

RECENT DEVELOPMENTS IN CLASS ACTION ARBITRATION

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I. INTRODUCTION

Class arbitration offers the benefits of the class action device with potential advantages not present in court litigation. Employers have less opportunity for delay in arbitration proceedings, where discovery is often limited, as are the grounds for judicial review. Arbitration providers, such as the American Arbitration Association (“AAA”) and JAMS, have class arbitration rules in place to govern the process. These rules track Federal Rule of Civil Procedure 23, and provide standards for class certification, class notice, and approval of settlements. Thus, class arbitration can be a viable alternative to class action litigation for employees subject to an enforceable arbitration agreement.¹

The law surrounding the availability of class arbitration continues to develop. The Federal Arbitration Act (“FAA”) applies to the FAA applies to all arbitration agreements in contracts involving interstate commerce, whether an action is brought in federal or state court. The FAA provides that arbitration agreements are valid and enforceable unless general contract principles provide grounds to render them unenforceable,² but is silent on the availability of class arbitration. The United States Supreme Court’s decision in *Green Tree Financial Corporation v. Bazzle*³ implies, however, that nothing in the FAA precludes class arbitration, even when the arbitration agreement does not specifically provide for it.⁴ Recent court decisions have come out

¹ Of course, the disadvantages must also be noted, such as no jury trial and much more narrow grounds for appeal of adverse decisions.

² See FAA, 9 U.S.C. § 2.

³ 539 U.S. 444 (2003).

⁴ *Green Tree* held that the arbitrator, not the court, should decide whether an arbitration agreement is indeed silent on the matter and therefore does not forbid class arbitration. See *id.* at 447, 452. In doing so, the Court recognized that class arbitration is available even where it is not specifically authorized in an agreement. See *id.* at 447, 452; see also *id.* at 454-55 (Justice Stevens’ concurrence, finding nothing in the FAA to preclude an arbitrator from finding class arbitrations permissible if not expressly prohibited by the applicable arbitration agreement).

both ways with respect to whether explicit bans on class arbitration are unenforceable due to their unconscionability. The California Supreme Court made clear in *Discover Bank v. Superior Court*⁵ that the FAA does not preclude California courts from finding class action waivers unenforceable and contrary to public policy. The Court will consider this term whether a pre-employment arbitration agreement that prohibits class actions in the wage and hour context is enforceable.⁶

Even though AAA and JAMS now have class arbitration rules, courts and arbitrators will continue to grapple with open issues regarding the proper scope of discovery, the rights of absent class members, the availability of injunctive relief,⁷ and the impact of class arbitration decisions on parallel court proceedings.

This presentation outlines recent developments in the continuing evolution of class arbitration, focusing on the validity of class action waivers in arbitration agreements under California law, and the availability of class proceedings when the arbitration agreement is silent on the matter. It also provides an overview of current class arbitration procedures.

II. CLASS ACTION WAIVERS IN ARBITRATION AGREEMENTS IN CALIFORNIA

While most disputes about the interpretation of arbitration agreements are left to the arbitrator, the courts determine certain “gateway” matters, including whether an agreement that prohibits class actions is enforceable.⁸ Arbitration agreements are presumed to be valid and enforceable under the FAA; however, courts can decline to enforce them when general contract defenses apply under state law.⁹ Several courts have declined to enforce arbitration agreements on the grounds that they are unconscionable. An agreement is unconscionable when there is an absence of meaningful choice on the part of one of the parties, combined with contract terms that are unreasonably favorable to the other party.¹⁰ Under California law, unconscionability has both a procedural and a substantive element.¹¹ The procedural element is shown by evidence of oppression and surprise, the inequality of bargaining power between the parties, and the absence of meaningful negotiation.¹² The substantive element focuses on whether the terms of the

⁵ 36 Cal.4th 148, 171 (2005).

⁶ See *Gentry v. Superior Court*, 37 Cal.Rptr.3d 790 (2006), review granted (2006).

⁷ See *Cruz v. PacifiCare Health Systems, Inc.*, 30 Cal.4th 303 (2003) (claims for injunctive relief to protect the general public under the California Unfair Competition Law, Bus. & Prof. Code §§ 17200, *et seq.*, are not subject to arbitration).

⁸ See *Discover Bank*, 36 Cal.4th at 171.

⁹ See *Ingle v. Circuit City Stores, Inc.*, 328 F.3d 1165, 1170 (9th Cir. 2003).

¹⁰ *Id.*

¹¹ *Armendariz v. Foundation Health Psychcare Services, Inc.*, 24 Cal.4th 83, 114 (2000).

¹² See *Ingle*, 328 F.3d at 1170.

agreement are unreasonably harsh or one-sided.¹³ The two prongs operate on a “sliding scale,” that is, “[t]he more substantively oppressive the contract term, the less evidence of procedural unconscionability is required to come to the conclusion that the term is unenforceable, and vice versa.”¹⁴

In June 2005, the California Supreme Court, in *Discover Bank v. Superior Court*, resolved a split of authority in California on the enforceability of class action waivers in consumer contracts. Previously, the Court of Appeal in *Szetela v. Discover Bank*¹⁵ held that an arbitration clause prohibiting class actions in a credit card agreement was unconscionable, while the Court of Appeal in *Discover Bank v. Superior Court*¹⁶ disagreed, holding that the FAA preempted the application of state substantive law to strike down an otherwise valid arbitration clause. The Supreme Court resolved this split, holding that the FAA does not prohibit California courts from refusing to enforce a class action waiver that is unconscionable.¹⁷ The Court further held that a class action waiver is both procedurally and substantively unconscionable, and therefore unenforceable, where it is a one-sided contract of adhesion that insulates one party from liability by making individual actions unlikely due to the small amount of damages per customer.¹⁸ *Discover Bank* has become the benchmark by which California courts now analyze class action waivers in arbitration agreements.

Several courts have applied *Discover Bank* to find similar class action waivers unconscionable. For example, in *Aral v. Earthlink, Inc.*, the court found “quintessential procedural unconscionability” where the “terms of a software agreement were presented on a ‘take it or leave it’ basis . . . with no opportunity to opt out.”¹⁹ In *Klussman v. Cross Country Bank*,²⁰ the court found that an arbitration clause in a credit card agreement was unconscionable because it implicitly waived class arbitration by designating disputes to be resolved by the National Arbitration Forum, whose rules prohibited class arbitrations without the affirmative consent of all parties. In addition, the court in *Independent Association of Mailbox Center Owners, Inc. v. Superior Court*²¹ found a franchise agreement banning class arbitration to be sufficiently adhesive to render the waiver unconscionable.

¹³ *Id.*

¹⁴ *Ingle*, 328 F.3d at 1171.

¹⁵ 97 Cal.App.4th 1094 (2002).

¹⁶ 129 Cal.Rptr.2d 393 (2003), *judgment reversed by Discover Bank, supra*, 36 Cal.4th 148.

¹⁷ *Discover Bank*, 36 Cal.4th at 163.

¹⁸ *Id.* at 161-163. In *Discover Bank*, the plaintiff alleged that defendant failed to adequately disclose that credit card customers making payments on the date they were due would be subject to an additional \$29.00 late fee if the payments were received after a certain time that day. The credit card agreement’s arbitration clause contained a class action waiver.

¹⁹ 134 Cal.App.4th 544, 557 (2005).

²⁰ 134 Cal.App.4th 1283 (2005).

²¹ 133 Cal.App.4th 396 (2005).

By contrast, both *Gentry v. Superior Court*²² and *Jones v. Citigroup, Inc*²³ distinguished *Discover Bank* and found no unconscionability where the defendants provided an opportunity to opt out after an extended waiting period. The California Supreme Court has granted review in both of these cases, signaling that the enforceability of class action waivers requires further clarification.²⁴

Of particular concern to the employment bar is *Gentry*, in which the California Court of Appeal for the Second Appellate District found that a class action waiver in a pre-employment arbitration agreement was enforceable. In *Gentry*, the Court of Appeal declined to find unconscionable a pre-employment dispute resolution agreement that prohibited class arbitrations. The plaintiff in *Gentry* sued his employer, Circuit City, for misclassifying him and others in the same position as exempt from California's overtime compensation requirements. Under the agreement, the employee agreed to resolve employment-related disputes through arbitration rather than in court, and prohibited the arbitrator in any such dispute from hearing the arbitration as a class action. The employee also received a form providing 30 days to opt out of the agreement, which the plaintiff did not do.

The court found the agreement neither procedurally nor substantively unconscionable. Under the court's analysis, procedural unconscionability was lacking because the arbitration agreement was not made a condition of employment, but rather plaintiff was given 30 days to opt out.²⁵ The court found it significant that the materials provided to the employee with the agreement explained the advantages and disadvantages of arbitration in straightforward language.²⁶ In addition, the court concluded that the class action waiver did not render the agreement substantively unconscionable, distinguishing it from the waiver in *Discover Bank*, where the disputes involved small

²² 37 Cal.Rptr.3d 790 (2006), review granted (2006).

²³ 38 Cal.Rptr.3d 461 (2006). In *Jones*, the court found no procedural unconscionability where the class action waiver in a credit card agreement's arbitration clause that allowed customers 26 days to opt out. The dissent found this situation to differ little from *Discover Bank* because, if the customer opted out, the credit card account would be terminated at the end of the current membership year or when the current card expired.

²⁴ The California Supreme Court remanded the Court of Appeal's decision in *Parrish v. Cingular Wireless, LLC*, 28 Cal. Rptr. 3d 802 (2005), for reconsideration in light of the *Discover Bank* decision. In *Parrish*, the Court of Appeal initially upheld the arbitration clause in a cell phone contract because it permitted customers to obtain relief in small claims court and required Cingular pay the costs of arbitration. The court did not find the prohibition on class actions unconscionable under these circumstances because it believed the agreement would not deter customers from pursuing small claims. However, upon reconsideration, the Court of Appeal reversed its decision and found the class action waiver unconscionable because it "operates to exculpate Cingular from responsibility for its own willful injury to a large class of consumers." *Parrish v. Cingular Wireless*, 2005 WL 2420719, *6 (2005).

²⁵ *Id.* at 793. The court distinguished this arbitration agreement from the one at issue in *Ingle v. Circuit City Stores, Inc.*, *supra*, in which the court found a class action waiver procedurally unconscionable because it denied the employee a meaningful opportunity to opt out of the arbitration agreement by providing only a three-day period in which to do so.

²⁶ *Id.* at 794.

amounts of individual damages that made it unlikely that the defendant would be held accountable for its wrongdoing. By contrast, the court found that the plaintiff had incentive to pursue his individual claims because he could recover substantial damages and penalties.²⁷ Notably, the court did not consider whether the terms of agreement were unreasonably harsh or one-sided, as is required under the substantive unconscionability analysis. The California Supreme Court's decision in *Gentry* will undoubtedly shape the future of employer's attempts to explicitly ban class arbitration.

III. THE AVAILABILITY OF CLASS ACTIONS IN ARBITRATION WHEN THE AGREEMENT IS SILENT ON THE MATTER

Under *Green Tree*, if an agreement does not explicitly ban class arbitration, then the arbitrator must decide whether, as a matter of contract interpretation, the agreement implicitly forbids it.²⁸ Prior to *Green Tree*, several federal cases held that class arbitrations are forbidden unless specifically authorized in the parties' arbitration clause.²⁹ The *Green Tree* decision implies that an arbitration clause that is silent on the subject does not necessarily preclude class arbitration. Subsequent court decisions have recognized this implication of *Green Tree*.³⁰

In response to *Green Tree*, both AAA and JAMS have adopted "clause construction" procedures in which the arbitrator must determine whether class arbitration is available under the arbitration clause.³¹ AAA class arbitration proceedings are not confidential and demands and awards are accessible on the AAA's website.³² A review of the AAA class arbitration docket reveals that the vast majority of clause construction determinations to date find in favor of the availability of class arbitration.

Most arbitrators apply straightforward principles of contract interpretation to make the clause construction determination. If the contract is unambiguous, its terms are given their plain and ordinary meaning. Often arbitration clauses will specify that they apply to "all claims" or "disputes" and will empower the arbitrator to award all available relief. Employment-related agreements may incorporate AAA National Rules for the Resolution of Employment Disputes, which empower the arbitrator to grant any remedy

²⁷ *Id.* at 794-795.

²⁸ 539 U.S. at 452.

²⁹ *See, e.g., Champ v. Siegel Trading Co.*, 55 F.3d 269, 274 (7th Cir. 1995) (upholding the lower court's refusal to certify a claim when the agreement was silent on issue of class arbitration). *But see Blue Cross v. Superior Court*, 67 Cal.App.4th 42 (1998) (finding class arbitration available despite an agreement's silence on the issue); *Sanders v. Kinko's, Inc.*, 99 Cal.App.4th 1106 (2002) (same).

³⁰ *See, e.g., Garcia v. DIRECTV, Inc.*, 115 Cal.App.4th 297, 304 n.4 (2004) ("Implicit in [*Green Tree v. Bazzle*] is the notion that, absent a class action waiver, classwide arbitration is proper under the FAA....").

³¹ *See* Rule 2, JAMS Class Action Procedures (Feb. 2005) accessible on the internet at http://www.jamsadr.com/rules/class_action.asp; Rule 3, Supplementary Rules for Class Arbitrations (Oct. 8, 2003) accessible at <http://www.adr.org/sp.asp?id=21936>.

³² AAA's class arbitration docket is accessible on the internet at <http://www.adr.org/sp.asp?id=25562>.

or relief deemed “just and equitable, including any remedy or relief that would have been available to the parties had the matter been heard in court.”³³ Such broad provisions unambiguously evince an intent to include class claims within the scope of arbitrable matters.³⁴ This is particularly the case where the arbitration agreement is governed under California law, which has expressly recognized the availability of class arbitration even where the agreement is silent on the matter, thereby raising a presumption in favor of class actions in the absence of any express waiver.³⁵

Even where an arbitration agreement is considered ambiguous on the availability of class arbitration, the contract must be construed *against* the drafting party.³⁶ This is particularly the case where the contract is one of adhesion, dictated to the weaker bargaining party on a take-it-or-leave-it basis.³⁷ Several AAA arbitrators have applied this well-settled principle of contract interpretation to find that the agreement at issue did not forbid class arbitration.³⁸ AAA arbitrators have also decided clause construction in favor of FLSA collective actions and statewide California wage and hour class actions.³⁹

IV. OVERVIEW OF CLASS ARBITRATION PROCEDURES

As noted above, both AAA and JAMS have published class arbitration rules that govern arbitration demands alleging class claims. This section summarizes major provisions of those rules.

A. Demand for Arbitration and Filing Fees

The initial demand for arbitration should expressly allege the claims for which class treatment is sought, and include the arbitration agreement under which the demand is brought. The AAA will administer demands for class arbitration where the arbitration

³³ AAA National Rules for the Resolution of Employment Disputes, Rule 34(d).

³⁴ *Cf. Mastrobucchi v. Shearson Lehman Hutton, Inc.*, 514 U.S. 52, 61 n. 7 (1995) (in deciding whether the arbitrator was authorized to award punitive damages, “it would seem sensible to interpret the ‘all disputes’ and ‘any remedy or relief’ phrases to indicate, at a minimum, an intention to resolve through arbitration any dispute that would otherwise be settled in court, and to allow the chosen dispute resolvers to award the same varieties and forms of damages or relief as a court would be empowered to award.”).

³⁵ *See Discover Bank*, 36 Cal.4th at 152 (“classwide arbitration . . . is well accepted under California law”), and at 157-158 (citations omitted); *Garcia*, 115 Cal.App.4th at 304 n.4 (“absent a class action waiver, classwide arbitration is proper. . .”).

³⁶ *See, e.g., Weil v. Fed. Kemper Life Assurance Co.*, 7 Cal.4th 125, 161 (1994).

³⁷ *See* Restatement (Second) Contract § 206, cmt. a.; *Maggio v. Winward Capital Management Co.*, 80 Cal.App.4th 1210 (2000).

³⁸ *See, e.g., Sidhu and GMRI*, AAA Case No. 11 160 02273 04 (June 10, 2005) at 2; *Olson and Rent-A-Center*, AAA Case No. 11 160 01831 04 (Oct. 21, 2005) at 1, 4; *Cole and Long John Silver’s Restaurant*, AAA Case No. 11 160 00194 04 (June 15, 2004) at 4. These decisions are accessible on AAA’s class arbitration docket at <http://www.adr.org/sp.asp?id=25562>.

³⁹ *See, e.g., Cole and Long John Silver’s Restaurants, Inc., supra* (FLSA collective action); *Sidhu and GMRI, Inc., supra* (California overtime class action).

agreement specifies resolution of disputed under any of the AAA rules, and is silent with respect to class claims, consolidation, or joinder of claims.⁴⁰ The AAA does not accept demands for class arbitration where the underlying agreement prohibits class claims, consolidation, or joinder, except where an order of a court directs the parties to submit their dispute to an arbitrator or to the AAA.⁴¹ The preliminary filing fee for a class arbitration demand is \$3,250, payable by the party making the demand. If the arbitrator determines that the class claims will proceed in the clause construction award, then a supplemental fee is calculated based on the amount demanded.⁴² The arbitrator has discretion to shift the fees based on the arbitration agreement or applicable law.⁴³

JAMS initially refused to enforce arbitration clauses that prohibited consumer and employee class actions, but reversed that policy to decide the issue on a case by case basis in each jurisdiction.⁴⁴

B. Arbitrator Selection

AAA requires one specialized class action arbitrator,⁴⁵ while selection of arbitrators for JAMS class arbitrations are the same as for any other arbitration proceeding.

C. Clause Construction Determination.

Both JAMS and AAA specifically require the arbitrator administering a demand for class arbitration to determine, as a threshold matter, whether the arbitration clause permits class arbitration.⁴⁶ The parties submit briefing and the arbitrator may hold a hearing on the matter. The general issues that arise at this stage are discussed above in Section III. Under both AAA and JAMS rules, the arbitrator may issue a partial, final award on clause construction that is subject to immediate court review. Under the AAA rules, the arbitrator must stay the arbitration for a period of at least 30 days to permit any party to move a court to confirm or to vacate the clause construction award.⁴⁷

⁴⁰ See American Arbitration Association Policy on Class Arbitrations (July 14, 2005) accessible on the internet at <http://www.adr.org/sp.asp?id=25967>.

⁴¹ *Id.*

⁴² See AAA Supplementary Rules for Class Arbitrations, Rule 11.

⁴³ *See id.*

⁴⁴ See March 10, 2005 press release accessible at http://www.jamsadr.com/press/show_release.asp?id=198.

⁴⁵ See AAA Supplementary Rules for Class Arbitrations, Rule 2(a) (at least one arbitrator must be selected from the AAA's national roster of class action arbitrators).

⁴⁶ JAMS Class Action Procedures, Rule 2; AAA Supplementary Rules for Class Arbitrations, Rule 3.

⁴⁷ AAA Supplementary Rules for Class Arbitrations, Rule 3.

D. Confidentiality

The presumption of confidentiality and privacy in arbitration proceedings does not apply to AAA class arbitrations. All class arbitration filings and hearings may be made public, subject to the arbitrator’s discretion under special circumstances.⁴⁸

E. Class Certification

The AAA and JAMS Rules track the requirements for class certification set forth in Federal Rule of Civil Procedure 23, including commonality, numerosity, maintainability, typicality and adequacy of representation.⁴⁹ The AAA rules require the arbitrator to set forth the class certification determination in a partial, final award subject to immediate court review, and to stay the arbitration proceedings for at least 30 days to permit any party to move a court to vacate or confirm the award.⁵⁰ By contrast, the JAMS rules leave it to the discretion of the arbitrator to set forth the determination in such a reviewable award.⁵¹

F. Class Notice

Both AAA and JAMS require that “best notice practicable” be provided to class members, informing them of the nature of the action, the definition of the class, the class claims and defenses, the binding effect of a class award, and that provides them with the opportunity to exclude themselves from the proceedings.⁵²

G. Final Award and Settlement

Both AAA and JAMS require the arbitrator to enter a reasoned, final award on class arbitration, whether or not favorable to the class, specifying the class members who were provided notice, who the arbitrator finds to be members of the class, and which class members opted out of the proceedings.⁵³ Both arbitration providers also require arbitrator approval of any settlement and notice to absent class members that provides an opportunity to opt out or object to the settlement.⁵⁴ Judicial review is highly deferential to the arbitrator, and an arbitration award will be vacated only if the conduct of the arbitrators violated the FAA, or an applicable state arbitration statute, or if the award itself is “completely irrational” or “constitutes manifest disregard of the law.”⁵⁵

⁴⁸ AAA Supplementary Rules for Class Arbitrations, Rule 9.

⁴⁹ JAMS Class Action Procedures, Rule 3; AAA Supplementary Rules for Class Arbitrations, Rule 4.

⁵⁰ AAA Supplementary Rules for Class Arbitrations, Rule 5.

⁵¹ JAMS Class Action Procedures, Rule 4(c).

⁵² JAMS Class Action Procedures, Rule 4; AAA Supplementary Rules for Class Arbitrations, Rule 6.

⁵³ JAMS Class Action Procedures, Rule 5; AAA Supplementary Rules for Class Arbitrations, Rule 7.

⁵⁴ JAMS Class Action Procedures, Rule 6; AAA Supplementary Rules for Class Arbitrations, Rule 8.

⁵⁵ *Coutee v. Barington Capital Group, L.P.*, 336 F.3d 1128, 1132 (9th Cir. 2003).

V. CONCLUSION

The courts and arbitration providers continue to shape the nature and scope of class arbitration. Recent decisions on the enforceability of class action waivers have gone both ways, and the California Supreme Court will soon resolve the *Gentry v. Superior Court* case, which could have longstanding implications for employees. AAA and JAMS have developed rules to govern the resolution of class arbitration, and arbitrators remain receptive to class arbitration where agreements are silent on the matter. However, there are still many grey areas about class arbitration procedures that require clarification.