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## LITIGATION

# Case Tests Validity of Class Action Waiver in Arbitration

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Nearly two years ago, the U.S. Supreme Court in *Green Tree Financial Corporation v. Bazzle* held that an arbitrator can certify a class when an arbitration agreement is silent or ambiguous on that issue. *Green Tree*, 539 U.S. 444 (2003). In so doing, the Supreme Court reversed a long line of federal courts' decisions that had generally ruled that plaintiffs cannot proceed as a class under agreements that are silent on the availability of class actions, unless both parties consent to such procedures. See, e.g., *Champ v. Siegel Trading Co.*, 55 F.3d 269 (7th Cir. 1995).

*Green Tree*, however, left unanswered the question of whether an express ban on classwide arbitration could be unenforceable as an unconscionable agreement under state law. That question has been the subject of great debate and discussion, and courts throughout the country have begun to render rulings on the issue. Several cases, including decisions from the California Court of Appeal, have held that a ban on class actions renders the arbitration agreement substantively unconscionable. See, e.g., *Szetela v. Discover Bank*, 97 Cal.App.4th 1094 (2002); *Leonard v. Terminix International Co.*, 854 So. 2d 529 (Ala. 2002); *Luna v. Household Finance Corp. III*, 236 F. Supp. 2d 1166 (W.D. Wash. 2002); *Mandel v. Household Bank (Nevada) National Association*, 105 Cal.App.4th 75 (2003) (relying on *Szetela* in concluding no-class-action provision is unconscionable), review granted, 132 Cal.Rptr.2d 525 (Cal. Apr. 9, 2003); *Ting v. AT&T*, 319 F.3d 1126 (9th Cir. 2003).

Numerous other jurisdictions, however, have upheld the validity of arbitration agreements against arguments contending they were invalid because they barred class actions. See, e.g., *Snowden v. Checkpoint Check Cashing*, 290 F.3d 631 (4th Cir. 2002) (arbitration agreement's bar to class actions was not unconscionable because plaintiff could potentially recover fees under applicable law); *Lloyd v. MBNA America Bank*, 27 Fed. Appx. 82 (3d Cir. 2002); *Marsh v. First USA Bank, N.A.*, 103 F. Supp. 2d 909 (N.D. Tex. 2000); *Vigil v. Sears National Bank*, 205 F. Supp. 2d 566 (E.D. La. 2002).

Last Thursday, the California Supreme Court heard oral arguments in *Discover Bank v. Superior Court*. One of the issues in *Discover Bank* is whether an arbitration agreement's waiver of class actions renders the agreement substantively unconscionable. This article concludes that upholding parties' agreement to waive class actions in arbitration comports with the text and the legislative history of the Federal Arbitration Act and Supreme Court decisions discussing the act. This article also concludes that there are compelling reasons why the procedural mechanism of a class action is not a good fit for the arbitral forum.

The interpretation of contracts is a state law question; therefore, arbitration agreements are interpreted under applicable state statutes. *Volt Information Sciences Inc. v. Board of Trustees of the Leland Stanford Jr. University*, 489 U.S. 468 (1989). As such, standard contract defenses such as fraud, duress or unconscionability can be applied to invalidate arbitration agreements. *Doctor's Associates Inc. v. Casarotto*, 571 U.S. 681 (1996).

These exceptions to enforceability correlate with Section 2 of the Federal Arbitration Act, which provides that arbitration agreements "shall be valid, irrevocable and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract." 9 U.S.C.A. Section 2. With respect to unconscionability claims in particular, the court has stated that the standards used to evaluate arbitration agreements must be the same as those used to examine other types of contracts. *Perry v. Thomas*, 482 U.S. 483 (1987).

Under California law, unconscionability has two elements, substantive and procedural. *Armendariz v. Foundation Health Psychare Services Inc.*, 24 Cal.App.4th 83 (2000). Both elements must be present before a contract is held to be unconscionable, though they need not be present in the same degree. State court decisions that have held as unconscionable arbitration clauses prohibiting class actions have done so on substantive unconscionability grounds. See, e.g. *Szetela*; *Leonard*.

These courts have reasoned that no class-action clause serves as a disincentive to defendants to stop bad business practices and grant them a "'get out of jail' free card while compromising important consumer rights." *Szetela*.

Courts that have held as unconscionable arbitration clauses prohibiting class actions have neglected to adequately address the text of or the legislative intent behind the Federal Arbitration Act. In *Szetela*, for example, the California Court of Appeal focused primarily on the benefits to the

defendant of the no class action provision and the supposed detriments to the plaintiff. The court assumed that, faced with a no class action clause, most plaintiffs would choose not to assert their claims in arbitration.

Based on this assumption, the Court of Appeal concluded that consumers have no effective forum in which to seek relief. This conclusion distorts the Federal Arbitration Act and U.S. Supreme Court decisions enforcing its provisions. The U.S. Supreme Court has repeatedly held that an arbitration agreement is valid "so long as the prospective litigant effectively may vindicate [his or her]" cause of action in the arbitral forum. *Gilmer v. Interstate/ Johnson Lane Corp.*, 500 U.S. 20 (1991). That the benefits of the forum may be slight does not, as courts such as *Szetela* seem to assume, render the arbitration agreement invalid.

Indeed, this judicial disregard for the adequacy of the arbitral forum is precisely what Congress sought to reverse in enacting the Federal Arbitration Act. See, e.g., *Rodriguez de Quijas v. Shearson/American Express Inc.*, 490 U.S. 477 (1989) (holding that "suspicion of arbitration as a method of weakening the protections afforded in the substantive law to would-be complainants, [is] far out of step with our current strong endorsement of the federal statutes favoring this method of resolving disputes"); *Metro East Center for Conditioning and Health v. Ouest Communications International Inc.*, 294 F.3d 924 (7th Cir. 2002) (arguments based on the costs of arbitration and preclusion of class actions are "the sort of litany the Federal Arbitration Act is supposed to silence").

Aside from inadequacy of a forum that does not permit class actions, courts such as *Szetela* have reasoned that the preclusion of class actions violates the public policy in favor of promoting judicial economy and streamlining litigation. This argument ignores Congress' intent in enacting the Federal Arbitration Act. Recognizing the act's policy of enforcing arbitration agreements, the Supreme Court has held that "while Congress was no doubt aware that the FAA would encourage the expeditious resolution of disputes, its passage 'was motivated, first and foremost, by a congressional desire to enforce agreements into which parties had entered.'" *Volt* (quoting *Dean Witter Reynolds Inc. v. Byrd*, 470 U.S. 213 [1985]); *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth Inc.*, 473 U.S. 614 (1985) (the primary concern of the legislature in enacting the statute was to enforce private agreements, which requires rigorous enforcement of arbitration agreements).

Accordingly, under the Federal Arbitration Act, courts must rigorously enforce the parties' agreement as they wrote it, "despite possible inefficiencies created by such enforcement" (*Champ*), and "even if the result is 'piece-meal litigation.'" *Bischoff v. DirecTV Inc.*, 180 F.Supp. 2d 1097 (2002).

Finally, there are compelling practical reasons why the class action procedure is simply not a good fit with the arbitral forum. For example, class actions have their genesis in Rule 23 of the Federal Rules of Civil Procedure, which complies with rigorous due process requirements before giving a class representative authority to bind absent class members. *Phillips Petroleum Co. v. Shutts*, 472 U.S. 797 (1985). Rule 23 of the Federal Rules of Civil Procedure and California's counterpart Section 382 of the Code of Civil Procedure are silent as to what rules would govern an arbitrator's exercise of authority over absent class members.

It was precisely this type of concern that led the California Supreme Court in *Broughton v. Cigna Healthplans*, 21 Cal.4th 1066 (1999), to hold that claims for injunctive relief under the Consumer Legal Remedies Act designed to protect the public from deceptive business practices were not subject to arbitration. Important to the court's analysis in *Broughton* was the fact that "the judicial forum has significant institutional advantages over arbitration in administering a public injunctive remedy, which as a consequence will likely lead to the diminution or frustration of the public benefit if the remedy is entrusted to arbitrators."

The Supreme Court in *Brougton* noted that "an arbitrator lacked the institutional continuity and the appropriate jurisdiction to sufficiently enforce and, if needed, modify a public injunction." *Cruz v. PacifiCare Health Systems Inc.*, 30 Cal.4th 303 (2003). The same type of conflict inheres in class action arbitrations, and, just as in *Broughton*, the "public statutory purpose" of class actions "transcends the private interest" in arbitration.

Whether the California Supreme Court will cease the opportunity in *Discover Card* to issue a ruling on the validity of class action waivers in arbitration clauses is unclear.

What is certain, however, is that no matter how the state high court rules, the debate is sure to rage on — until the U.S. Supreme Court issues a pronouncement on the matter.

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