schmitz, *Contracting Culture*, *supra* note 13, at 160 (stating "consumers rarely read or understand" arbitration agreements).

78 *Cf.* Becher, *supra* note 43, at 739 ("The more complicated or lengthy the [standard form contract], the more likely a consumer is not to read it.").

79 Jeff Sovern, *Opting In, Opting Out, or No Options at All: The Fight for Control of Personal Information*, 74 WASH. L. REV. 1033, 1086 (1999) ("While some reports are to the con-

consumers and employees have less information than corporate defendants about the arbitration process, and this lack of information makes a meaningful choice more difficult.[81]

Any number of examples confirm that opt-out rights are rarely exercised and that a default option carries significant weight. Music subscription clubs rely on status quo or inertia bias for much of their profit, which is made when consumers fail to cancel a subscription that is automatically renewed.[82] Studies have shown that many employees fail to opt into their employer-sponsored retirement plans, even though the benefits to employees are clear.[83]

Not surprisingly, arbitration opt-out clauses are likely to have the same effect, with consumers and employees failing to opt out without making any "voluntary" choice at all. To the extent possible, plaintiffs can drive this point home with discovery showing that only a small percentage of putative class members have opted out of arbitration, or even that the defendant knew few consumers would read its arbitration agreement or exercise the opt-out right.[84]

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trary, many studies have now demonstrated the existence of 'information overload,' meaning that overloaded consumers either do not make optimal decisions or overlook relevant information.").

[80] *See* Becher, *supra* note 43, at 738 ("becoming [an] informed [consumer] is not costless"); Sovern, *supra* note 79, at 1074–90 (discussing possible transaction costs that can affect an opt-out system).

[81] *See* Schwartz, *Enforcing Small Print*, *supra* note 13, at 57 ("Unlike the drafting party, who has . . . probably experienced both arbitration and litigation, the adherent is unlikely to have had any such experience and is also unlikely to undertake the time and expense to research the implications of an arbitration clause or obtain legal advice."); *see also* Becher, *supra* note 43, at 739 ("At the time of contracting it is difficult for consumers to know whether the cost of inefficient terms is likely to be higher than the cost of reading and understanding any given set of form contract terms."); Schmitz, *Contracting Culture*, *supra* note 13, at 160 (stating "consumers generally lack resources to research . . . mandatory arbitration schemes"); Schmitz, *Dangers of Deference*, *supra* note 46, at 46 (stating "consumers often do not see need to negotiate or resist form arbitration provisions because they do not appreciate the provisions' effects or realize how terms may foster unfairness in practice."); *cf.* Becher, *supra* note 43, at 740:

> When people have a hard time predicting how their choices will end up affecting their lives, they have less to gain by numerous options and perhaps even by choosing for themselves. In this respect, most consumers struggle to realize how their choice to enter one set of contractual terms (rather than another) will affect their rights, risks, and entitlements. (internal quotation marks omitted).

[82] This practice is known as "negative option marketing." For a discussion of its effect on consumer behavior, see Sovern, *supra* note 79, at 1091–94, and THALER AND SUNSTEIN, *supra* note 46, at 35.

[83] *See* THALER & SUNSTEIN, *supra* note 46, at 107–08.

[84] *Cf.,* Hoffman v. Citibank (South Dakota), N.A., 546 F.3d 1078, 1085 (9th Cir. 2008) (remanding for consideration of, *inter alia*, how many consumers exercise opt-out right); Ting v. AT&T, 182 F. Supp. 2d 902, 930 (N.D. Cal. 2002) (citing the defendant's own research showing

Depending on the factual context, several additional responses to a defendant's opt-out argument may also be available. In some cases, plaintiffs can show that they were pressured into agreeing to arbitration,[85] that they would have *felt* pressured into agreeing to arbitration (*e.g.*, because the company's preference for arbitration was clear or because opting out came with negative consequences),[86] that they were rushed through the decision-making process,[87] that the defendant made opting out difficult,[88] or that the arbitration clause misleadingly emphasized the benefits of arbitration without highlighting any of its potential disadvantages.[89] At least two of these factors were deemed significant in *Gentry v. Superior Court*, which held a defendant's arbitration agreement procedurally unconscionable notwithstanding opt-out language.[90]

C. FAA Preemption Arguments

Corporations have long argued that the FAA preempts application of any state law that would invalidate class action bans. This argument has been rejected by courts across the country because nearly every decision striking down a class action ban turns on generally applicable state contract law, which is not preempted by the FAA.[91] Notwithstanding this long line of case law, corporate defendants won a surprise victory in late 2007 when the Third Circuit

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that many of its consumers would not read its dispute-resolution agreement), *rev'd in part but aff'd as to unconscionability*, 319 F.3d 1126 (9th Cir. 2003).

85 *See, e.g.*, Circuit City Stores, Inc. v. Mantor, 335 F.3d 1101, 1106–07 (9th Cir. 2003).

86 *See* Gentry v. Super. Ct., 165 P.3d 556, 42 Cal. 4th 443, 471–72 (Cal. 2007); Massie v. Ralphs Grocery Co., 2007 WL 1395580, at *7 (Cal. Ct. App. May 14, 2007).

87 *Cf.*, Higgins v. Super. Ct., 140 Cal. App. 4th 1238, 1252 (Cal. Ct. App. 2006) (citing evidence that agreements were reviewed and signed in five to ten minutes).

88 *Cf.*, Massie v. Ralph's Grocery Co., 2007 WL 1395580, at *7 (ruling purported opt-out right did not eliminate procedural unconscionability where, *inter alia*, various obstacles made it difficult for employee effectively to opt out).

89 *E.g.*, Gentry, 42 Cal. 4th at 470–71.

90 *Id.*

91 *See, e.g.*, Shroyer v. New Cingular Wireless Servs., Inc., 498 F.3d 976, 987–93 (9th Cir. 2007) (rejecting FAA preemption argument because "'the principle that class action waivers are, under certain circumstances, unconscionable as unlawfully exculpatory is a principle of California law that does not specifically apply to arbitration agreements, but to contracts generally.'") (quoting Discover Bank v. Super. Ct., 113 P.3d 1100, 1112 (Cal. 2005)); Ting v. AT&T, 319 F.3d 1126, 1152 (9th Cir. 2003); Kinkel v. Cingular Wireless LLC, 857 N.E.2d 250, 263 (Ill. 2006) ("Because our analysis on the question of class action waivers is applicable to all contracts governed by Illinois law, it can be applied to render the class action waiver in an arbitration clause unenforceable without undermining the goals and policies of the FAA."); Scott v. Cingular Wireless, 161 P.3d 1000, 1008 (Wash. 2007):

suggested in dicta in *Gay v. CreditInform*[92] that Pennsylvania cases striking down class action bans created a conflict with federal law.[93]

Gay is a poorly reasoned decision that fails to mention the many cases rejecting FAA preemption arguments. Fortunately, *Gay* is also distinguishable from most cases because of its unique interpretation of Pennsylvania law. *Gay* interpreted Pennsylvania law to require that plaintiffs always be permitted to proceed with a class action *in court*, rather than with class-wide arbitration. In other words, the Third Circuit understood Pennsylvania law to express a clear preference for court over arbitration: under the Third Circuit's reading, a provision expressly permitting class arbitration would be unconscionable under Pennsylvania law unless it also permitted "*judicial* class actions."[94]

If this were an accurate summary of the relevant Pennsylvania cases, corporate defendants would have at least some argument that the cases' holdings discriminate against arbitration in violation of the FAA. Regardless of whether *Gay* correctly interpreted Pennsylvania law, however, it is clear that most state decisions striking down class action bans have relied on generally applicable contract law that expresses no preference for court over arbitration. These cases hold that class *proceedings* must be permitted, but they recognize (as has the Supreme Court)[95] that class actions can proceed either in arbitration or in court.

The New Jersey Supreme Court's recent decision in *Muhammad v. County Bank*[96] provides one example of this difference. *Muhammad* held the defendant's class action ban unenforceable, but the court ultimately ordered the parties to proceed with class-

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> Congress simply requires us to put arbitration clauses on the *same* footing as other contracts, not make them the special favorites of the law. . . . [C]ontracts that effectively exculpate their drafter from liability under the [Consumer Protection Act] for broad categories of liability are not enforceable in Washington, even if they are embedded in an arbitration clause. The arbitration clause is irrelevant to the unconscionability. (citation omitted).

92 511 F.3d 369 (3d Cir. 2007).

93 *Id*. at 393–95.

94 *Id*. at 394:

> To the extent, then, that [Pennsylvania cases] hold that the inclusion of a waiver of the right to bring *judicial* class actions in an arbitration agreement constitutes an unconscionable contract, they are not based 'upon such grounds as exist at law or in equity for the revocation of *any* contract' pursuant to *section 2* of the FAA, and therefore cannot prevent the enforcement of the arbitration provision in this case. (quoting 9 U.S.C. § 2, first & second emphasis is added (judicial & any)).

95 Green Tree Fin. Corp. v. Bazzle, 539 U.S. 444, 450–51 (2003) (recognizing the possibility of classwide arbitration).

96 912 A.2d 88 (N.J. 2006).

wide arbitration.[97] Similarly, in *Scott v. Cingular Wireless*,[98] the Washington Supreme Court explained that "[c]lass action waivers have very little to do with arbitration. . . . [W]e see no reason why the purposes of favoring individual arbitration would not equally favor class-wide arbitration."[99]

Decisions like these do not discriminate against arbitration because, under their reasoning, a class action ban would be unconscionable whether applied to arbitration or to litigation, and striking such a ban does not necessarily preclude class-wide arbitration. Plaintiffs should be able to distinguish the Third Circuit's *Gay* decision on these grounds in most cases, much as the Third Circuit itself did recently in *Homa v. American Express Co.*,[100] limiting *Gay* and holding that New Jersey law as stated in *Muhammad* is not preempted by the FAA.[101]

D. Fee-Shifting Statutes and Regulatory Enforcement as Class Action Substitutes

Corporate defendants often argue that fee-shifting statutes provide sufficient incentives for attorneys to take on individual claims, making class actions unnecessary and preventing class action bans from being exculpatory. Many companies also contend that class bans are not exculpatory because they do not prevent statutory enforcement by federal and state regulatory agencies.

With respect to companies' fee-shifting arguments, the reality is that the remote possibility of a post-trial (or post-arbitration) fee recovery does not provide enough incentive for most attorneys to take on the risk and expense of a complex individual case against a well-heeled defendant. This is particularly true when costs are likely to far outweigh any individual claimant's recovery: notwithstanding a statute's fee-shifting language, few courts or arbitrators will be willing to award what might be $100,000 or more in attorneys' fees for a case that was never valued at more than $10,000.

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97 *Id*. at 103.

98 161 P.3d 1000 (Wash. 2007).

99 *Id*. at 1008.

100 558 F.3d 225, 228–30 (3d Cir. 2009).

101 *See also* Lowden v. T-Mobile USA, Inc., 512 F.3d 1213, 1221 n.3 (9th Cir. 2008) ("Unlike the Third Circuit's conclusion as to the applicable state law in *Gay*, we determine that the Washington Supreme Court in *Scott* does not hold 'that an agreement to arbitrate may be unconscionable simply because it is an agreement to arbitrate.'") (internal quotation marks omitted).

Reasonable courts understand this,[102] and attorneys' fees case law supports the point.[103]

As the First Circuit explained in the antitrust case *Kristian v. Comcast Corp.*, "[i]n any individual case, the disproportion between the damages awarded to an individual consumer antitrust plaintiff and the attorney's fees incurred to prevail on the claim would be so enormous that it is highly unlikely that an attorney could ever begin to justify being made whole by the court."[104] The upshot is that no sensible attorney would form a business plan based on bringing small claims on an individual basis in the hopes that a court (or arbitrator) might award attorneys' fees proportionate to the complexity of the case.

Companies' arguments regarding regulatory enforcement are subject to a similar response.[105] Contrary to the assertion that federal and state agencies provide a meaningful alternative to class actions, most enforcement agencies are overwhelmed, underfunded, and incapable of prosecuting any significant percentage of the cases brought to them—let alone a significant percentage of all potential claims.[106] These agencies may have only limited authority under the governing statute,[107] and they often view private en-

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102 *See, e.g.*, Kristian v. Comcast Corp., 446 F.3d 25, 58–59 (1st Cir. 2006); Cooper v. QC Fin. Servs., Inc., 503 F. Supp. 2d 1266, 1289 (D. Ariz. 2007) ("There is no indication that 'attorney fees are an adequate substitute for the class action' mechanism or that they ameliorate the problems posed by such class-action waivers.") (quoting Discover Bank v. Super. Ct., 113 P.3d 1100, 1110 (Cal. 2005)); Laster v. T-Mobile USA, Inc., 407 F. Supp. 2d 1181, 1191–92 (S.D.Cal. 2005); Muhammad v. County Bank of Rehoboth Beach, Del., 912 A.2d 88, 100 (N.J. 2006); Vasquez-Lopez v. Beneficial Or., Inc., 152 P.3d 940, 951 (Or. Ct. App. 2007).

103 *See, e.g.*, Hensley v. Eckerhart, 461 U.S. 424, 434-37, 103 S. Ct. 1933, 1940–42 (1983) (stating a district court is vested with broad discretion to reduce a fee award based on the results obtained); F.H. Krear & Co. v. Nineteen Named Trustees, 810 F.2d 1250, 1264 (2d Cir. 1987) (noting the "general rule" that New York courts "will rarely find reasonable an award to a plaintiff that exceeds the amount involved in the litigation."); James v. Thermal Master, Inc., 562 N.E.2d 917, 920 (Ohio Ct. App. 1988) (affirming trial court's decision to reduce attorneys' fee in light of small jury award).

104 *Kristian*, 446 F.3d at 59 n.21.

105 *See* Sternlight & Jensen, *supra* note 31, at 91–92.

106 Gentry v. Super. Ct., 165 P.3d 556, 42 Cal. 4th 443, 464–65 (Cal. 2007) ("[A] deluge of claims would simply outstrip the resources of the [Department of Labor Standards Enforcement] . . . impacting not only these claimants but others unrelated to this suit.") (quoting from declaration of former state regulatory official submitted in another case); S.D.S. Autos, Inc. v. Chrzanowski, 976 So. 2d 600, 610 (Fla. Dist. Ct. App. 2007) (stating "public enforcement resources are necessarily limited"); *Vasquez-Lopez*, 152 P.3d at 950 (stating "the amount of consumer fraud in the state far exceeds the Department of Justice's ability to investigate and prosecute it."); *see also* Ting v. AT&T, 182 F. Supp. 2d 902, 919–20 (N.D. Cal. 2002) (rejecting argument that class members could obtain adequate remedy through the Federal Communications Commission), *rev'd in part but aff'd as to unconscionability*, 319 F.3d 1126 (9th Cir. 2003).

107 *See, e.g.*, *Vasquez-Lopez*, 152 P.3d at 950.

forcement as an important corollary to government enforcement. In most cases, the argument that regulatory litigation is sufficient is also inconsistent with clear legislative intent to allow for private enforcement of consumer and employee protections.[108] For these reasons, corporate defendants' regulatory enforcement argument has been rejected by several courts.[109]

III. Conclusion

The enforceability of class action bans in mandatory arbitration clauses remains one of the most hotly contested issues in all of consumer and employee litigation. An increasing number of courts have held such bans unenforceable under a variety of theories, but exculpatory clauses are too valuable for corporate defendants to have given up the fight. Notwithstanding companies' efforts to defend these clauses with renewed FAA preemption arguments and revised contract terms, consumer and employee plaintiffs have strong arguments that class action bans are unenforceable under most states' generally applicable contract law.

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108 *See, e.g.*, *Kristian*, 446 F.3d at 59 ("When Congress enacts a statute that provides for both private and administrative enforcement actions, Congress envisions a role for both types of enforcement. Otherwise, Congress would not have provided for both. Weakening one of those enforcement mechanisms seems inconsistent with the Congressional scheme."); *cf.* Scott v. Cingular Wireless, 161 P.3d 1000, 1006 (Wash. 2007) ("Private actions by private citizens are now an integral part of [Consumer Protection Act] enforcement.")

109 *See Kristian*, 446 F.3d at 59; *Ting*, 182 F. Supp. 2d at 919–20; *Gentry*, 42 Cal. 4th at 464–65; *S.D.S. Autos*, 976 So. 2d at 610; *Vasquez-Lopez*, 152 P.3d at 950.