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CLASS ACTION LITIGATION

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REPORT

While most courts have not gone so far as to hold that class action waivers in consumer arbitration agreements are *per se* unenforceable, some state courts have found that class action waivers in consumer contract arbitration provisions are, as a matter of law, void as against state public policy, according to attorneys Jeffrey J. Greenbaum and Jason L. Jurkevich.

''In view of these developments, sellers of consumer products and services may wish to re-evaluate their arbitration clauses and class action waivers, and if they wish to retain them, to determine whether they should be revised to make them more likely to survive judicial scrutiny,'' the authors suggest, and provide a guide for such an evaluation.

Of the various modifications that have been implemented to make no-class-action arbitration provisions more consumer-friendly, the authors observe that the one that has found most success is the provision that enables the consumer to opt out of arbitration within a specified period of time following purchase without having to rescind the purchase.

Class Action Waivers in Arbitration Agreements: Can They Survive?

By Jeffrey J. Greenbaum and Jason L. Jurkevich

Mandatory arbitration provisions are a common part of consumer contracts. Many arbitration clauses also have class action waivers whereby the consumer expressly agrees not to join or bring a claim as part of a class action. These provisions allow providers of consumer products and services to facilitate the resolution of disputes with customers on an individual basis, without the concern that class action litigation will exponentially increase the cost of settlement or resolution.

In recent years, several state and federal courts have refused to enforce mandatory arbitration provisions in consumer agreements involving relatively small-value claims, when enforcement of the arbitration provisions would preclude proceeding on a class-wide basis. These courts have concluded that requiring a plaintiff to forego a class action and arbitrate on an individual basis would discourage a consumer from pursuing a claim because the cost of pursuing the claim can outweigh the

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potential recovery, even where the claimant may be statutorily entitled to recover treble damages, costs and reasonable attorneys' fees. While most courts have not gone so far as to hold that class action waivers in consumer arbitration agreements are *per se* unenforceable, these several decisions put into question whether other courts will uphold these clauses, particularly where the value of the claims involved are small. At least a few state courts have gone even further, holding that class action waivers in consumer contract arbitration provisions are, as a matter of law, void as against state public policy.[1] Moreover, legislation has been introduced in Congress that would prohibit pre-dispute agreements requiring mandatory arbitration of consumer disputes. Among the findings and declarations in the proposed legislation is the observation that arbitration provisions in consumer contracts often contain clauses, such as class action waivers, that ''deliberately tilt the system against individuals.''[2] In light of the mounting challenges to consumer arbitration, one provider of alternative dispute resolution services has announced that it will no longer administer consumer arbitration services.[3]

In view of these developments, sellers of consumer products and services may wish to re-evaluate their arbitration clauses and class action waivers, and if they wish to retain them, to determine whether they should be revised to make them more likely to survive judicial scrutiny. The purpose of this article is to provide a guide for such an evaluation. It will: (i) review the reasoning of the courts that have struck down and those that have upheld class action waivers; (ii) look at how some attempts to modify class action waivers, such as opt-outs, fee-shifting and ''success'' premiums, have fared in the courts; and (iii) suggest some additional ideas for modifying or possibly replacing traditional binding arbitration provisions.

A. Why Certain Courts Don't Like Class Action Waivers in Arbitration Provisions

Under both federal law and most states' laws, resolution of disputes through arbitration is favored. The Federal Arbitration Act (FAA)[4] ''embodies the national policy favoring arbitration and places arbitration agreements on equal footing with all other contracts.''[5] Where arbitration provisions in consumer contracts are accompanied by class action waivers, however, courts are faced with a competing public policy favoring the use of the class action device for the large-scale resolution of small-value claims. As the United States Supreme Court has observed, ''[t]he 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.''[6]

Some courts have become increasingly concerned that arbitration provisions with class action waivers will act as *de facto* exculpatory clauses, allowing a company to escape liability for wrongful conduct because most consumers will not spend the resources required to pursue arbitration in order to recover a relatively small amount of money. As a result, certain courts have refused to enforce them, holding either that such clauses are unconscionable or that they are void as against public policy. Regardless of the precise legal grounds, the main concern driving these courts' conclusions is that individual plaintiffs, by and large, will not bother, or cannot afford, to spend the sums necessary to recover a small amount, thus allowing a company to escape liability for wrongful conduct.

Cases Overturning Class Action Waivers

Two cases illustrate the alternative approaches that courts have taken to reach similar results. In *Muhammad v. County Bank of Rehoboth Beach*,[7] the New Jersey Supreme Court held that a class action waiver in an arbitration provision that was contained in a ''pay day'' loan agreement was unconscionable and thus unenforceable. Concluding that the class action waiver constituted a contract of adhesion and thus bore hallmarks of ''procedural unconscionability,''[8] the court proceeded to hold that the class action waiver in the arbitration provision in the context of a small value claim — even trebled, the damages would be less than $600— was ''substantively unconscionable'' as well because it operated as a *de facto* exculpatory clause, shielding the defendant lender from liability under statutorily-imposed duties. First, as the court reasoned, without the possibility of proceeding on a class-wide basis, many ''rational'' claimants may forego their rights rather than spend time and resources on a small value claim. Second, without the class action mechanism with its notice requirements, many parties may never even realize that they have been harmed. Finally, small-value claims, if not pursued on a class-wide basis, are less likely to attract competent counsel, even where there is the possibility of recovering legal fees and treble damages.[9]

In contrast, in *Feeney v. Dell Inc.*,[10] the Supreme Judicial Court of Massachusetts rejected a class action waiver in a consumer contract arbitration provision because the prohibition contravened Massachusetts public policy.[11] Citing the Massachusetts consumer protection statute, which expressly provides for the maintenance of class actions,[12] the court found that the state has ''a strong public policy in favor of the aggregation of small consumer protection claims. . . . [The] class action prohibition undermines this policy and, in so doing, defeats 'the presumption' that arbitration provides 'a fair and adequate mechanism for enforcing statutory rights.' ''[13] Although the Massachusetts court in *Feeney* explicitly stated that its holding was not based on un-

[1] *Feeney v. Dell Inc.*, 908 N.E.2d 753 (Mass. 2009); *Fiser v. Dell Computer Corp.*, 188 P.3d 1215 (N.M. 2008); *Discover Bank v. Super. Ct. of Los Angeles*, 113 P.3d 1100 (Cal. 2005).

[2] S. 931, 111th Cong. § 2(7) (2009); H.R. 1020, 111th Cong. § 2(7) (2009).

[3] Press Release, Nat'l Arbitration Forum, National Arbitration Forum to Cease Administering All Consumer Arbitrations in Response to Mounting Legal and Legislative Challenges (July 19, 2009) (available at http://www.adrforum.com/newsroom.aspx?&itemID=1528&news=3).

[4] 9 U.S.C. § 1 *et seq.*

[5] *Buckeye Check Cashing Inc. v. Cardegna*, 546 U.S. 440, 443 (2006).

[6] *Amchem Prods. v. Windsor*, 521 U.S. 591, 617 (1997).

[7] 912 A.2d 88 (N.J. 2006).

[8] *Id.* at 97.

[9] *Id.* at 99-100.

[10] 908 N.E.2d 753 (Mass. 2009).

[11] *Id.* at 761.

[12] Mass. Gen. Laws ch. 93A, § 9(2).

[13] 908 N.E.2d at 762-763.

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conscionability,[14] its discussion as to why the class action waiver violates public policy closely follows that of the New Jersey Supreme Court in *Muhammad*.

In both cases, the state courts held that their decisions regarding the unenforceability of the class action waiver in the consumer arbitration agreement were not pre-empted by the FAA, which provides that agreements to arbitrate ''shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract,''[15] because their decisions, rooted in common law contract defenses of unconscionability and violation of public policy, were applicable to any contract, not just arbitration agreements.[16]

Other state and federal courts have reached similar conclusions. The highest courts in Alabama,[17] California,[18] Illinois,[19] New Mexico,[20] North Carolina,[21] Washington[22] and West Virginia[23] have struck down class action waivers on the grounds of unconscionability where the elimination of the class mechanism would make pursuit of the individual consumer's claim prohibitively expensive relative to the value of the claim. Additionally, a number of federal courts of appeal, including the First,[24] Second,[25] Third,[26] Fifth,[27] Ninth[28] and Eleventh[29] Circuits, have struck down certain class action waivers in arbitration agreements, usually relying on state law grounds of unconscionability or, as in one Second Circuit decision, on the theory that the class waiver in a credit card agreement with merchants would preclude them from vindicating their statutory right to be free from illegal tying agreements.[30] There, although not a consumer contract case, merchants claimed that the credit card company forced them to pay above-market discount rates for accepting its credit cards by illegally tying the credit cards to its traditional charge cards.[31] The Second Circuit applied similar reasoning as in consumer cases, concluding that ''the size of the recovery received by any individual plaintiff will be too small to justify the expenditure of bringing an individual action.''[32]

In addition, several federal circuit courts have struck down certain class action waivers in arbitration agreements, usually relying on state law grounds of unconscionability or, as in one Second Circuit decision, on the theory that the class waiver in a credit card agreement with merchants would preclude them from vindicating their statutory right to be free from illegal tying agreements.

Cases Upholding Class Action Waivers

Not every court faced with a class action waiver in a consumer arbitration agreement refuses to enforce it. In jurisdictions like Texas[33] and Delaware,[34] the ability to

[14] *Id.* at 761 n.25, 26.

[15] 9 U.S.C. § 2.

[16] 912 A.2d at 95; 908 N.E.2d at 768.

[17] *Leonard v. Terminix Int'l Co.*, 854 So.2d 529 (Ala. 2002) (arbitration clause unconscionable because it restricted plaintiffs to forum where expense of pursuing claim far exceeded amount in controversy).

[18] *Discover Bank v. Superior Court of Los Angeles*, 113 P.3d 1100, 1110 (Cal. 2005) (class action waivers are unconscionable ''at least under some circumstances,'' such as ''when the waiver is found in a consumer contract of adhesion in a setting in which disputes between the contracting parties predictably involve small amounts of damages'').

[19] *Kinkel v. Cingular Wireless LLC*, 857 N.E.2d 250 (Ill. 2006) (class arbitration waiver that required consumer to pay costs of arbitration was unconscionable).

[20] *Fiser v. Dell Computer Corp.*, 188 P.3d 1215 (N.M. 2008) (class waiver in consumer arbitration agreement was unconscionable because it violated fundamental state public policy, *i.e.*, opportunity for class relief).

[21] *Tillman v. Commer. Credit Loans, Inc.*, 655 S.E.2d 362 (N.C. 2008) (class action waiver in arbitration provision found in consumer loan agreement was unconscionable, considering totality of circumstances).

[22] *Scott v. Cingular Wireless*, 161 P.3d 1000 (Wash. 2007) (class action waiver that prevents consumers from pursuing valid claims, effectively insulating other side from liability from small claims, is unconscionable).

[23] *State ex rel. Dunlap v. Berger*, 567 S.E.2d 265, 282 (W.Va. 2002) (''provisions in a contract of adhesion that if applied would impose unreasonably burdensome costs upon or would have a substantial deterrent effect upon a person seeking to enforce and vindicate rights and protections or to obtain statutory or common law relief and remedies . . . under state law'' are unconscionable).

[24] *Skirchak v. Dynamics Research Corp.*, 508 F.3d 49 (1st Cir. 2007) (sustaining challenges to arbitration agreements containing class action waivers based upon Massachusetts state law principles of unconscionability).

[25] *In re Am. Express Litig.*, 554 F.3d 300 (2d Cir. 2009) (court struck down arbitration clause containing class action waiver as unenforceable).

[26] *Homa v. American Express Co.*, 558 F.3d 225 (3d Cir. 2009) (class arbitration waiver was unenforceable under New Jersey public policy); *but see Gay v. Creditinform*, 511 F.3d 369 (3d Cir. 2007) (refusing to invalidate arbitration clause with class action waiver under Pennsylvania law because state law was preempted by FAA).

[27] *Iberia Credit Bureau v. Cingular Wireless LLC*, 379 F.3d 159 (5th Cir. 2004) (holding class waiver unconscionable based on state contract principle of unconscionability).

[28] *Chalk v. T-Mobile USA*, 560 F.3d 1087 (9th Cir. 2009) (arbitration agreement's class-action waiver was substantively unconscionable and unenforceable under Oregon law based on unilateral nature of waiver and resulting disincentive to litigate); *Lowden v. T-Mobile USA*, 512 F.3d 1213 (9th Cir.), *cert. denied*, ___ U.S. ___, 129 S. Ct. 45 (2008) (class action waiver unconscionable under Washington state law); *Shroyer v. New Cingular Wireless Servs., Inc.*, 498 F.3d 976 (9th Cir. 2007) (class action waiver unconscionable under California law).

[29] *Dale v. Comcast Corp.*, 498 F.3d 1216 (11th Cir. 2007) (class action waiver in cable television subscription agreement unconscionable under Georgia law).

[30] *In re Am. Express*, 554 F.3d at 320.

[31] *Id.* at 307-308.

[32] *Id.* at 320.

[33] *AutoNation USA Corp. v. Leroy*, 105 S.W.3d 190, 200 (Tex. App. 2003) (no entitlement to proceed as class action under Texas law).

[34] *Edelist v. MBNA Am. Bank*, 790 A.2d 1249 (Del. Super. 2001). At least one federal district court has disagreed with the holding in *Edelist* and concluded that a class action waiver in

pursue small claims on a class basis is not a fundamental public policy that trumps the validity of parties' contractual agreements to arbitrate. In Utah, a statute specifically allows for class action waivers in consumer credit agreements.[35] In *Walther v. Sovereign Bank*,[36] the Maryland Court of Appeals, upholding a class action waiver in a mortgage loan agreement, criticized opinions that struck down similar provisions as ''giv[ing] short shrift'' to the strong public policy favoring the enforcement of arbitration provisions.[37] Several federal courts have similarly upheld class action waivers involving federal statutory claims, holding that requiring plaintiffs to arbitrate did not prevent them from vindicating their statutory rights.[38] Many cases look to the factual circumstances and the nature of the claims.

Cases Finding Potential Damages Sufficiently Substantial to Uphold Class Action Waivers

Additionally, some courts have held that, under the circumstances of a particular case, a plaintiff's potential damages were substantial enough that the cost of individual arbitration would not deter most consumers from pursuing their claims. The Eighth Circuit upheld a class action waiver in the terms and conditions that accompanied a pre-paid gift card, holding that the waiver was not unconscionable under Missouri law. The arbitration provision at issue did not limit the card holder's entitlement to punitive or exemplary damages or counsel fees. Under the Truth-in-Lending Act, the plaintiff could recover statutory damages of $2,000, costs and fees in addition to actual damages (of about $45). Consequently, the potential recovery ''would likely exceed the costs of pursuing her claim.''[39] Similarly, in *Carideo v. Dell Inc.*,[40] a federal district court in Washington held that a class action waiver was not unconscionable under Washington law, where the damages at issue — between $1,300 and $1,700 for each allegedly defective computer, in addition to the availability of statutory and punitive damages and an award of attorneys' fees — were not unreasonably small in relation to the likely cost of pursuing claims individually.[41] The court in *Carideo* distinguished the case from the Washington Supreme Court's decision in *Scott v. Cingular Wireless*,[42] which struck the class action waiver in a cellular service agreement. Unlike the potential damages in *Carideo*, the damages in *Scott* did not exceed $45 per claimant.[43]

Different courts may reach opposing conclusions as to whether a particular amount of damages is high enough to avoid a finding of unsconscionability. In *Davis v. Dell Inc.*,[44] a New Jersey federal district court held that potential damages between $1,000 and $3,000 for each potential plaintiff were substantial enough to enforce a no-class action arbitration provision in a case involving the New Jersey Consumer Fraud Act (which provides for treble damages and reasonable attorneys' fees).[45] In contrast, in *Cohen v. DIRECTV*,[46] a case brought under California's consumer protection statute (which similarly provides for treble damages and counsel fees),[47] a California appellate court concluded that $1,000 may not be considered by many consumers of satellite television as sufficient to warrant individual litigation.[48]

B. What Some Companies Are Doing to Preserve Class Action Waivers

In response to the increasing number of decisions refusing to enforce class action waivers in consumer arbitration agreements, several companies have sought to revise their agreements so as to alleviate those factors that resulted in court decisions finding them unconscionable.

''Opt Out'' Provisions

One of the more successful modifications of consumer arbitration agreements containing class action waivers to withstand claims of unconscionability is a clause that enables consumers to opt out of the arbitration provision altogether within a certain amount of time following the purchase. Many courts that have passed on arbitration provisions with an ''opt-out'' clause have ruled that the consumer's ability to choose whether or not to submit to individual arbitration is sufficient to alleviate issues of unsconscionability raised by typical contracts of adhesion. In *Guadagno v. E*Trade Bank*,[49] for example, because the customer had an opportunity to notify the bank of her decision to opt out of the arbitration provision within 60 days after executing the Account Agreement, the arbitration provision and class action waiver were not presented ''on a take it or leave it basis'' and were therefore not unconscionable.[50] In *Honig v. Comcast of Ga. I, LLC*,[51] the court stated that the ''opt-out'' provision was one of the ''most important[]'' differences between the arbitration provision at issue, which was upheld, and earlier versions that had been deemed unconscionable.[52] As explained by a federal district court in Arkansas, ''[a]lthough the parties may have unequal bargaining power, the effects of that inequality are ameliorated by the opt-out clause.''[53]

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an arbitration provision contained in a credit card agreement would be unenforceable under Delaware law. *See Caban v. J.P. Morgan Chase & Co.*, 606 F. Supp.2d 1361, 1370-71 (S.D.Fla. 2009).

[35] Utah Code Ann. § 70C-4-105.

[36] 872 A.2d 735 (Md. 2005).

[37] *Id.* at 751.

[38] *Johnson v. W. Suburban Bank*, 225 F.3d 366, 373-378 (3d Cir. 2000) (no ''irreconcilable conflict'' between Truth in Lending Act or Electronic Fund Transfer Act and class waiver in arbitration agreement); *Randolph v. Green Tree Fin. Corp.*, 244 F.3d 814, 818 (11th Cir. 2001) (''Congress did not intend to preclude parties from contracting away their ability to seek class action relief under [Truth in Lending Act]'').

[39] *Pleasants v. Am. Express Co.*, 541 F.3d 853, 859 (8th Cir. 2008).

[40] 520 F. Supp.2d 1241 (W.D.Wash. 2007).

[41] *Id.* at 1247.

[42] 161 P.3d 1000 (Wa. 2007).

[43] *Id.* at 1002.

[44] No. 07-630, 2008 U.S. Dist. LEXIS 62490 (D.N.J. Aug. 15, 2008).

[45] *Id.* at *12. *See also N.J.S.A.* § 56:8-19.

[46] 142 Cal. App. 4th 1442 (2d Dist. 2006).

[47] *Id.* at 1445. *See also* Cal. Civ. Code § 1780.

[48] *Id.* at 1452.

[49] 592 F. Supp.2d 1263 (C.D.Cal. 2008).

[50] *Id.* at 1270.

[51] 537 F. Supp. 2d 1277 (N.D. Ga. 2008).

[52] *Id.* at 1289.

[53] *Magee v. Advanced Am. Servicing of Ark., Inc.*, No. 08-6105, 2009 U.S. Dist. LEXIS 27903, *23 (W.D.Ark. April 1, 2009).

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One of the more successful modifications of consumer arbitration agreements containing class action waivers to withstand claims of unconscionability is a clause that enables consumers to opt out of the arbitration provision altogether within a certain amount of time following the purchase.

In some instances, however, the arbitration provision does not allow the consumer simply to opt out of arbitration but, rather, provides the consumer with a period of time to elect to rescind the purchase or close an account. In other words, if consumers do not want to abide by the terms of the arbitration provision, they do not get the benefit of the product or service. Consumers usually have a period of several weeks following the purchase to make such a decision. In such cases, depending on the circumstances, some courts have upheld such provisions as providing a meaningful choice to consumers, while others have questioned whether the arrangement was any different than a typical ''take it or leave it'' offer.[54]

Some credit card companies have tried a ''hybrid'' approach to the opt-out provision: If card holders notify the bank that they do not want to accept the arbitration provision, they are entitled to use the card until the later of the current membership year or the expiration date on the card.[55] At least one federal district court in Kentucky held that approach sufficient to provide its card members with a ''meaningful choice'' whether or not to accept arbitration.[56] In a different case involving a similar provision, the Ninth Circuit believed there was a factual issue whether the bank's ''instructions for non-acceptance'' provision provided enough of a meaningful opportunity to opt out to be enforceable.[57]

Some consumer advocates have argued that even an opt-out provision that is not contingent on returning the product or service, but which must be exercised within a specified period following purchase, does not provide enough of a meaningful choice because the average consumer may not read all the terms and conditions that accompany the product or service, or may not know enough about arbitration to make an informed choice.[58] In contrast, one commentator has observed that ''ignorance, or worse, apathy, has almost never been held a defense to a freely entered contract in which the party had a legitimate option.''[59] At least to date, that view — that the consumer has meaningful choice — is the prevailing view in the courts.

Cost and Fee-Shifting

Another common modification in arbitration provisions containing class action waivers provides that the company will pay all of the costs of the arbitration (as long as the claim is not found to be frivolous) and, in some cases, pay the consumer's counsel fees if he or she prevails.

Another common modification in arbitration provisions containing class action waivers provides that the company will pay all of the costs of the arbitration (as long as the claim is not found to be frivolous) and, in some cases, pay the consumer's counsel fees if he or she prevails.

These types of arbitration provisions have met with mixed success in court. Courts which have enforced arbitration provisions with a class action waiver along with some kind of fee-shifting or enhanced damages provision tend to focus on the ability of the consumer to pursue a claim individually in a cost-effective manner. Thus, in *Stephens v. Wachovia Corp.*,[60] the plaintiff failed to prove that the cost of pursuing her individual claim in arbitration would be prohibitive where the bank agreed to pay all of the plaintiff's arbitration fees in excess of $125, which was not excessive relative to the amount of her damage claim of $420.[61] In *Wachovia*, the absence of any counsel fee-shifting provision was immaterial because such fees would have been unavailable in litigation anyway.[62] Similarly, in *Davidson v. Cingular Wireless LLC*,[63] the court upheld an arbitration provision that prohibited class actions but provided that the wireless carrier would pay all costs of an arbitration not found to be frivolous and twice the amount of reasonable attorneys' fees incurred by the consumer if she was awarded an amount greater than the carrier's last settlement offer.

The courts that find arbitration provisions with class action waivers unconscionable notwithstanding the in-

[54] *Compare Cicle v. Chase Bank USA*, 583 F.3d 549 (8th Cir. 2009) (amendment to credit agreement providing for class waiver that was deemed accepted unless card holder closed account was not procedurally unconscionable) *with Davis v. Chase Bank USA*, 299 Fed. Appx. 662, 664 (9th Cir. 2008) (amendment to credit agreement providing for class waiver that was deemed accepted unless card holder closed account was procedurally unconscionable; characterizing amendment as ''opt-out'' provision ''does not change the fact that it was given on a 'take it or leave it' basis'').

[55] *Hoffman v. Citibank (South Dakota) N.A.*, 546 F.3d 1078, 1080-81 (9th Cir. 2008).

[56] *Eaves-Leanos v. Assurant Inc.*, No. 07-CV-18-S, 2008 U.S. Dist. LEXIS 1460 (W.D.Ky. Jan. 8, 2008).

[57] *Hoffman*, 546 F.3d at 1085.

[58] Jeffrey W. Stempel, *Mandating Minimum Quality In Mass Arbitration*, 76 U. Cin. L. Rev. 383, 432 (2008).

[59] Ramona L. Lampley, *Is Arbitration Under Attack?: Exploring the Recent Judicial Skepticism of the Class Arbitration Waiver and Innovative Solutions to the Unsettled Legal Landscape*, 18 Cornell J.L. & Pub. Pol'y 477, 511 (2009).

[60] No. 06-246, 2008 U.S. Dist. LEXIS 31949 (W.D.N.C. Mar. 7, 2008).

[61] *Id.* at *16, *20.

[62] *Id.* at *20.

[63] No. 06CV00133-WRW, 2007 U.S. Dist. LEXIS 21040 (E.D.Ark. Mar. 23, 2007).

clusion of cost and fee-shifting focus on whether the provisions continue to operate as *de facto* exculpatory clauses. In *Scott v. Cingular Wireless*,[64] the Washington Supreme Court struck down an arbitration provision with a class waiver which provided that the wireless carrier would pay all administrative costs of the arbitration and would also reimburse the claimant's reasonable counsel fees if he or she recovered at least the amount of the demand. The court held that the cost and fee-shifting provision was not sufficient to remove the economic obstacles to seeking individual relief through arbitration. Under the provision, if the claimant recovered 99 percent of her claim, she would not be entitled to recover legal fees. Even if she did recover the full amount of her demand, an arbitrator may consider the amount in controversy when awarding fees, and if the amount in dispute is small, the claimant may not recover the full amount of her fees. Both of these factors served as disincentives for attorneys to take on such small-value cases individually through arbitration. As a result, the class action waiver acted as an exculpatory clause.[65]

''Success'' Premiums

In addition to paying all the costs of arbitration and reimbursing legal fees to successful claimants, one wireless phone service provider has also provided for a ''success'' premium if the consumer recovers more in arbitration than the provider's last settlement offer, including minimum damages between $5,000 and $10,000 and reimbursement of double the amount of the claimant's reasonable counsel fees. Like more tradition fee-shifting provisions, these ''success'' premiums have also met with mixed success in court. California courts, in particular, have routinely refused to enforce such provisions. In *Steiner v. Apple Computer Inc.*,[66] a wireless carrier argued that its ''customer friendly'' arbitration provision — which provided for payment of all arbitration costs (except for a frivolous claim) plus a success premium of $7,500 and double attorneys' fees if the consumer was awarded more than the carrier's last settlement offer — ameliorated any issues of unconscionability. The carrier argued that, given the availability of the significant premiums, it was more likely to settle with consumers for the full value of their claim. Consequently, consumers would obtain full relief at little or no cost to themselves. The district court rejected that argument, concluding that the availability of enhanced damages and double counsel fees were ''illusory.'' The carrier only had to settle with a small percentage of consumers until, at some point, other customers would believe that ''the only likely *potential* recovery available through arbitration would be the $114.95 [the actual damages], but not the [success] Premium.''[67] Without the availability of the premium, most consumers would not even make the ''allegedly minimal effort to arbitrate'' unless they had the time, resources or inclination to seek only $115.[68] As a result, the class action waiver still operated as a *de facto* exculpatory clause and was thus unconscionable. The deciding factor for the *Steiner* court was not whether the cost of pursuing a claim individually would exceed the recovery but, rather, whether the class action waiver would result in most consumers not bothering to make an effort to pursue their claims.

In contrast, in *Laster v. T-Mobile USA Inc.*,[69] another California federal court faced with the same arbitration provision found that the incentive on the carrier to settle claims for full value at the outset of the dispute, rather than face the potential of having to pay the success premiums, was a sufficient incentive to consumers to pursue their claims individually rather than through a class action, where individual recoveries would likely be significantly less.[70] Nevertheless, the court in *Laster* still held that the class action waiver was unconscionable because, without the public notice provided by a class action, thousands of customers who were unaware of the alleged wrongdoing would never seek redress. As a result, according to that court, the arbitration provision was not an adequate substitute for a class action as a deterrent of wrongdoing.[71]

In contrast to those courts, in *Francis v. AT&T Mobility LLC*,[72] a Michigan federal district court upheld the same ''consumer-friendly'' arbitration provision and class action waiver. The *Francis* court criticized *Steiner*'s characterization of the premiums offered by the carrier as illusory, agreeing instead with *Laster* that the premiums further ''the goal of informally resolving billing disputes before they reach arbitration.''[73] Moreover, the state attorney general still had the power to deter allegedly wrongful behavior through administrative enforcement actions.[74]

C. Is There a Future for Consumer Arbitration?

There is no simple solution for consumer products and services companies seeking to preserve the enforceability of class action waivers in their standard form arbitration provisions. While there are a few jurisdictions where the enforceability of class action waivers is likely, such as Texas and Utah, a choice of law provision calling for the application of one of those state's laws is no guarantee that a court in another forum will uphold that choice of law. Though courts commonly respect contractual choice of law provisions, following the *Restatement* approach, they may refuse to do so if the chosen state has no substantial relationship to the parties or transaction, or if the application of the chosen law would be contrary to a fundamental policy of a state with a materially greater interest in the determination of the issue and whose law would apply in the ab-

[64] 161 P.3d 1000 (Wash. 2007).
[65] *Id.* at 1007.
[66] 556 F. Supp. 2d 1016 (N.D.Cal. 2008).
[67] *Id.* at 1030 (emphasis in original).
[68] *Id.*
[69] No. 05-1167, 2008 U.S. Dist. LEXIS 103712 (S.D.Cal. Aug. 11, 2008), *aff'd sub. nom. Laster v. AT&T Mobility LLC*, No. 08-56394, 2009 U.S. App. LEXIS 23599 (9th Cir. Oct. 27, 2009).
[70] *Id.* at *33-*36. The Ninth Circuit apparently disagreed with the district court, stating that ''a person normally will not find it worth the time or the hassle to try to recover such a small amount, even if that person spends no money to hire an attorney or to invoke the arbitration process.'' *Laster v. AT&T Mobility*, 2009 U.S. App. LEXIS 23599, at *14 n.8.
[71] *Id.* at *37-*43.
[72] No. 07-14921, 2009 U.S. Dist. LEXIS 12578 (E.D. Mich. Feb. 18, 2009).
[73] *Id.* at *26.
[74] *Id.* at *26-*27. *See also Strawn v. AT&T Mobility LLC*, 593 F. Supp. 2d 894 (S.D. W. Va. 2009) (upholding ''customer friendly'' arbitration agreement with class action waiver).

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sence of the contractual choice of law provision.[75] Even where a company can establish a substantial relationship with a sympathetic forum, courts in jurisdictions where class action waivers have not fared as well have not hesitated to ignore a choice of law provision on the grounds that enforcing it would result in enforcement of the class action waiver, which would contravene a fundamental policy of the forum state. Because the forum state is often the plaintiff's home state, those courts conclude that the forum state has a materially greater interest in ensuring that its citizens are able to vindicate their rights through a class action than the other state has in minimizing its resident companies' legal expenses.[76] Thus, if a court believes that a class action waiver is unconscionable, a choice of law provision will not necessarily change the outcome. Some companies have incorporated a provision calling for application of the law of the customer's home state. While such a provision does not guarantee the enforceability of class action waivers, it can prevent consumers from forum-shopping in consumer-friendly states.[77]

Of the various modifications that have been implemented to make no-class-action arbitration provisions more consumer-friendly, the one that has found most success is the provision that enables the consumer to opt out of arbitration within a specified period of time following purchase without having to rescind the purchase. That type of provision will undoubtedly become more common in arbitration provisions going forward. While consumers may still argue that providing an opt-out period that expires shortly after purchase does not provide a meaningful choice to most consumers, who either may not read the terms and conditions or may not understand the differences between litigation and arbitration, consumers with meaningful choices are frequently held to the terms of their agreements.

Sometimes when these clauses are invalidated, companies may be faced with what they consider the worst of both worlds, being forced into class-wide arbitration. In some cases, courts have severed the class action waiver, which was held to be unenforceable, and upheld the remainder of the arbitration provision. For example, in *Muhammad v. County Bank of Rehoboth*, the New Jersey Supreme Court held that the plaintiff had to arbitrate her claims, but could do so on a class-wide basis.[78] Companies tend to be averse to class arbitration, believing that it combines the disadvantages of class action litigation—enormous exposure to damages, class counsel fees and substantial defense costs—with the disadvantages of arbitration, *i.e.,* no set rules on discovery or admissibility of evidence and extremely limited opportunity for appellate review.[79] The U.S. Supreme Court has been asked to decide whether imposing class-wide arbitration on parties whose contract is silent on that issue is consistent with the FAA.[80] Regardless of how that case may be decided, in order to minimize the chances of being thrust into class arbitration, companies should include clauses stating that the class action waiver is not severable from the remainder of the arbitration agreement. Thus, a judicial determination that the class action waiver is unenforceable will negate the agreement to arbitrate, as the Ninth Circuit recently held.[81] If a company is forced to face a class action, it will at least have the benefits of the rules of civil procedure, evidence and appellate review.

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Pending legislation in Congress could threaten not only the enforceability of class action waivers in consumer arbitration agreements, but the enforceability of virtually all consumer arbitration agreements. The Arbitration Fairness Act of 2009 would prohibit all predispute arbitration agreements relating to consumer, franchise, civil rights or employment disputes (other than in collective bargaining agreements).[82] The prospects for this legislation are not clear. A previous attempt to pass similar legislation during the last Congress ended at the committee stage. Delaware, Texas and Utah — the three states that are most often associated with the enforceability of arbitration agreements with class action waivers — are all represented on the Senate Judiciary Committee, and Texas and Utah are also represented in the House Committee on the Judiciary. On the other hand, the current White House and Democratic-controlled Congress may be more sympathetic to this legislation.

If Congress were to pass the pending legislation in its current form, consumer products and services companies would have to radically re-think their approach to

[75] *Restatement (Second) Conflict of Laws* § 187.

[76] *See, e.g., Feeney v. Dell*, 908 N.E.2d 753, 766-767 (Mass. 2009); *Homa v. American Express Co.*, 558 F.3d 225, 232 (3d Cir. 2009).

[77] *See Halprin v. Verizon Wireless Svc's LLC*, No. 07-4015, 2009 U.S. Dist. LEXIS 41149 (D.N.J. May 13, 2009) (court upheld Virginia choice of law, which would enforce class waiver, since plaintiff was Virginia resident and purchased and used cell phones in Virginia); *McGinnis v. T-Mobile USA, Inc.*, No. C08-106Z, 2008 U.S. Dist. LEXIS 65779 (W.D. Wash. July 22, 2008) (Georgia law applied to Georgia plaintiff).

[78] 912 A.2d at 103.

[79] Plaintiffs' lawyers may also want to avoid class arbitration because an arbitrator's freedom from strict compliance with the law may affect the size of a counsel fee award, and plaintiffs would similarly be limited in their ability to seek judicial review.

[80] *Stolt-Nielsen S.A. v. Animalfeeds Int'l Corp.*, 548 F.3d 85 (2d Cir. 2008), *cert. granted*, ___ U.S. ___, 129 S. Ct. 2793 (2009). The order appealed from in *Stolt-Nielsen* (which was not a consumer case) vacated an arbitration panel's award on the grounds that the panel's decision to allow class arbitration where the parties' agreement was silent on that issue was in manifest disregard of the law. The Second Circuit reversed, holding that while it may not agree with the panel's decision, it did not rise to the level of manifest disregard of the law. *Stolt-Nielsen*, 548 F.3d at 87, 97. It is possible that the Supreme Court may issue a limited ruling, deciding only whether the arbitration panel manifestly disregarded the law in imposing class arbitration, but declining to decide whether, as a matter of law, class arbitration may be imposed in the absence of an express agreement.

[81] *Chalk v. T-Mobile USA, Inc.*, 560 F.3d 1087, 1098 (9th Cir. 2009).

[82] S. 931, 111th Cong. § 3(a) (2009); H.R. 1020, 111th Cong. § 4 (2009) (same).

dispute resolution with customers. In these circumstances, companies may want to consider opt-out provisions, with time limits after purchase for making such decisions, since an agreement that allows a consumer to choose litigation rather than arbitration is arguably not one that ''requires arbitration'' and therefore may not run afoul of the proposed law.

Alternatively, companies could include a contractual provision requiring a period for non-binding mediation before any lawsuit may be commenced. If companies pay all costs of mediation, and approach settlement from a perspective that seeks to fairly compensate consumers and their counsel for legitimate claims, consumers may come to realize that they (and their counsel) may well do better through such a process than they would through expensive and drawn out class litigation with uncertain chances of success. Companies would have to decide whether such models make economic sense for their businesses.

While the future of class action waivers and consumer arbitration is unclear, what is clear is that the next few years will bring new developments, new questions and new challenges.

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