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Using Arbitration to Eliminate Consumer Class Actions: Efficient Business
Practice or Unconscionable Abuse?

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[T]he prohibition on class actions will prevent class members from effectively vindicating their rights in certain categories of claims, especially those involving practices applicable to all members of the class but as to which any consumer has so little at stake that she cannot be expected to pursue her claim... And the only justification advanced for [the ban], that it will limit AT & T's cost of litigation, is insufficient to overcome numerous determinations by legislators and courts . . . that class action treatment offers the public a vehicle for vindicating legal rights when individual claims are not economically feasible. For all these reasons, the ban on class actions is substantively unconscionable.

Ting v. AT & T, 182 F. Supp. 2d 902, 930-31 (N.D. Cal. 2002)

Introduction

Companies are increasingly drafting arbitration clauses worded to prevent consumers from bringing class actions against the company either in litigation or in arbitration.³ Take a look at the form contracts you receive regarding your credit card, cellular phone, land phone,

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³ One author notes that evading class action liability may be one of companies' principal motivations in imposing arbitration. See Carroll E. Neesemann, *Should an Arbitration Provision Trump the Class Action? Yes: Permitting courts to strike bar on class actions in otherwise clean clause would discourage use of arbitration*, DISP. RESOL. MAG., Spring 2002, at 13. See also Edward Wood Dunham, *The Arbitration Clause as Class Action Shield*, 16 FRANCHISE L.J. 141 (1997) (urging franchisers to use arbitration to prevent class actions by franchisees); Alan S. Kaplinsky & Mark J. Levin, *Excuse Me, But Who's the Predator?: Banks Can Use Arbitration Clauses as a Defense*, BUS. L. TODAY, May/June 1998, at 24 (urging banks to use arbitration to prevent consumer class actions); Michael R. Pennington, *Every Health Insurer's Litigation Nightmare: A Case Study of How One Class Action Affected the Business of One Insurer*, 28 THE BRIEF 46, 52 (1999) (noting Alabama insurers are imposing arbitration to limit exposure to class actions); J.T. Westermeir, *How Arbitration Clauses Can Help Avoid Class Action Damages: Strategies for Managing Risks of Litigation*, 14 COMPUTER L. STRATEGIST 1 (1997) (discussing computer manufacturers' and internet service providers' use of arbitration to avoid class action liability).

insurance, mortgage, and so forth. Most likely, the majority of them include arbitration clauses, and many of those include prohibitions on class actions.⁴ Companies are seeking to use these clauses to shield themselves from class action liability, either in court or in arbitration.⁵

Companies' attempts to avoid class action exposure give rise to both legal and policy questions. From a legal standpoint, should this be and is it permitted under existing law? This Article will explain that while many courts have allowed companies to use arbitration clauses to elude class actions, an increasing number are striking such clauses as unconscionable.⁶ From the policy perspective, what should we make of companies' attempts to use arbitration clauses as a shield against class actions?⁷ Are these attempts an efficient business practice that will redound to the benefit of customers in general or are they an abuse of customers and the public at large? Similarly, how should we view the courts' regulation

⁴ One study found that thirty percent of the arbitration clauses examined contained explicit class action prohibitions. Linda Demaine & Deborah Hensler, *Only Another Forum: Substituting Arbitration for the Courthouse in Consumer Disputes*, ___ Law & Contemp. Probs. __ (2003) at 13 (stating, in study of arbitration clauses affecting hypothetical average citizen in Los Angeles, that sixteen of the 52 arbitration clauses examined contained such a prohibition). It is not clear whether clauses in California, a state that allows arbitral class actions, would be more or less likely to contain such prohibitions.

⁵ For examples of some of these clauses, see Jean R. Sternlight, *As Mandatory Binding Arbitration Meets the Class Action, Will the Class Action Survive?* 42 WM. & MARY L. REV. 1, 6 n.5 (2000). [hereinafter Sternlight, *As Mandatory Binding Arbitration Meets the Class Action*].

⁶ Although this Article will focus on the unconscionability challenge, it is also possible to attack class action prohibitions on the ground that they violate plaintiffs' rights under the federal statute under which they bring their claims. See Sternlight, *As Mandatory Binding Arbitration Meets the Class Action*, *supra* note __, at 92-105. Depending on the wording of the class action prohibition, it may also be possible to argue that it precludes the litigation of class actions, but not the arbitration of class actions. In California, arbitral class actions are well accepted, and they have been used in a few other jurisdictions as well. *Id.* at 37-53. See also **Bazzle v. Green Tree Financial Corp., No. 25523, 2002 WL 1955753** (S. Car. Aug. 26, 2002) (holding that arbitrator could certify arbitral class action, though clause was silent as to this possibility); *Brennan v. ACE INA Holdings, Inc.*, No. 00-CV-2730, 2002 WL 1804918 *3 (Aug. 1, 2002) (finding that where arbitration clause was silent on subject of class actions, it should be up to the arbitrator to determine whether matter should proceed individually, or instead as a class action).

⁷ For a short argument that this is bad policy, see Jean R. Sternlight, *Should an Arbitration Provision Trump the Class Action? No: Permitting companies to skirt class actions through mandatory arbitration would be dangerous and unwise*, DISP. RESOL. MAG., Spring 2002, at 13.

of class action prohibitions through the unconscionability doctrine? Is such a case-by-case analysis the best way to examine the legitimacy of this corporate practice?

This Article will attempt to answer these questions. Section I will examine the courts' use of the unconscionability doctrine to regulate companies' arbitral restriction of class actions. It will summarize the current state of the law in this area.⁸ Next, Section II will consider whether, from a policy perspective, we ought to permit companies to protect themselves against class actions.⁹ Specifically, it will examine the economic argument that by permitting companies to eliminate class actions we may actually benefit consumers at large by lowering prices.¹⁰ This Article suggests that such an analysis is incomplete, and that there are good reasons to preserve the class action from elimination. Finally, Section III takes on the question of whether, assuming class actions should be protected, unconscionability claims are the best mechanism for determining which arbitration clauses are valid and which arbitration clauses are not valid.¹¹ This Section argues that while the unconscionability attack has produced some good results, it is a very costly means for attacking class action prohibitions. In the interest of both public policy and efficiency, it would be preferable if Congress would pass legislation prohibiting companies from eliminating their exposure to consumer class actions.

⁸ See *infra*

⁹ See *infra*

¹⁰ See Stephen J. Ware, *Paying The Price of Process: Judicial Regulation of Consumer Arbitration Agreements*, 2001 J. DISP. RESOL. 89 (2001), discussed *infra* at _____. See also Christopher R. Drahozal, "Unfair" Arbitration Clauses, 2001 U. ILL. L. REV. 695, 771-72 [hereinafter Drahozal, "Unfair" Arbitration Clauses] (suggesting that there may be reasons, such as lower prices or higher payments, why rational persons or businesses would agree to seemingly unfair arbitration, but recognizing that regulation is most necessary where market constraints are weakest); Stephen J. Ware, *Arbitration under Assault: Trial Lawyers Lead the Charge*, Policy Analysis No. 433 (April 18, 2002), at 6, 9 available at <http://www.cato.org/pubs/pas/pa-433es.html> (urging that bills prohibiting mandatory arbitration would likely harm consumers, in that mandatory arbitration makes dispute resolution more accessible to most consumers and "almost certainly lowers prices").

¹¹ See *infra*

I. Is It Unconscionable for Companies to Use Arbitration Clauses to Eliminate Class Actions?

A. The Unconscionability Defense to Arbitration

While the Supreme Court views arbitration favorably,¹² it has always made clear that unconscionable arbitration provisions should not be enforced. Section 2 of the Federal Arbitration Act (FAA) provides that written arbitration provisions “shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract.”¹³ Throughout the pro-arbitration era that commenced in the 1980s, the Court has emphasized that unconscionability is one appropriate ground for revoking an arbitration agreement.¹⁴ Similarly, the Court has frequently stated that it will compel arbitration of federal statutory claims only “so long as the prospective litigant effectively may vindicate [his or her] statutory cause of action in the arbitral forum, [such that] the statute will continue to serve both its remedial and deterrent function.”¹⁵ Thus, in *Green Tree Financial Corp. v. Randolph*,¹⁶ the Court recognized that if it could be proven that a company had designed an arbitration process to be so costly that the consumer could

¹² For an examination of the development of the Supreme Court’s pro-arbitration philosophy, see Jean R. Sternlight, *Panacea or Corporate Tool?: Debunking the Supreme Court’s Preference for Binding Arbitration*, 74 WASH. U. L.Q. 637, 644-674 (1996).

¹³ Federal Arbitration Act, 9 U.S.C. § 2 (1999).

¹⁴ See, e.g., *Doctor’s Assocs., Inc. v. Casarotto*, 517 U.S. 681, 682 (1996) (“Generally applicable contract defenses, such as...unconscionability, may be applied to invalidate arbitration agreement.”); *Allied-Bruce Terminix Cos., Inc. v. Dobson*, 513 U.S. 265, 281 (1995) (“States may regulate contracts, including arbitration clauses, under general contract law principles.”); *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*, 473 U.S. 614, 627 (1985) (“[C]ourts should remain attuned to well-supported claims that the agreement to arbitrate resulted from the sort of fraud or overwhelming economic power that would provide grounds ‘for the revocation of any contract.’”).

¹⁵ *Gilmer v. Interstate/Johnson Lane Corp.*, 500 U.S. 20, 28 (1991), quoting *Mitsubishi*, 473 U.S. at 637. In *Mitsubishi* the Court had earlier explained that arbitration clauses could not be used to deprive persons of their substantive rights. “We . . . note that in the event the choice-of-forum and choice-of-law clauses operated in tandem as a prospective waiver of a party’s right to pursue statutory remedies for antitrust violations, we would have little hesitation in condemning the agreement as against public policy.” *Mitsubishi*, 473 U.S. at 637 n.19.

¹⁶ *Green Tree Fin. Corp.-Alabama v. Randolph*, 531 U.S. 79 (2000).

not vindicate her rights, then that arbitration clause would not be valid.¹⁷ While all the claims raised in the Supreme Court to date happen to involve federal statutory claims, there is no reason to believe that the Court would preclude the use of arbitration to eliminate statutory claims while permitting companies to use arbitration to eliminate common law or state statutory claims.¹⁸

B. Class Action Prohibitions May Be Unconscionable

Building on these principles, numerous courts have now held that inclusion of a class action prohibition in an arbitration clause may render that clause unconscionable.¹⁹ Several examples of the reasoning of these decisions are provided, below.

¹⁷ While the Court, in *Randolph*, found that plaintiff had failed to meet her evidentiary burden of proving that the arbitration process would be excessively costly, subsequent courts have applied the *Randolph* analysis to strike several clauses. *See, e.g.*, *Phillips v. Assocs. Home Equity Servs., Inc.*, 179 F. Supp. 2d 840, 846 (N.D. Ill. 2001) (holding arbitration clause unenforceable as inconsistent with the Truth in Lending Act on grounds of prohibitive cost where the arbitration fees ranged from \$750-\$5,000/day and hardship was evidenced by borrower's affidavit and fact that borrower was in the lender's target "subprime" market); *Camacho v. Holiday Homes, Inc.*, 167 F. Supp. 2d 892, 897 (W. D. Va. 2001) (refusing to compel arbitration of a Truth in Lending Act claim on the basis of prohibitive cost to the consumer where consumer had "limited income" to pay administrative fees of \$2,000 and even if "rare" waiver of administrative fees were granted the consumer would still likely be responsible for as much as \$4,100 in fees and expenses for the arbitrator); *Giordano v. Pep Boys–Manny, Moe & Jack, Inc.*, 2001 WL 484360, at *6-7 (E.D. Pa. 2001) (striking provision of arbitration clause requiring employer and employee to share arbitration costs of the Fair Labor Standards Act claim on showing that the employee earned \$400/week and would be responsible for \$2,000 in arbitration fees).

¹⁸ *See also Armendariz v. Found. Health Psychcare Servs., Inc.*, 24 Cal. 4th 83 (Cal. 2000) (holding that a contract requiring employees to waive rights to redress sexual harassment or discrimination under Fair Employment and Housing Act in favor of arbitration was contrary to public policy and unlawful).

¹⁹ At the time Professor Sternlight began writing about class actions and arbitration in 1998, no court had issued such a decision. By the time she finished her first article on the subject (*see Sternlight, As Mandatory Binding Arbitration Meets the Class Action, supra* note ____), three courts had found a class action prohibition contributed to an arbitration clauses' unconscionability. Today, at least eleven decisions from both federal and state courts have held that class action prohibitions contained in arbitration clauses either contributed to a finding that the clause was unconscionable or must be severed, due to their unfairness. *See Mandel v. Household Bank*, 105 Cal. App. 4th 75 (Cal. App. 2003) (severing class action prohibition as unconscionable); *Luna v. Household Finance Corp.* III, No. C02-1635L, 2002 WL 31487425, Nov. 4, 2002) (finding that class action prohibition weighed heavily in favor of finding of substantive unconscionability); *Comb v. Paypal, Inc.*, No. C-02-1227 JF (PVT), 2002 WL 2002171 (N.D. Cal. Aug. 30, 2002) (voiding arbitration clause as unconscionable on grounds that it permitted excessive arbitral fees, prevented plaintiffs from bringing a class action, and imposed potentially costly venue requirement); *ACORN v. Household Int'l, Inc.*, No. C 02-1240 CW, 2002 WL 1563805, at *10 (N.D. Cal. June 21, 2002) (voiding arbitration clause in part due to manifest one-sidedness and unfairness of class action prohibition); *Ting v. AT & T*, 182 F. Supp. 2d 902 (N.D. Cal. 2002) (holding arbitration clause unconscionable in part due to class action prohibition); *Lozada v. Dale Baker Oldsmobile, Inc.*, 91 F. Supp. 2d 1087, 1104-05 (W.D. Mich. 2000) (voiding arbitration clause as unconscionable in part because it eliminated class actions); *In re Knepp*, 229 B.R. 821, 843 (N.D. Ala. 1999)

To date, *Ting v. AT & T*²⁰ has focused most extensively on the question of whether a class action prohibition is unconscionable. Upon stipulation of the parties the case was certified as a class action,²¹ and it then went to trial on the question of whether AT & T had acted illegally in imposing a new legal remedies provision upon its customers.²² The new legal remedies provision contained an arbitration provision, and precluded customers' use of class actions.²³

The district court found the new legal remedies provision unconscionable.²⁴ Having reviewed evidence regarding the kinds of lawsuits filed against AT & T and its competitors in recent years, the court found "[i]t would not have been economically feasible to pursue the claims in these cases on an individual basis, whether the case was brought in court or in arbitration."²⁵ The court explained "[i]t is undisputed that the lawyers who represented the plaintiffs in these cases would not have taken them if the only claim they could have pursued was the claim of the individual plaintiff."²⁶ The court found this worrisome not only because

(refusing to enforce arbitration clause imposed on debtor in part because it would prejudice prosecution of plaintiff's claim as a class action); *Leonard v. Terminix Int'l Co.*, No 1010555, 2002 WL 31341084, *8 (Ala. Oct. 18, 2002) (holding arbitration clause unconscionable because it both limited claimants' prospective relief and also precluded them from proceeding as a class); *Szetela v. Discover Bank*, 97 Cal. App. 4th 1094 (Cal. App. 2002) (severing portion of arbitration clause that purported to eliminate class actions); *Powertel v. Bexley*, 743 So. 2d 570, 576 (Fla. App. 1999) (voiding arbitration clause as unconscionable in part because it eliminated class actions); *State ex rel. Dunlap v. Berger*, No. 30035, 2002 WL 1305726 (W. Va. June 13, 2002) (finding class action prohibition contributed to finding of unconscionability). *See also* *Lytle v. Citifinancial Services, Inc.*, 2002 Pa. Super. 327, *17-18 (Pa. Super. 2002) (remanding to trial court question of whether class action prohibition was unconscionable, and recognizing that determination would turn on evidence presented by parties); *Eastman v. Conesco Fin. Servicing Corp.*, No. 01-1743, 2002 WL 1061856 (Wis. App. May 29, 2002) (certifying up, to Wisconsin Supreme Court, question of whether arbitration clause should be held unconscionable due to class action prohibition). Another California case, *Ramirez v. Circuit City Stores*, 90 Cal. Rptr. 2d 916, 920-921 (Cal. App. 1999), similarly relied in part on a class action prohibition to find unconscionability. While that decision was superceded when review was granted by the California Supreme Court, 995 P.2d 137 (Cal. 2000), the California Supreme Court never issued a decision on the merits.

²⁰ *Ting*, 182 F. Supp. 2d at 902.

²¹ *Id.* at 906.

²² *Id.*

²³ *Id.* at 940-941, Attachment No. 1.

²⁴ *Id.* at 931.

²⁵ *Id.* at 918.

²⁶ *Id.* The court explained:

plaintiffs would be left without the opportunity to obtain relief, but also because the company would be able to escape liability, and thus would not be deterred from committing illegal acts.²⁷ The court also rejected AT & T's argument that FCC enforcement would be sufficient to protect plaintiffs' rights, concluding as a matter of fact that such enforcement was unlikely.²⁸ Finding AT & T's claim that it devised the new legal remedies provision "to give the consumers a broad range of options" and to avoid meritless suits to be "somewhat disingenuous,"²⁹ the court instead concluded that "AT & T's principal purpose was to put sufficient obstacles in the path of litigants to effectively deter many claims from being pursued."³⁰ Thus, the court found the class action ban to be substantively unconscionable.³¹

The lawyer would almost certainly incur more in costs and time charges just getting the complaint prepared, filed and served than she would recover, even if the case were ultimately successful . . . While retaining counsel on an hourly basis is possible, in view of the small amounts involved, it would not make economic sense for an individual to retain an attorney to handle one of these cases on an hourly basis and it is hard to see how any lawyer could advise a client to do so. The net result is that cases such as the ones listed above will not be prosecuted even if meritorious.

Id.

²⁷ *Id.* ("Thus, the prohibition on class action litigation functions as an effective deterrent to litigating many types of claims involving rates, services or billing practices and, ultimately would serve to shield AT & T from liability even in cases where it has violated the law.").

²⁸ *Id.* at 919. The court based its conclusion on examination of FCC reports for the past ten years and on FCC's own statement "that it does not consider the award of damages to a class of individuals to be consistent with its consumer complaint procedures." *Id.* The court went on to conclude that "the FCC is not a forum before which a class member can effectively vindicate her right to recover damages from AT & T in a variety of contexts." *Id.* at 920.

²⁹ *Id.* The court explained:

As to AT & T's purpose in devising the Legal Remedies Provisions, Mr. Delery testified that AT & T "wanted to give the consumers a broad range of options" to resolve disputes, and that AT & T wanted to avoid "opening up the business to lawsuits that really have no merit." I find this testimony to have been somewhat disingenuous. Absent the Legal Remedies Provisions, consumers would have a broad range of legal options available, and the limitations on consumers' rights and remedies in the Legal Remedies Provisions apply to all suits, even those with merit. Based on all the evidence before me, I find that AT & T's principal purpose was to put sufficient obstacles in the path of litigants to effectively deter many claims from being pursued.

Ting, 182 F. Supp. 2d at 920-21.

³⁰ *Id.* at 920-21.

³¹ *Id.* at 931.

In its conclusion, the *Ting* court explained that AT & T's legal remedies clause was void not because it required arbitration, but rather because it contained substantially unfair features:

This lawsuit is not about arbitration. If all AT & T had done was to move customer disputes that survive its informal resolution process from the courts to arbitration, its actions would likely have been sanctioned by the state and federal policies favoring arbitration. While that is what it suggested it was doing to its customers, it was actually doing much more; it was actually rewriting substantially the legal landscape on which its customers must contend. Aware that the vast majority of service related disputes would be resolved informally, AT & T sought to shield itself from liability in the remaining disputes by imposing Legal Remedies Provisions that eliminate class actions, sharply curtail damages in cases of misrepresentation, fraud, and other intentional torts, cloak the arbitration process with secrecy and place significant financial hurdles in the path of a potential litigant. It is not just that AT & T wants to litigate in the forum of its choice--arbitration; it is that AT & T wants to make it very difficult for anyone to effectively vindicate her rights, even in that forum. That is illegal and unconscionable and must be enjoined.³²

*Szetela v. Discover Bank*³³ is a second interesting and important case in this area. In that matter, a credit card holder attempted to bring a class action against the credit card company alleging various unfair practices that caused cardholders to be charged fees for exceeding their credit limits.³⁴ When the trial court granted Discover's motion to compel, the plaintiff was required to go to arbitration, individually, where he won an award of \$29 (the overlimit fee).³⁵ The plaintiff then appealed, seeking the opportunity to bring a class action. The court explained that "[t]he essence of Szetela's argument is that the no class action provision is unconscionable and should not be enforced."³⁶

After finding procedural unconscionability, the court went on to find that the class action prohibition was substantively unconscionable as well. First, the court emphasized that

³² *Id.* at 938-39.

³³ *Szetela v. Discover Bank*, 97 Cal. App. 4th 1094 (Cal. App. 2002).

³⁴ *Id.* at 1097.

³⁵ *Id.*

³⁶ *Id.* at 1099.

“[t]he manifest one-sidedness of the no class action provision at issue here is blindingly obvious.”³⁷ Next, the court explained that the clause was intended to preclude customers with small claims from obtaining relief,³⁸ thereby providing Discover with what the court called “virtual immunity from class or representative actions despite their potential merit.”³⁹ The *Szetela* court found this immunity from class actions troubling not only because it was “harsh and unfair to Discover customers who might be owed a relatively small sum of money, but . . . also [because it] serves as a disincentive for Discover to avoid the type of conduct that might lead to class action litigation in the first place.”⁴⁰

By imposing this clause on its customers, Discover has essentially granted itself a license to push the boundaries of good business practices to their furthest limits, fully aware that relatively few, if any, customers will seek legal remedies, and that any remedies obtained will only pertain to that single customer without collateral estoppel effect. The potential for millions of customers to be overcharged small amounts without an effective method of redress cannot be ignored.⁴¹

The court also found the class action prohibition problematic from a public policy perspective because it allowed litigants to contract away a procedural device, class actions, that serves the courts’ interests in efficiency.⁴²

Having found the class action prohibition unconscionable, the *Szetela* court issued a writ of mandate directing the trial court to strike that portion of the arbitration clause that

³⁷ *Id.* at 1100. The court explained that “[a]lthough styled as a mutual prohibition on representative or class actions, it is difficult to envision the circumstances under which the provision might negatively impact Discover, because credit card companies typically do not sue their customers in class action lawsuits.” *Id.* at 1101.

³⁸ *Id.* (“This provision is clearly meant to prevent customers, such as *Szetela* and those he seeks to represent, from seeking redress for relatively small amounts of money, such as the \$29 sought by *Szetela*.”).

³⁹ *Id.*

⁴⁰ *Id.*

⁴¹ *Id.* The court elsewhere characterized the class action prohibition as “granting Discover a ‘get out of jail free’ card while compromising important consumer rights.” *Id.*

⁴² *Id.* at 1102 (“To allow litigants to contract away the court’s ability to use a procedural mechanism that benefits the court system as a whole is no more appropriate than contracting away the right to bring motions in limine, seek directed verdicts, or use other procedural devices that allow the courts to operate in an efficient manner.”).

prohibited class actions.⁴³ Note that in California, arbitral class actions are permitted, and apparently this is what the appellate court contemplated in merely striking that portion of the clause.⁴⁴

In two subsequent federal court cases, *ACORN v. Household International Inc.*,⁴⁵ and *Comb v. Paypal, Inc.*,⁴⁶ the Northern District of California followed the basic rationale of *Szetela*, and concluded that a class action prohibition contained in an arbitration clause was unconscionable.⁴⁷ The *ACORN* court rejected the defendant's argument that *Szetela* only applied in those jurisdictions that accept arbitral class actions.⁴⁸ The *Comb* court similarly rejected defendant's argument that the FAA preempted the *Szetela* conclusion that the class action prohibition was unconscionable.⁴⁹ Rather than merely severing the class action

⁴³ *Id.*

⁴⁴ See Keating v. Superior Court, 31 Cal. 3d 584, 612-613 (Cal. 1982) (endorsing, albeit less than enthusiastically, the concept of classwide arbitration). For a discussion of the benefits and disadvantages of classwide arbitration see Sternlight, *As Mandatory Binding Arbitration Meets the Class Action*, *supra* note ___, at 37-52.

⁴⁵ *ACORN v. Household Int'l, Inc.*, No. C 02-1240 CW, 2002 WL 1563805 (N.D. Cal. June 21, 2002).

⁴⁶ *Comb v. Paypal, Inc.*, No. C-02-1227 JF (PVT), 2002 WL 2002171 (N.D. Cal. Aug. 30, 2002).

⁴⁷ *ACORN*, 2002 WL 1563805 at *13-14; *Comb*, 2002 WL 2002171 at *9.

⁴⁸ The defendants in *ACORN* asserted that whereas California state courts may order arbitral class actions, federal courts may not, except where expressly permitted by the terms of the arbitration agreement, and that in light of this purported distinction it would not be appropriate to find the class action prohibition unconscionable because the federal court could not have ordered classwide arbitration in any event. 2002 WL 1563805 at *10-11. The district noted that defendants had failed to establish that federal courts cannot order classwide arbitration, *id.* at *14 n.2, but stated that even accepting that proposition for purposes of this motion, the defendants' "subtle argument is ultimately unpersuasive." *Id.* at *11. Instead, the court found that the defendants had merged their substantive unconscionability analysis with their analysis of proper remedy. *Id.* "If federal courts are not permitted to order class-wide arbitration, then an alternative remedy must be devised to prevent enforcement of an unconscionable contract." *Id.* Note that defendants' argument that federal courts cannot order classwide arbitration, absent specific language in the arbitration clause, is based on such cases as *Champ v. Siegel Trading Co., Inc.*, 55 F.3d 269, 274-75 (7th Cir. 1995). For a critique of this position see Sternlight, *As Mandatory Binding Arbitration Meets the Class Action*, *supra* note ___, at 84-90.

⁴⁹ *Comb*, 2002 WL 2002171 at *8 (holding that while preemption would prevent California from adopting a statute that would prevent enforcement of arbitration covered by the FAA, ordinary state law such as unconscionability doctrines are not preempted). See also Mandel v. Household Bank, 105 Cal. App. 4th 75, 82 (Cal. App. 2003) (rejecting preemption argument). But see *Discover Bank v. Superior Court*, 105 Cal. App. 4th 326, 331 (Cal. App. 2003) (concluding that "where a valid arbitration agreement governed by the FAA prohibits classwide arbitration, section 2 of the FAA preempts a state court from applying state substantive law to strike the class action waiver from the agreement."). The *Discover* court asserted that "if a state statute requiring a nonwaivable judicial forum for resolution of consumer disputes must give way to section 2 of the FAA, it necessarily must follow that a state judicial policy precluding classwide arbitration waivers must also give way to section 2 of the FAA." *Id.* at 343. It further stated: "While a state may prohibit the contractual

prohibition, both federal courts found they must hold the entire arbitration clause unconscionable.⁵⁰

West Virginia's Supreme Court recently issued another interesting decision discussing class action prohibitions. *State ex rel. Dunlap v. Berger*⁵¹ involved a class claim brought against Friedman's Jewelry by an individual who alleged that he, and others, had been deceived into purchasing unrequested insurance when buying jewelry at the store. In Mr. Dunlap's case, he paid \$1.48 for credit life insurance and \$6.96 for property insurance.⁵² On behalf of the class he sought declaratory and injunctive relief, as well as various types of damages and attorney fees.⁵³ When Friedman's sought to compel arbitration, based on a contract that had been signed by Mr. Dunlap, Dunlap contended that the arbitration provision was unconscionable.⁵⁴ This challenge was based, in part, on a class action exclusion.⁵⁵

The court accepted Dunlap's argument that the class action exclusion was unconscionable. Emphasizing that "[c]lass action relief--including the remedies of damages, rescission, restitution, penalties, and injunction--is often at the core of the effective prosecution of consumer...cases,"⁵⁶ the court found that the \$8.46 that Friedman's added to Dunlap's purchase price "is precisely the sort of small-dollar/high volume (alleged) illegality

waiver of statutory consumer remedies, including the right to seek relief in a class action, such protections fall by the wayside when the waiver is contained in a validly formed arbitration agreement governed by the FAA." *Id.* at 346. These authors do not follow this "logic," but that is an article for another day.

⁵⁰ *ACORN*, 2002 WL 1563805, at *14 (striking the entire arbitration provision as unconscionable based not only on class action prohibition, but also on other provisions). The *Acorn* court stated:

The interlocking nature of these hindrances indicates that the purpose of the arbitration agreement is not to transfer claims to a more expeditious forum but to deter Defendants' customers from bringing claims. As such, the agreement's purpose is 'tainted with illegality' and severance is not appropriate.

Id. See also *Comb*, 2002 WL 2002171 at *9.

⁵¹ *State ex rel. Dunlap v. Berger*, No. 30035, 2002 WL 1305726 (W. Va. June 13, 2002).

⁵² *Id.* at *4.

⁵³ *Id.* at *3.

⁵⁴ *Id.* at *5.

⁵⁵ *Id.* at *12-13.

⁵⁶ *Id.* at *12.

that class action claims and remedies are effective at addressing.”⁵⁷ It explained: “In many cases, the availability of class action relief is a *sine qua non* to permit the adequate vindication of consumer rights.”⁵⁸

The *Dunlap* court found that elimination of class actions was problematic because it would potentially enable companies to get away with illegal acts.

Thus, in the contracts of adhesion that are so commonly involved in consumer and employment transactions, permitting the proponent of such a contract to include a provision that prevents an aggrieved party from pursuing class action relief would go a long way toward allowing those who commit illegal activity to go unpunished, undeterred, and unaccountable.⁵⁹

Not surprisingly, given this language, the court went on to conclude that the class action prohibition was unconscionable.⁶⁰ Rather than rewrite the arbitration provision, to eliminate the class action exclusion and other problematic terms, the court found it must void the arbitration provision altogether.

Friedman’s...by tying substantively unconscionable exculpatory and limitation of liability provisions to an arbitration provision in a form contract of adhesion, has sought to unilaterally use (one could say “misuse”) the honorable mechanism of arbitration--that has found a respected place in the commercial life of our nation--as a scheme or mechanism to shield itself from legal accountability for misconduct.

Under such circumstances, we think a court doing equity should not undertake to sanitize any aspect of the unconscionable contractual attempt.⁶¹

Other courts have employed similar themes in voiding class action prohibitions as unconscionable. For example, in *Powertel v. Bexley*⁶² a Florida appellate court stated: “The arbitration clause also effectively removes Powertel’s exposure to any remedy that could be pursued on behalf of a class of consumers...Class litigation provides the most economically

⁵⁷ *Id.* at *13.

⁵⁸ *Id.*

⁵⁹ *Id.*

⁶⁰ *Id.* *15.

⁶¹ *Id.* at *17-18.

⁶² *Powertel v. Bexley*, 743 So. 2d 570 (Fla. App. 1999).

feasible remedy for the kind of claim that has been asserted here...By requiring arbitration of all claims, Powertel has 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.”⁶³

Similarly, in *In re Knepp*⁶⁴ a federal bankruptcy court explained: “If this approach [allowing the elimination of class actions] prevails, the pervasive use of arbitration agreements in consumer contracts could have the effect of eliminating class actions as an option available to aggrieved consumers. If class actions are no longer an option, the vast majority of consumer claims involving relatively small sums of money on an individual basis will be left without a remedy.”⁶⁵

On the other hand, while the discussion above may make it sound like class action exclusions are clearly unconscionable, numerous court decisions have enforced arbitration clauses containing a class action prohibition.⁶⁶ Some of these are cases in which plaintiffs apparently did not even try to make an unconscionability argument. For example, in *Johnson v. West Suburban Bank*,⁶⁷ the court rejected plaintiff’s argument that class action prohibitions were impermissible under particular federal statutes,⁶⁸ but noted that it might have reached a different result if plaintiff had been able to show that the arbitral forum selected was inadequate to vindicate his statutory rights.⁶⁹ Similarly, in *Randolph v. Green Tree Financial*

⁶³ *Id.* at 576.

⁶⁴ *In re Knepp*, 229 B.R. 821, 842 (N.D. Ala. 1999).

⁶⁵ *Id.*

⁶⁶ *See, e.g.*, *Lomax v. Woodmen of the World Life Ins. Society*, No. Civ. A 1:01-CV-2134-W, 2002 WL 314 (July 16, 2002) (stating prohibition of class action, without more, does not render arbitration clause unconscionable); *Lozano v. AT & T Wireless*, No. CV-02-00090WJR (AJWX), 2002 WL 1940290, 4-6 C.D. Cal. June 10, 2002) (refusing to find class action exclusion unconscionable and explaining that plaintiffs relinquish such “procedural niceties” as class actions when they agree to arbitrate their claims). Other cases enforcing arbitration clauses excluding class actions are summarized in Alan S. Kaplinsky & Mark J. Levin, *2001: An Arbitration Odyssey*, 57 BUS. LAW. 1287 (2002).

⁶⁷ *Johnson v. West Suburban Bank*, 225 F.3d 366 (3d Cir. 2000), *cert. denied* 531 U.S. 1145 (2001).

⁶⁸ *Id.* at 369. The statutes at issue were the Truth in Lending Act and the Electronic Fund Transfer Act.

⁶⁹ *Id.* at 373. Nor was an unconscionability argument made in *Johnson*.

Corp.- Alabama,⁷⁰ on remand from the Supreme Court,⁷¹ the Eleventh Circuit stated that “a contractual provision to arbitrate TILA claims is enforceable even if it precludes a plaintiff from utilizing class action procedures in vindicating statutory rights under TILA.”⁷²

However, in this case, once again, no mention is made of an argument that the prohibition was unconscionable.⁷³

In other cases, however, in which plaintiffs have at least presented the outlines of the unconscionability argument to a court, it has been rejected. For example, in *Pick v. Discover Financial Services, Inc.*,⁷⁴ the court refused to void an arbitration provision on the ground of a class action exclusion, stating “it is generally accepted that arbitration clauses are not unconscionable because they preclude class actions.”⁷⁵

Courts such as *Pick* have often cited the Supreme Court’s decision in *Gilmer v. Interstate/Johnson Lane Corp.*⁷⁶ to support the proposition that companies are free to proscribe class actions. The *Gilmer* Court opined in dictum that “even if the arbitration could

⁷⁰ *Randolph v. Green Tree Fin. Corp.-Alabama*, 244 F.3d 814 (11th Cir. 2001).

⁷¹ *Green Tree Fin. Corp.-Alabama v. Randolph*, 531 U.S. 79 (2000).

⁷² *Randolph*, 244 F.3d at 819.

⁷³ *See also* *Arellano v. Household Fin. Corp. III*, No. 01 C 2433, 2002 WL 221604 (N.D. Ill. Feb. 13, 2002) (explaining that plaintiff failed to show that the arbitral class action prohibition was impermissible under TILA, without discussing unconscionability); *Rains v. Found. Health Sys. Life & Health*, 23 P.3d 1249, 1253 (Colo. App. 2001) (refusing to void arbitration clause on basis of class action exclusion but failing to mention unconscionability argument); *Pyburn v. Bill Heard Chevrolet*, 63 S.W.3d 351, 364 (Tenn. App. 2001) (concluding that plaintiff had failed to show he could not vindicate his rights without a class action, but failing to mention an unconscionability challenge).

⁷⁴ *Pick v. Discover Fin. Servs., Inc.*, No. Civ.A 00-935-SLR, 2001 WL 1180278 (D. Del. Sept. 28, 2001).

⁷⁵ *Id.* at *5 (citing *Gilmer v. Interstate/Johnson Lane Corp.*, 500 U.S. 20, 32 (1991) and *Johnson v. West Suburban Bank*, 223 F.3d 366, 377 (3d Cir. 2000)). *See also* *Vigil v. Sears National Bank*, No. Civ. A. 01-2690, 2002 WL 246448, at *2 (E.D. La. Feb. 19, 2002) (“[T]he fact that the clause implicitly waives . . . the ‘right’ to proceed by class action does not, in itself, render the clause unconscionable”); *AutoNation USA Corp. v. Leroy*, 2003 WL 1884889, *7 (Tex.App. April 17, 2003) (“While there may be circumstances in which a prohibition on class treatment may rise to the level of fundamental unfairness, [plaintiff’s] generalizations do not satisfy her burden to demonstrate that the arbitration provision is invalid here.”). *Cf.* *Forest v. Verizon Communications, Inc.*, No. 01-CV-1101, 2002 WL 1988367 (D.C. Ct. App. Aug. 29, 2002) (holding that forum selection clause resulting in denial of class action, because state law did not permit class actions, was not unconscionable or unreasonable given that company’s principal place of business was located in that particular state).

⁷⁶ *Gilmer v. Interstate/Johnson Lane Corp.*, 500 U.S. 20 (1991).

not go forward as a class action or class relief could not be granted by the arbitrator, the fact that the [ADEA] provides for the possibility of bringing a collective action does not mean that individual attempts at conciliation were intended to be barred.”⁷⁷ However, it is critical to recognize several limitations to this statement. First, the Court found that plaintiff had in fact failed to show that class relief was unavailable, since the court concluded that relevant New York Stock Exchange Rules allowed for collective proceedings, and that the EEOC could also seek class-wide relief.⁷⁸ Second, Mr. Gilmer brought his suit individually, and not as a class action at all. Third, Gilmer certainly did not try to argue that the class action exclusion was unconscionable. Finally, it is simply not clear what the Court meant in stating that individual attempts at conciliation should not be barred.

What makes the difference as to whether or not courts find a class action prohibition to be unconscionable? The next section will address this issue.

C. Good Arguments and Good Facts

Class action unconscionability arguments depend on the same building blocks as most legal claims: good arguments and good facts. When plaintiffs simply make a general assertion that class action prohibitions are unconscionable, their attack is likely to fail.⁷⁹ But, if they can assemble facts necessary to support some or all of the sub-arguments set out

⁷⁷ *Id.* at 32.

⁷⁸ *Id.*

⁷⁹ See F. Paul Bland, Jr., *Is That Arbitration Clause Unconscionable? PROVE IT!*, THE CONSUMER ADVOC. (National Association of Consumer Advocates, Washington, D.C.), July-Aug. 2002, at 1, 5 [hereinafter Bland, *Is that Arbitration Clause Unconscionable?*] (observing that the one common thread in cases where the plaintiffs failed to show that class action prohibitions were unconscionable was “that the plaintiffs treated the cases principally as posing legal rather than factual issues”); James C. Sturdevant, *The Critical Importance of Creating an Evidentiary Record to Prove that a Mandatory, Pre-Dispute Arbitration Clause is Unconscionable*, ___ Forum ___ (2000) (urging that attorneys seeking to defeat motions to compel arbitration engage in substantial discovery and seek to amass factual cases showing that the clause is illegal and unconscionable, rather than relying on purely legal arguments that are likely to fail).

below, they have a good chance of success.⁸⁰ To prevail on an unconscionability claim courts generally require that plaintiffs demonstrate both procedural and substantive unconscionability.⁸¹ While both requirements are significant, this Article will focus on the showing necessary to establish substantive unconscionability, because the proof necessary to establish procedural unconscionability is no different for class action exclusions than for other alleged flaws in arbitration clauses.⁸²

1. Certain claims simply are not financially feasible if brought individually

All of the court decisions striking class action exclusions have emphasized that many small dollar claims simply are not feasible, if brought individually.⁸³ In essence, these cases are recognizing the point made by Professor Marc Galanter, and others, that by increasing

⁸⁰ See Bland, *Is That Arbitration Clause Unconscionable?*, *supra* note ___, at 1 (“Fighting a mandatory arbitration clause is not for the lazy, the meek, or those exclusively inclined to broad abstractions. The key to success for a consumer advocate who wishes to avoid having her client forced into a particularly unfair arbitration system is both simple and difficult: one should put a powerful factual record before the court.”). See also *Lytle v. Citifinancial Services, Inc.*, 2002 Pa. Super. 327, *17-18 (2002) (recognizing that class action could be unconscionable, but ordering remand to permit parties to present evidence so that court could determine whether class action was needed to permit plaintiffs to present their claims).

⁸¹ See, e.g., *Armendariz v. Found. Health Psychcare Servs., Inc.*, 24 Cal. 4th 83 (Cal. 2000) (“The prevailing view is that [procedural and substantive unconscionability] must both be present in order for a court to exercise its discretion to refuse to enforce a contract or clause under the doctrine of unconscionability.”).

⁸² Paul Bland has discussed some of the proof plaintiffs’ counsel need to produce to establish procedural unconscionability. See Bland, *Is That Arbitration Clause Unconscionable?*, *supra* note ___, at 1-2. See also *Blair v. Scott Specialty Gases*, 283 F.3d 595, 604-610 (2002) (discussing the types of evidence plaintiffs must provide for a court to find an arbitration clause unenforceable).

⁸³ See *Ting v. AT & T*, 182 F. Supp. 2d 902, 918 (N.D. Cal. 2002) (“It would not have been economically feasible to pursue the [small dollar] claims...on an individual basis, whether the case was brought in court or in arbitration.”); *In re Knepp*, 229 B.R. 821, 842 (N.D. Ala. 1999) (“If class actions are no longer an option, the vast majority of consumer claims involving relatively small sums of money on an individual basis will be left without a remedy.”); *Leonard v. Terminix Int’l Co.*, No 1010555, 2002 WL 31341084, *8 (Ala. Oct. 18, 2002) (“The limitation upon recovery of ‘indirect, special, and consequential damages or loss of anticipated profits’ in the arbitration clause and elsewhere in the agreement and the preclusion of eligibility for class-action treatment by inserting a provision requiring arbitration deprive the Leonards of a meaningful remedy and lead us to conclude that Terminix has extracted unreasonably favorable and patently unfair terms in its contract of adhesion.”); *Szetela v. Discover Bank*, 97 Cal. App. 4th 1094, 1101 (Cal. App. 2002) (“[The class action exclusion] is...harsh and unfair to Discover customers who might be owed a relatively small sum of money.”); *Powertel v. Bexley*, 743 So. 2d 570, 576 (Fla. App. 1999) (“Class litigation provides the most economically feasible remedy for the kind of claim that has been asserted here. The potential claims are too small to litigate individually, but collectively they might amount to a large sum of money.”); *State ex rel. Dunlap v. Berger*, No. 30035, 2002 WL 1305726, at *13 (W. Va. June 13, 2002) (indicating that Mr. Dunlap’s claim of \$8.46 in added insurance charges “is precisely the sort of small-dollar/high volume (alleged) illegality that class action claims and remedies are effective at addressing.”)

plaintiffs' transaction costs defendants can induce plaintiffs to settle their claims if not drop them altogether.⁸⁴ Citing the Supreme Court's oft-stated rationale for supporting class actions,⁸⁵ such decisions explain that it is often just not rational for individual consumers or attorneys to bring claims of a few hundred dollars or possibly much less.⁸⁶ Courts have concluded that it is no more rational to bring such small claims in arbitration than it is in litigation.⁸⁷ At the same time, these courts have emphasized that the company that perpetuated small dollar illegal acts against numerous consumers should not be permitted to escape liability simply because it would be irrational for any single individual to bring the claim. Rather, such a dearth of enforcement would lead to unjust enrichment on the part of the company,⁸⁸ and failure to deter illegal conduct.⁸⁹

⁸⁴ Eliminating the possibility of class actions is one of but many ways of increasing plaintiffs' transaction costs. *See, e.g.,* Jean R. Sternlight, *Panacea or Corporate Tool?: Debunking the Supreme Court's Preference for Binding Arbitration*, 74 Wash. U. L.Q. 637, 682-683 (discussing such additional mechanisms for increasing transaction costs as imposing high arbitral fees and selecting a distant forum). As Professor Galanter has pointed out, when one party imposes high transaction costs on the other, it may encourage a settlement that would not otherwise have been desirable. Marc Galanter, *The Quality of Settlements*, 1988 J. Disp. Res. 55, 70-72. *See also* Lisa B. Bingham, *Self-Determination in Dispute System Design and Mandatory Commercial Arbitration*, ___ Law & Contemp. Probs. ___ (2003) (explaining that by controlling dispute system design one party can impose transaction costs on the other, thereby dramatically altering the available settlement range or making it no longer cost effective for the opposing party to bring a claim).

⁸⁵ *See, e.g.,* Deposit Guar. Nat'l Bank v. Roper, 445 U.S. 326, 338-39 (1980) (noting that class actions make it possible to bring claims that otherwise would not be feasible); Eisen v. Carlisle & Jacquelin, 417 U.S. 156, 161 (1974) (stating that absent a class action "[n]o competent attorney would undertake [the petitioner's] action to recover so inconsequential an amount").

⁸⁶ *See, e.g., Dunlap*, 2002 WL 1305726, at *13 (stating that plaintiff's total claim of \$8.46 "is precisely the sort of small-dollar/high volume (alleged) illegality that class action claims and remedies are effective at addressing."); *Powertel*, 743 So. 2d at 576 ("The potential claims are too small to litigate individually, but collectively they might amount to a large sum of money"); *Leonard*, 2002 WL 31341084 at *5, *8 (showing that plaintiffs, while bringing a claim worth less than \$500, would face substantial fees and costs in arbitration that were substantially higher than the amount of that claim).

⁸⁷ *See, e.g., Ting v. AT & T*, 182 F. Supp. 2d 902, 918 (N.D. Cal. 2002) ("It would not have been economically feasible to pursue the claims in these cases on an individual basis, whether the case was brought in court or in arbitration."). The *Ting* court observed that most claims for less than \$1,000 against AT & T are likely to be handled by customer service representatives, rather than either through litigation or arbitration. *Id.* at 917.

⁸⁸ *See, e.g., Ting*, 182 F. Supp. 2d at 918 ("[T]he prohibition on class action litigation . . . would serve to shield AT & T from liability even in cases where it has violated the law"); *Eastman v. Consec Fin. Servicing Corp.*, No. 01-1743, 2002 WL 1061856, at *3 (Wis. App. May 29, 2002) ("Because each individual plaintiff suffered less than \$200 actual damage, the cost and inconvenience of separate actions would result in no recovery for most plaintiffs and substantial unjust enrichment to Consec, assuming the plaintiffs' claims have merit.").

⁸⁹ *See, e.g., Comb*, 2002 WL 2002171 at *9 ("PayPal appears to be attempting to insulate itself contractually from any meaningful challenge to its alleged practices"); *Szetela*, 97 Cal. App. 4th at 1101 (explaining that the

Plaintiffs are most successful where they can support these assertions factually, rather than asking courts to assume that small claims cannot feasibly be brought. Testimony from parties, local attorneys, or experts can be used to establish which cases plaintiffs and their attorneys deem worth bringing. Such testimony needs to be specific as to what kinds of damages and attorney fees would be available, why these are not sufficient, and why mere joinder of claims would not be sufficient, assuming that would be allowed under the arbitration clause. If, as is sometimes true, the arbitration clause would permit plaintiffs to litigate cases that are small enough to qualify for small claims court, plaintiffs will need to show why that remedy is insufficient.⁹⁰

The *Ting* litigation illustrates some of the kinds of evidence that plaintiffs can use to try to support their claim that a class action prohibition is unconscionable. In that case, for example, the plaintiffs took discovery to determine the nature of litigation that had been brought against AT & T and its competitors in the past.⁹¹ The plaintiffs' counsel "contacted more than a dozen attorneys who had previously brought class actions against AT & T to learn about their cases."⁹² When virtually all of those attorneys stated they would be willing to testify "that they would not have been able to pursue the claims at issue in those cases-- even if the claims were valid--if they were unable to proceed on a class basis,"⁹³ AT & T

clause "serves as a disincentive for Discover to avoid the type of conduct that might lead to class action litigation," essentially granting Discover "a license to push the boundaries of good business practices to their furthest limits,"); *Powertel*, 743 So. 2d at 576 ("The prospect of class litigation ordinarily has some deterrent effect on a manufacturer or service provider, but that is absent here.").

⁹⁰ They might show, for example, that it would be infeasible for an individual plaintiff to obtain representation for a small claims matter, to succeed on a pro se basis, to obtain sufficient discovery to prevail in small claims court, or to obtain needed injunctive relief from a small claims court judge.

⁹¹ See Bland, *Is That Arbitration Clause Unconscionable?*, *supra* note __, at 5. See also *Ting*, 182 F. Supp. 2d at 915, 917 (summarizing types of litigation); Sturdevant, *supra* note __ at __ (observing that *Ting* plaintiffs took "[d]ocumentary and deposition discovery as to class action litigation and the results that has been filed against AT&T").

⁹² E-mail from Paul Bland, Esq., Trial Lawyers for Public Justice, to Jean R. Sternlight (July 29, 2002) (on file with author) [hereinafter Bland E-mail].

⁹³ Bland, *Is that Arbitration Clause Unconscionable?*, *supra* note __, at 5.

“stipulated to what they would have said rather than face this litany of damaging testimony.”⁹⁴ The plaintiffs’ counsel also “introduced testimony from three experts on the subject of whether counsel could be found to bring such cases on an individual basis.”⁹⁵ “These experts each testified that all or nearly all consumers with such claims would not have been able to find competent counsel to handle their claims on an individual basis, in or out of arbitration, even if their claims were entirely valid.”⁹⁶ The court found, on the basis of this evidence, that the lawyers who represented plaintiffs in class actions against AT & T or its competitors would not have handled those cases as individual matters.⁹⁷ Plaintiffs also presented evidence that it was unlikely legal aid programs would have the resources to take such cases.⁹⁸ The court observed that the defendant, in contrast, “did not produce any testimony from any practicing lawyer, or any other evidence, that any of the cases [previously filed] . . . would be economically feasible to litigate under the Legal Remedies Provisions of the CSA.”⁹⁹

Depending on the stage at which they are making their proof, plaintiffs may also be able to rely on expert affidavits. For example, Edward Sherman, an eminent professor of complex litigation, opined in his affidavit in *Sullivan v. QC Financial Services Inc., et al.*, that the plaintiffs’ suit alleging that the defendants’ payday loan interest rates violated the Indiana Loansharking statute was:

⁹⁴ Bland, *Is That Arbitration Clause Unconscionable?*, *supra* note __, at 5.

⁹⁵ Bland E-mail, *supra* note __; Sturdevant, *supra* note __ at __ (noting that three experienced consumer attorneys “testified as experts that virtually all consumers with statutory claims would not have been able to locate competent counsel to represent their interests in the absence of a certified class action, even if their claims had a high likelihood of success”).

⁹⁶ Bland, *Is That Arbitration Clause Unconscionable?*, *supra* note __, at 5.

⁹⁷ *Ting*, 182 F. Supp. 2d at 918 (stating this evidence was “undisputed”).

⁹⁸ *Id.* at 919 (citing testimony from a consumer attorney).

⁹⁹ *Id.* The court recognized that defendant had presented “some conclusory contradiction from one of defendant’s experts, Professor Priest, which I did not find convincing inasmuch as he does not practice in this area and his conclusions were largely unsupported by any evidence.” *Id.*

[A] “negative value suit,” that is, a suit in which the potential recovery to any individual would be too small and the costs of litigation too large to have an adequate incentive to litigate individually. Consumer class actions are often negative value suits and have a much stronger claim for class action treatment than would a contract between two corporations or well-heeled parties in which there is an arbitration clause. . . . Some consumers may do the same kind of calculus as do attorneys in judging that the recovery in a case may not justify the time and expense of pursuing a remedy through litigation or arbitration.¹⁰⁰

2. Apart from finances, individual claims are not feasible due to problems with lack of information as to the merits of the claim or the nature of arbitration

As Professor Sherman has noted, consumers often lack knowledge that particular conduct engaged in by defendant is illegal.¹⁰¹ When they are being charged an excessive interest rate or check bouncing charge, for example, few would have the knowledge or even an intuition that their rights were being violated. Nor, given the relatively small amounts at stake, would most consumers find it worthwhile to seek legal advice to determine whether their rights were being violated. As a Wisconsin appellate court explained: “Unless class action is authorized, many plaintiffs will be unaware of the allegedly illegal activities and will not commence any proceedings.”¹⁰²

Here, one of the virtues of class actions is that they require that putative class members be notified of the potential violation of their rights.¹⁰³ Once notified, class members can typically opt in or out of the class, depending on how the suit has been structured.¹⁰⁴ Thus, whereas lack of information as to the existence of a possible claim will

¹⁰⁰ Affidavit of Professor Edward F. Sherman in *Sullivan v. QC Financial Services Inc.*, Cause No. 82D03-0003-CP-738 (Vanderburgh Superior Court, Indiana) at ¶ 8 (on file with author).

¹⁰¹ *Id.* at ¶ 9(a).

¹⁰² *Eastman v. Conesco Fin. Servicing Corp.*, No. 01-1743, 2002 WL 1061856, at *3 (Wis. App. May 29, 2002).

¹⁰³ *See, e.g.*, FED. R. CIV. P. 23(c)(2) and 23(d)(2). Although notice is only required for those class actions certified under 23(b)(3), courts are free to give notice in other cases and often do. *See* MANUAL FOR COMPLEX LITIGATION, THIRD (1995) at 224 (observing that notice, while required for (b)(3) class actions, may be advisable at times for (b)(1) and (b)(2) class actions as well); HERBERT NEWBERG & ALBA CONTE, NEWBERG ON CLASS ACTIONS (1992) (Chapter 8- Notice to Class Members- detailing information about notice to class members in class action suits).

¹⁰⁴ With respect to those claims brought under FED. R. CIV. P. 23(b)(3), a right to opt out must be afforded. *See* FED. R. CIV. P. 23(c)(2). *See* MANUAL FOR COMPLEX LITIGATION, *supra* note ____, at 231. This right may but

prevent most individual consumers from filing a claim in arbitration or litigation, a single informed consumer could help initiate a class action that might help many others.

Lack of information as how to file a claim may also be important. Individual consumers may well be unsure how to file an individual claim either in litigation or in arbitration. If their claim is not large enough to attract an attorney who could represent them on a contingent fee basis, this is a formidable barrier to bringing a claim. Moreover, to the extent that the consumer realizes she is required to bring her claim in arbitration, lack of understanding or even misunderstandings regarding that process may particularly deter filing of a claim.¹⁰⁵

Thus the class action not only provides financial feasibility through combining small claims but also surmounts serious deterrents to the filing of claims that are due to lack of

need not be afforded for claims brought under FED. R. CIV. P. 23(b)(1) or 23(b)(2). *See* MANUAL FOR COMPLEX LITIGATION, *supra* note ____, at 217.

¹⁰⁵ Professor Sherman made precisely these points:

b. Even consumers who have a feeling that there is something wrong with their contract or its performance by the other side are rarely willing or able to take the necessary steps to invoke arbitration and follow it through effectively to the end. This is especially true of the putative “payday loan” class members in this case who, by virtue of the kind of loan they took out, are probably financially strapped. Although a consumer can pursue arbitration without a lawyer, he or she would be at a disadvantage and might well lack basic information about how to initiate such a proceeding and how to proceed effectively at various stages. Of course, such persons would be under a similar disadvantage as to filing individual suits, but the class action provides a means for them to obtain redress by simply not opting out and letting the representative plaintiff and class attorneys bear the responsibility and cost of proceeding in the interests of the class.

c. Consumers may also fail to invoke arbitration because of lack of knowledge or distrust of the process. This is especially true of “payday loan” borrowers who are often unsophisticated concerning legal matters and may be hesitant to devote the time and expense to arbitration. 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. Of course, there are also serious doubts in our society about the efficacy of the court system, especially if one must hire his own attorney to pursue litigation, but the class action provides a feasible alternative for the impecunious consumer. Individual arbitration is less attractive than class action treatment regarding attorneys fees and costs. In an arbitration, the consumer would have to pay his own attorneys and investigation/preparation costs, while attorneys fees in a class action are generally not payable unless the class prevails and then are generally authorized by the court out of the recovery to the class at large.

information on the part of the average consumer. When companies eliminate the class action, they greatly decrease the likelihood that any claims will be filed against them.

3. Even if individual suits were feasible, they would not result in full enforcement of the law

The federal court in *Ting* pointed out another critically important aspect of class actions: many types of relief can only be afforded on a group basis, and not individually.

Specifically, *Ting* examined the kinds of claims that had previously been filed against AT&T:

In 2000, AT & T was named as a defendant in 59 consumer long distance suits filed in other courts (not small claims courts) nationwide. It appears that the principal types of claims which members of the class can expect to litigate outside small claims court are not individual billing disputes or disputes about poor service, but claims of intentional misconduct, such as discrimination or harassment in the course of providing service, credit reporting problems and problems relating to identity theft and claims that involve practices or problems that pertain to all or a group of consumers. Examples of group claims include complaints about the way AT & T is measuring the length of a call or complaints that AT & T has misrepresented the terms of a calling plan in its advertising. If a consumer complains about such a practice, AT & T can try to satisfy the consumer by making a billing adjustment, but it cannot change its practice as to only that consumer without being considered discriminatory under the FCC's standards. In other words, if AT & T decided on an informal basis to measure the length of one class member's phone calls a certain way, it would be discriminating in violation of the FCA if it measured the calls of other similarly situated class members differently.¹⁰⁶

That is, even if an individual successfully were to arbitrate a claim against AT & T, it is highly unlikely that an arbitrator would order the kind of declaratory or injunctive relief that might put a stop to any illegal practice on a widespread basis.

Although some might argue that several successful suits for individual relief might lead a company to change its overall policy, in fact it is not at all obvious that this is true. A company may find it worthwhile to pay off a few individual claims but keep its overall

Affidavit of Edward Sherman, *supra* note __, at ¶ 9.

policy. This is in effect a form of price discrimination, which offers a lower price to those very few customers who are enterprising enough to complain about an illegal policy.¹⁰⁷ When the individual claims are arbitrated, rather than litigated, it is even less likely that they will lead to company-wide reform. Unlike the public litigation result, which may lead to widespread publicity based on even a small individual claim, the arbitration process is private. Reporters cannot read and report on arbitration claims as they do with complaints filed in court.

So, to the extent that class actions are eliminated, many types of relief simply will not be available against a company. Whereas an individual consumer might be able to recover the excessive \$20 check bouncing charge that was levied against her, she could not, through either litigation or arbitration, obtain an order mandating the company to change the policy. Such relief might, however, realistically be obtained in a class action.

Once again, plaintiffs who seek to void class action preclusion should not present this argument in the abstract, but rather should gather specific evidence, as did the *Ting* plaintiffs, regarding the types of claims that can and cannot effectively be prosecuted individually. In *Ting* plaintiffs' counsel used document requests and depositions, and also interviewed former plaintiffs' counsel to gather specific information regarding the types of claims that had been filed against A T&T in recent years.¹⁰⁸

¹⁰⁶ *Ting*, 182 F. Supp. 2d at 915.

¹⁰⁷ DENNIS W. CARLTON & JEFFREY M. PERLOFF, MODERN INDUSTRIAL ORGANIZATION 274-92 (3d ed. 2000). The authors' discussion of the use of coupons and rebates highlights this point. They note that using cents-off coupons or offering rebates allows companies to price discriminate. Only some consumers – those who put a relatively low value on their time, for example— will take the time to collect, sort, and use coupons or send in the wrappers required for a rebate. *Id.* at 275. Similarly, only some consumers will have the expertise and time to pursue individual claims.

¹⁰⁸ See Bland E-mail, *supra* note ____ (discussing interviews with attorneys who had sued AT & T); Bland, *Is that Arbitration Clause Unconscionable?*, *supra* note __, at 5 (discussing interviews with attorneys who had sued AT & T); *Ting v. AT & T*, Case No. C 012969 BZ ADR, Plaintiffs' Statement Re: Discovery (Aug. 28, 2001) (on file with author) (describing document and deposition discovery sought from AT & T).

4. Administrative enforcement actions are not an adequate substitute for the class action

In multiple cases companies have attempted to fight the claim that class action preclusions are unconscionable by arguing that various government agencies are available to defend group rights of consumers and others. For example, the Chamber of Commerce's amicus brief in *Green Tree Financial Corp. v. Randolph*¹⁰⁹ urged: "[E]nforcement of arbitration agreements for TILA claims will have no effect on the powerful deterrent force of agency and criminal enforcement mechanisms provided by TILA. These enforcement mechanisms make class actions unnecessary to ensure a high level of TILA compliance."¹¹⁰ Similarly, in *Ting* defendant AT & T argued that a class action was not needed, and thus the class action preclusion was not unconscionable, because the FCC could adequately protect consumers' rights.¹¹¹ At a minimum, one cannot help but see such arguments as ironic, given that the attorneys and firms charged with defending their corporate clients are not usually advocates of funding or power for the government agencies that they are now praising.¹¹²

The *Ting* plaintiffs presented facts related to actual FCC activity that convinced the court that governmental enforcement actions could not take the place of class actions. The court stated:

Under all these circumstances, I find that the FCC is not a forum before which a class member can effectively vindicate her right to recover damages from AT & T in a

¹⁰⁹ *Green Tree Fin. Corp. v. Randolph*, 531 U.S. 79 (2000).

¹¹⁰ Brief of the Chamber of Commerce of the United States of America as Amicus Curiae in Support of Petitioners at *18, 2000 WL 744157, *Green Tree Fin. Corp. v. Randolph* (No. 99-1235).

¹¹¹ 182 F. Supp. 2d at 919 (discussing AT & T's position that consumer claims should be presented to the FCC).

¹¹² For example, note that in *EEOC v. Waffle House*, various business organizations argued that an employee's agreement to arbitrate should prevent the federal EEOC from seeking monetary damages on that individual's behalf. See Brief of Amici Curiae Assoc. of Mass., Conn. Bus. and Indus. Ass'n and New England Legal Found. in Support of Respondent, 2001 WL 799187, *EEOC v. Waffle House, Inc.* (No. 99-1823). If this position had prevailed, the agencies' ability to protect the rights of those employees required to arbitrate claims individually would have been tightly constrained. Fortunately, however, a 6-3 majority of the Court refused to allow companies to use arbitration to escape this government regulation. *EEOC v. Waffle House, Inc.*, 534 U.S. 279 (2002) (holding that an employee agreeing to arbitrate future employment discrimination disputes does not preclude the EEOC from bringing action seeking damages on the employee's behalf).

variety of contexts. Nor is the FCC an effective forum for a class of similarly situated consumers seeking to recover damages from AT & T for a class wide practice without each consumer having to file an individual complaint under Section 208.¹¹³

This conclusion by the court, that the FCC could not be relied on to enforce consumers' rights, was critical to the court's finding that the class action exclusion was unconscionable.

II. **But, Are Class Action Prohibitions Efficient?**

Using the rationales set forth thus far, it can be argued that class actions are beneficial to consumers, and that the use of class action exclusions is therefore detrimental to consumers. However, Professor Stephen Ware legitimately points out that a fair analysis of class exclusions should be more complex.¹¹⁴ In particular, he suggests that the gains companies make by eliminating class actions may be passed on to consumers,¹¹⁵ and that as a

¹¹³ 182 F. Supp. 2d at 920. The *Ting* court explained its findings as follows:

A review of FCC reports for the past ten years discloses that until recent years there are very few reports of FCC decisions involving a complaint by an individual consumer against a long distance carrier. Most of the complaints in recent years have concerned "slamming," the unauthorized substitution of a consumer's preferred long distance carrier for another without proper consent. It was largely undisputed at trial that it took the FCC approximately seventeen years before it effectively responded to "slamming" complaints. In recent years, in response to consumers' complaints, the FCC has initiated investigations which ultimately resulted in changes in telephone company practices and in the imposition of forfeitures, or the payment of "voluntary contributions," to the United States Treasury. At defendant's request, I took judicial notice of 14 orders of the FCC adopting consent decrees or imposing forfeitures or notices of apparent liability, all of which issued during the year 2000. With the exception of *In the Matter of MCI WorldCom Communications, Inc.*, 15 F.C.C.R. 12, 181 (2000), in which the FCC approved a mechanism for providing some credit to certain consumers adversely impacted by the company's practices, see *id.* at 12, 182, the FCC does not appear to have concerned itself with obtaining individual relief for the complainants, even in situations where the FCC has concluded the carrier committed an "egregious" practice... This is not surprising, since the FCC has stated that it does not consider the award of damages to a class of individuals to be consistent with its consumer complaint procedures... Nor have I seen a single report of the FCC addressing a consumer complaint for an intentional tort allegedly committed by a carrier.

182 F. Supp. 2d at 919-920.

¹¹⁴ See Ware, *supra* note ____. See also Drahozal, "Unfair" Arbitration Clauses, *supra* note ____ (analyzing franchise contracts and concluding that not only are unfair predispute arbitration agreements less prevalent than the existing literature might suggest, and also arguing that not all arbitration clauses can be labeled unfair).

¹¹⁵ It is interesting to consider why companies would apparently prefer to be sued individually rather than in a class action. That is, why is eliminating class actions a "gain" for the company? If a company engaged in no illegal conduct, would it not often be quicker and cheaper for the company to establish the validity of its conduct, once and for all, in a class action? On the other hand, if the company in fact engaged in illegal conduct, it is easier to see why the class action is more costly than arbitration. The class device allows multiple

society we might be better off allowing companies to engage in this strategy.¹¹⁶ “Attempts to make arbitration more favorable (or “fair”) to consumers have a downside for consumers if the effect of those attempts is to raise businesses’ arbitration costs.”¹¹⁷ As to class actions in particular, Ware argues that cases “requiring that arbitration preserve the class action, raise the cost of arbitration to businesses and, therefore, raise prices to consumers.”¹¹⁸ While he does not insist that companies must be allowed to eliminate class actions, he does urge that policy makers should consider the effect on prices in determining how much leeway to afford companies.¹¹⁹

Professor Ware’s argument, however, is itself incomplete. While it is certainly true, as a matter of economic theory, that all of a company’s savings may be passed on to consumers in the form of lower prices, it is also true that they may not. This panglossian event occurs only to the extent that the requirements of perfect competition are met.¹²⁰

Four market characteristics are critical to define perfect competition:

claimants who might well have been deterred by the arbitral requirement to bring successful claims. Perhaps the most efficient and cost effective solution is for companies to obey the law?

¹¹⁶ To support this argument Professor Ware cites economic theory. He explains that “[i]n a market economy, characterized by freedom of entry and exit,” if any company is earning an excessive profit, other companies will enter that market and begin competing by selling the goods or services at a lower price. This, argues Ware, will cause prices to fall and benefit consumers. Ware, *supra* note ___, at 91-92, citing JAMES D. GWARTNEY & RICHARD L. STROUP, *ECONOMICS: PRIVATE AND PUBLIC CHOICE* 532-39, 563-65 & 595-98 (7th ed. 1995).

¹¹⁷ *Id.* at 93. See also Stephen J. Ware, *Arbitration under Assault: Trial Lawyers Lead the Charge*, Policy Analysis No. 433 (April 18, 2002), at 9-10 available at <http://www.cato.org/pubs/pas/pa-433es.html> (arguing, more generally, that mandatory arbitration is beneficial for most consumers, businesses, and society as a whole, and that it is only plaintiffs’ trial lawyers and consumers who would have hoped to bring large cases who will be harmed). Cf. Stephen J. Ware, *The Effects of Gilmer: Empirical and Other Approaches to the Study of Employment Arbitration*, 16 OHIO ST. J. DISP. RES. 735, 741 (recognizing that the extent to which costs imposed by statute on employers will be borne by employers, employees and consumers “is determined by the elasticity of supply and demand in the ultimate product market, and in the markets for the factors of production, labor and capital”).

¹¹⁸ *Id.* at 94.

¹¹⁹ *Id.* at 99.

¹²⁰ It is clear that Ware is thinking of price reductions resulting from cost-savings in a competitive market. He states, “Assuming that consumer arbitration agreements lower the dispute-resolution costs of businesses that use them, competition will (over time) force these businesses to pass their cost-savings to consumers.” *Id.* at 91.

(1) There should be a sufficient number of small buyers and sellers such that no single buyer nor seller can influence the market price. No seller should produce a large percentage of the total market output.

(2) The good or service produced should be homogenous, so that no firm produces a unique product.

(3) Entry and exit into the market should be very easy. No significant barriers to entry should exist such as licenses, economies of scale, high capital setup costs, or brand loyalty.

(4) All buyers and sellers should have very good access to relevant information such as prices, quality and characteristics of goods, costs of production, and so on.¹²¹

Are these conditions likely to be met in the real world of the kinds of companies who are mandating arbitration and eliminating class actions? Think again about phone companies, credit card companies, banks, and insurance companies. While there are many small purchasers of these services, the number of producers is definitely quite limited. For example, of the over 6,000 banks and nonbank holding companies that issue credit cards, only fifty or so do so nationally. Moreover, approximately sixty percent of the total outstanding balances in the period from 1989-1994 was held by only ten issuers of credit cards.¹²² In banking, the ten largest banks held 36.9 percent of total deposits nationally in 1998, an increase of roughly 17 percentage points since 1990.¹²³ In such markets, it is far

¹²¹ See WALTER NICHOLSON, *MICROECONOMIC THEORY: BASIC PRINCIPLES AND EXTENSIONS* 401-02 (7th ed. 1998).

ROBERT S. PINDYCK & DANIEL L. RUBINFELD, *MICROECONOMICS* 252-53 (5th ed. 2001).

¹²² Victor Stango, *Competition and Pricing in the Credit Card Market*, 82 *REV. OF ECON. AND STATS.* 499, 500 (August 2000).

¹²³ Steven J. Pilloff, *Commercial Banking in THE STRUCTURE OF AMERICAN INDUSTRY* 224, 237 (Walter Adams & James Brock, eds., 10th ed. 2001). For further evidence on the banking industry see Stephen A. Rhoades, ed., *Special Issue on Industrial Organization Topics in Banking*, 12 *REV. OF INDUST. ORG.* (February 1997).

from clear that no single seller of such products and services can influence the market price.¹²⁴

Second, the products of these companies are not entirely homogeneous. Rather, these companies attempt to distinguish themselves based on interest rates, types of service, and so on. Consumers will not necessarily drop one credit card, bank, insurer or phone company at will to pick up another. Rather, there are differences among these products and also costs to making the switch. Switching banks, for example, results in significant costs such as those associated with opening and closing accounts and making arrangements for direct deposits.¹²⁵

Third, as Professor Ware notes, but does not emphasize, his argument is entirely dependent on the idea of free entry and exit from the market.¹²⁶ When access to the market is impeded, as in a monopoly or cartel situation, companies are able to keep their profits.¹²⁷ High capital investment requirements, lack of information, or other barriers to entry may make it difficult or impossible for new companies to enter a particular market.¹²⁸ With respect to local phone service, for example, both government regulations and substantial capital outlay requirements substantially limit access to the field. In fact, entry barriers in

¹²⁴ For evidence that the largest firms in health insurance control a significant share of the market, *see, e.g.*, Roger Feldman et al, *HMO Consolidations: Now National Mergers Affect Local Markets*, 18 HEALTH AFFAIRS 96-104 (July-Aug. 1999). *See also* Stephen E. Foreman et al., *Monopoly, Monopsony and Contestability in Health Insurance: A Study of Blue Cross Plans*, 34 ECONOMIC INQUIRY 662-77 (Oct. 1996).

¹²⁵ Economists call the phenomenon of firms within a market producing similar but distinctive products "product differentiation." For introductory discussions, see JOSEPH E. STIGLITZ & CARL E. WALSH, PRINCIPLES OF MICROECONOMICS 251-53 (3d ed. 2002); RICHARD G. LIPSEY ET AL., MICROECONOMICS 254-56 (12th ed. 1999). For evidence that consumers do not regard one company's credit card as a perfect substitute for another, and that there are costs to search and switching, see Paul Calem & Loretta Mester, *Consumer Behavior and the Stickiness of Credit Card Interest Rates*, 85 AM. ECON. REV. 1327-36 (Dec. 1995).

¹²⁶ Ware, *supra* note __, at 91 (assuming "a market economy, characterized by freedom of entry and exit").

¹²⁷ LIPSEY ET AL., *supra* note __ at 236-37.

¹²⁸ LIPSEY ET AL., *supra* note __ at 236-37 and 266-69; STIGLITZ & WALSH, *supra* note __ at 258.

local telephone service have been characterized as “formidable.”¹²⁹ In banking, lack of information about local business and residents can constitute a serious barrier to entry since unfamiliarity with local conditions makes evaluation of risk difficult.¹³⁰

In sum, economic theory gives rise to significant doubt that companies pass on to consumers the entire cost-savings they earn from using arbitration clauses to eliminate class actions.¹³¹ It is not surprising that, to date, no published studies show that the imposition of mandatory arbitration leads to lower prices.

Also, as Professor Ware recognizes, low prices neither are nor necessarily should be policy makers’ primary concern.¹³² Many government regulations clearly increase companies’ costs, and these regulations may even increase prices, but policy makers have determined that many such regulations make sense.¹³³ For example, we require manufacturers of tires, drugs and cars to meet minimum standards to protect public health and safety. Congress has recently passed new legislation geared to insure that businesses and

¹²⁹ Manley R. Irwin & James McConnaughey, *Telecommunications*, in WALTER ADAMS & JAMES BROCK, EDS., *THE STRUCTURE OF AMERICAN INDUSTRY* 308 (10th ed. 2001). One objective of the Telecommunications Act of 1996, Pub. L. 104-104, Feb. 8, 1996, 110 Stat. 56, 47 USC § 251 et seq., was to increase competition at the local level by introducing competitive local exchange carriers (CLECs), but such alternative local service providers have had only a minimal effect on the market share of local monopolies, primarily the Regional Bell Operating companies. *See generally* Irwin & McConnaughey, *supra* at 309-11.

¹³⁰ Pilloff, *supra* note __ at 234. *See also* Stango, *supra* note __ at 500-01 for a summary of evidence that markups on credit cards remained high even as credit card interest rates fell, suggesting that the market was not perfectly competitive.

¹³¹ Suppose the market is imperfectly competitive, even monopolistic. What guidance does economic theory give us now about whether cost-savings will be passed on to consumers in the form of lower prices? In this case, not surprisingly, the answer is less clear than it is in a competitive market. The extent to which cost-savings by a monopoly will be transferred to consumers depends crucially on the elasticity of the market demand curve and on the shape of the firm’s marginal cost curve. *See* HAL R. VARIAN, *INTERMEDIATE MICROECONOMICS: A MODERN APPROACH* 420-25 (6th edition, 2003).

¹³² Ware, *supra* note __, at 90, 99 (recognizing that regulation may yield benefits that outweigh any costs). *See also* Christopher R. Drahozal, *Privatizing Civil Justice: Commercial Arbitration and the Civil Justice System*, 9 KAN. J.L. & PUB. POL’Y 578, 587-88 (2000) (stating that there is a tradeoff between the costs and benefits of regulating arbitration).

¹³³ As noted earlier, it is also interesting to consider when and why it would be cheaper for companies to be sued in numerous individual suits rather than in a single class action. Whereas a company that committed legal violations may find it preferable to avoid class liability, a company that committed no illegal acts may be better off establishing its non-liability, once and for all, in a class action. *See supra* note __. That is, the elimination of class actions may be particularly important for those companies that act illegally.

accountants are honest in their accounting practices.¹³⁴ Will such rules lead to higher prices? Perhaps. But Congress has determined that any such costs are well worthwhile in order to protect investors and the public from fraudulent activity.

Further, Professor Ware does not emphasize the distributive aspects of his argument. Even assuming that permitting companies to eliminate class actions would cause prices of phone service or credit or insurance to drop slightly, how should this be weighed against the cost to the individual consumers of those products who find themselves unable to bring a claim to vindicate their legal rights? Those consumers may well feel that any small gains for the group as a whole do not warrant their individual losses. And, if given the informed choice, many consumers might well be willing to pay a slightly higher price in order to preserve their right to bring a claim if they felt their legal rights were violated.¹³⁵ That is, in economic terms, the lower price situation may not be Pareto optimal.¹³⁶ Rather, a consumer who had full information might well prefer to pay a slightly higher price in order to retain the right to sue the company if something went wrong.¹³⁷

¹³⁴ The Sarbanes-Oxley Act of 2002, P.L. 107-204.

¹³⁵ As a thought experiment, one might put consumers behind a Rawlsian “veil of ignorance.” See JOHN RAWLS, *A THEORY OF JUSTICE* 136-142 (1971) (definition concept of the veil of ignorance). Would such consumers, unsure whether they might have the desire to sue a company in a class action to eliminate illegal practices, be willing to trade that opportunity for a slightly reduced price? Clearly companies have not been willing to give consumers the choice, because in the vast majority of situations companies do not permit consumers to choose whether they would prefer arbitration to litigation. Instead, advocates of mandatory arbitration have consistently argued that it is not practical to afford consumers such a genuine choice. One of the authors (Sternlight) served on a task force of the ABA Section of Dispute Resolution, in 2001, that debated the mandatory arbitration issue, and observed that mandatory arbitration advocates rejected the idea that arbitration would be acceptable only if consumers had the opportunity to decide whether or not they would want it, pre-dispute. See also Samuel Estreicher, *Saturns For Rickshaws: The Stakes in the Debate over Predispute Employment Arbitration Agreements*, 16 OHIO ST. J. ON DISP. RESOL. 559 (2001) (arguing that it is not practical to permit employees to choose between arbitration and litigation on a post-dispute basis).

¹³⁶ Although Professor Ware is correct in his insistence that perfect information on the part of consumers is not necessary to ensure that price reductions are passed along to consumers, Ware, *supra* note __ at 92, an efficient solution cannot be achieved without such perfect information. STIGLITZ & WALSH, *supra* note __ at 232-35 and 287-301.

¹³⁷ Professor Ware has recognized and attempted to counter this argument. Stephen J. Ware, *Consumer Arbitration As Exceptional Consumer Law (With a Contractualist Reply to Carrington & Haagen)*, 29 McGeorge L. Rev. 195, 221-213 n. 95. However, we do not find his arguments compelling. First he asserts

Moreover, even if informed consumers might gamble that they would not need to litigate, in return for a lower price, policy makers might still be justified in prohibiting the elimination of class actions. Regulation is sometimes appropriate to protect individuals from their own irrational actions that might fail to serve their best interests.¹³⁸ In particular, psychologists have shown that individuals often behave in irrational but predictable fashion.¹³⁹ They tend to be overoptimistic, so they might well undervalue the cost of giving up their right to sue a company.¹⁴⁰ Similarly, individuals are not necessarily risk neutral, but

that it is improper to consider what consumers “would have” agreed to, since contract law ought to focus on what they did actually agree to. Second, he urges that courts can’t easily determine what consumers “would have” agreed to. Third, he urges it is no more appropriate to equalize information than to equalize any other property. *Id.* In essence, the difference between Ware’s position and our own is that we believe in the propriety of government regulation, and he does not. The question is precisely whether contracts *ought* to be enforced if they would not have been entered into, by persons possessing full information. While Ware is correct that courts cannot easily determine what individual consumers would have agreed to, on a case-by-case basis, they can and do frequently determine what a reasonable person would have done. Moreover, we urge legislative action rather than such individualized determinations. We believe it is perfectly appropriate for legislatures to take steps to correct informational inequities, and we also believe it is appropriate for legislatures to redistribute wealth and income in appropriate circumstances.

¹³⁸ A new field, variously denominated “behavioral law and economics” or “law and behavioral science” has recently emerged that attempts to modify standard economic assumptions with these psychological insights. *See, e.g.* CASS SUNSTEIN ED., *BEHAVIORAL LAW AND ECONOMICS* (2000); Russell B. Korobkin & Thomas S. Ulen, *Law and Behavioral Science: Removing the Rationality Assumption from Law and Economics*, 88 CAL. L. REV. 1051 (2000); Jon D. Hanson & Douglas A. Dysar, *Taking Behavioralism Seriously: The Problem of Market Manipulation*, 74 N.Y.U. L. REV. 630 (1999); Christine Jolls et al, *A Behavioral Approach to Law and Economics*, 50 STAN. L. REV. 1471 (1998); *Symposium: The Legal Implications of Psychology: Human Behavior, Behavioral Economics, and the Law*, 51 VAND. L. REV. 1497-1788 (1998). For a critique of this new discipline see Gregory Mitchell, *Taking Behavioralism too Seriously? The Unwarranted Pessimism of the New Behavioral Analysis of Law*, 43 WM. & MARY L. REV. 1907 (2002).

¹³⁹ The word “irrational” is not intended as a slur, but rather denotes that individuals’ expressed preferences may not make sense from a mathematical probabilistic standpoint. *See also* Korobkin & Ulen, *supra* note __ at 1144 (explaining that their identification of deviations from behavior that would be predicted by rational choice theory does not equate to a claim that people are generally irrational). For a summary of some common irrational behaviors *see* Jean R. Sternlight, *Lawyers’ Representation of Clients in Mediation: Using Economics and Psychology to Structure Advocacy in a Nonadversarial Setting*, 14 OHIO ST. J. DISP. RES. 269, 306-313 (1999).

¹⁴⁰ *See, e.g.* Christine Jolls et al, *A Behavioral Approach to Law and Economics* in SUNSTEIN, *supra* note __ at 46-49 (explaining that individuals’ inability to accurately assess risks may undermine the “consumer sovereignty” arguments against paternalism and government regulation). Of course, it is also true that government bureaucrats and politicians may themselves be affected by irrational biases. *Id.* at 48-49. *See also* Roger G. Noll and James E. Krier, *Some Implications of Cognitive Psychology for Risk Regulation*, in SUNSTEIN, *supra* note __ at 325-354 (recognizing that politicians who seek to retain or gain positions may be influenced by voters’ expressed preferences, even if they recognize them to be irrational).

rather may take irrational gambles on prospective losses.¹⁴¹ It has been shown that people often are risk seeking with respect to moderate-to-high probability losses, and risk averse with respect to low probability losses.¹⁴² Thus, even assuming an informed consumer would accept a binding arbitration provision in return for a slight lower price, policy makers might well determine that it would be inappropriate to allow companies to impose such a restriction on consumers.¹⁴³ This is particularly true if one accepts the argument of Professors Hanson and Kysar, that companies will inevitably seek to take advantage of consumers' irrational behavior by manipulating the market to serve their own interests.¹⁴⁴

¹⁴¹ Cognitive psychologists Daniel Kahneman and Amos Tversky developed this widely accepted account of decisionmaking known as "prospect theory." See, Daniel Kahneman and Amos Tversky, *Prospect Theory: An Analysis of Decision Under Risk*, 47 *ECONOMETRICA* 263 (1979). See also Amos Tversky and Daniel Kahneman, *Rational Choice and the Framing of Decision*, 59 *J. BUS.* S251 (1986); Daniel Kahneman and Amos Tversky, *Judgment Under Uncertainty: Heuristics and Biases*, in DANIEL KAHNEMAN ET AL., eds *JUDGMENT UNDER UNCERTAINTY: HEURISTICS AND BIASES* 3 (1982).

¹⁴² Chris Guthrie, *Framing Frivolous Litigation: A Psychological Theory*, 67 *U. CHICAGO L. REV.* 163, 165-67. It is unclear whether a well informed consumer would view the risk of being required to take a dispute to mandatory arbitration rather than litigation as low, moderate, or high. It is also unclear how the informed consumer would calculate the expected value of such a risk, i.e. how harmful they would think it would be to forego the opportunity to litigate. But, we can say with some confidence that individuals would not typically be able to evaluate these probabilities in a rational, risk-neutral fashion, and this can provide a justification for regulation.

¹⁴³ Of course, the mere possibility existence of these irrationality phenomena should not be used to justify regulation any more than the assumptions of perfect competition should be used to oppose regulation. Ideally, policy makers would empirically investigate the need for regulation in this area. Where the necessarily empirical work has not been done, however, policy makers have no choice but to rely on their intuitions and instincts. Unfortunately, as noted earlier, policy makers may themselves be affected by these same biases, and may also be influenced by voters' irrational preferences, even if they recognize them to be irrational. See *supra* ____ Nevertheless, regulation does at least afford an opportunity to protect consumers or others from their own irrationality.

¹⁴⁴ Jon D. Hanson & Douglas A. Kysar, *Taking Behavioralism Seriously: Some Evidence of Market Manipulation*, 112 *HARV. L. REV.* 1420 (1999) (drawing on a case study of the tobacco industry to argue that "because a multitude of nonrational factors influence individual decisionmaking, consumers cannot be expected to engage in efficient product purchasing analysis – regardless whether manufacturers are required to supply product warnings"); Hanson & Kysar, *supra* note ____ at 747 ("Manufacturers, to survive, *must* behave 'as if' they are attempting to manipulate consumer risk perceptions. And in light of the immense power of the market forces driving these attempts, it seems highly doubtful that manufacturer strategies (be they deliberate or accidental) will fail.") While Handon & Kysar focus on manufacturers' potential use of packaging, manufacture, and marketing to take advantage of consumers' irrationalities, the same analysis could be applied to the manner of providing an arbitration provision. Indeed, discovery conducted in the *Ting* litigation showed that A T & T had spent substantial resources determining how best to implement their binding arbitration provision so that it would not be opposed by consumers. *Ting v. AT & T*, 182 F. Supp. 2d 902, 911-13 (N.D. Cal. 2002). In short, merely requiring companies to provide accurate and visible descriptions of their binding arbitration requirements will not be sufficient to protect consumers from unfair arbitration provisions.

At least one company has tried a version of Professor Ware's argument, in court, but the court did not find it persuasive. In *Ting v. AT&T*¹⁴⁵ the district court stated:

AT & T has suggested that if its costs are lower, it can charge less. It presented no evidence that the Legal Remedies Provisions would produce lower charges...Nor am I prepared to make that assumption, since while lower costs can produce lower charges, they can also produce higher profits. In any event, 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.¹⁴⁶

As the *Ting* court notes, one of the problems with Professor Ware's argument is that it could be used to support elimination of all forms of government regulation. In this era of Enron and WorldCom, this is quite a hard sell.

In considering whether it is appropriate to permit companies to use arbitration clauses to eliminate class actions, policy makers should also be very cognizant of the important role that litigation by affected individuals plays in the American legal system. Whereas some countries choose to enforce their laws by establishing large and powerful government bureaucracies, the United States has generally taken a different approach. Although we obviously do have government agencies devoted to protecting the rights of consumers and others, these tend to be on a small scale compared to those of other nations, such as many European countries.¹⁴⁷ Instead, we rely on the affected individuals to bring their own lawsuits, and call them public attorneys general. In a system like ours that is dependent on such lawsuits to provide for enforcement of the laws, the elimination of class actions is far

¹⁴⁵ *Ting v. AT & T*, 182 F. Supp. 2d 902 (N.D. Cal. 2002).

¹⁴⁶ *Id.* at 931 n.16.

¹⁴⁷ See Christopher R. Drahozal & Raymond J. Friel, *Consumer Arbitration in the EU and the US*, 28 N.C. J. INT'L L. & COM. REG. (2002) (forthcoming) (draft, on file with authors) (noting that European countries take a more regulatory approach to consumer law than does the United States); Richard M. Alderman, *Pre-Dispute Mandatory Arbitration in Consumer Contracts: A Call for Reform*, 38 HOUS. L. REV. 1237, 1263 (2001) (noting that "[t]he American justice system substantially relies upon private enforcement to help define and explain regulatory legislation and to insure that it is enforced"). For a general discussion of some of the institutional

more worrisome than it would be in a system that instead uses government bureaucracies to protect consumers' rights.¹⁴⁸

Having considered all these policy arguments, and absent any empirical proof that allowing companies to eliminate class actions would serve the best interests of consumers, these authors conclude that the practice of allowing U.S. companies to use arbitration clauses to insulate themselves from class action liability is quite problematic. This practice ought, at minimum, be subject to regulation.

III. The Need for Congressional Action

Assuming that policy makers determine that it is worrisome to provide companies with unrestricted license to eliminate class actions, what is the best way to regulate this practice? As Professor Ware notes,¹⁴⁹ our current approach requires prospective class plaintiffs to argue, on a case-by-case basis, that the elimination of class actions is unconscionable or otherwise illegal.¹⁵⁰ Faced with these arguments, courts are reaching

differences between the U.S. and European approaches to consumer law *see* A. Brooke Overby, *An Institutional Analysis of Consumer Law*, 34 VAND. J. TRANSNAT'L L. 1219 (2001).

¹⁴⁸ It is interesting to note that the EU countries, in addition to using various government agencies to protect consumers' rights, have also prohibited companies from imposing mandatory arbitration on consumers. *See* Council Directive 1993/13/EEC, 1993 O.J. (L 95), *available at* http://europa.eu.int/comm/consumers/policy/developments/unfa_cont_terms/index_en.html (governing unfair terms in consumer contracts); Commission Recommendation 1998/257/EC, 1998 O.J. (L 115), *available at* http://europa.eu.int/comm/consumers/policy/developments/acce_just/index_en.html (recommendation on the principles applicable to the bodies responsible for the out-of-court settlement of consumer disputes). For a discussion of how mandatory arbitration is treated outside the United States *see* Jean R. Sternlight, *Is the U.S. Out on a Limb? Comparing the U.S. Approach to Mandatory Consumer and Employment Arbitration to That of the Rest of the World*, 56 U. MIAMI L. REV. ____ (forthcoming 2002) (draft on file with authors).

¹⁴⁹ Ware, *supra* note __, at 89 (noting that “[c]ourts regulate consumer arbitration by enforcing arbitration clauses that have certain features, while refusing to enforce arbitration clauses that lack those features.”).

¹⁵⁰ The primary argument plaintiffs have made, in addition to unconscionability, is that the use of an arbitration clause to eliminate class actions may violate the federal statute under which plaintiffs have brought their claim. For a discussion of this argument *see* Sternlight, *As Mandatory Binding Arbitration Meets the Class Action*, *supra* note __, at 93-105. The argument remains available, and has prevailed in at least two cases, *see*, *Lozada v. Dale Baker Oldsmobile, Inc.*, 91 F. Supp. 2d 1087 (W.D. Mich. 2000) (finding the arbitration clause unenforceable because the clause violates provisions of the Truth in Lending Act); *Bailey v. Ameriquest Mortgage Co.*, No. Civ. 01-545 (JRTFLN), 2002 WL 100391 (D. Minn. Jan. 23, 2002) (holding that in a Fair Labor Standards Act case “the inability to proceed collectively, particularly when considered in connection with [other unfair provisions], has the effect of rendering plaintiff’s individual claims impractical to pursue,” and voiding the clause for that and other reasons). However, most courts have rejected plaintiffs’ attempts to argue

disparate conclusions. Some are voiding arbitration clauses that eliminate class actions,¹⁵¹ some are severing that portion of the clause,¹⁵² and many are upholding the arbitration clauses, despite the class action prohibition.¹⁵³ As noted earlier, plaintiffs' challenges are most likely to succeed where they are based upon a substantial factual record.¹⁵⁴

Are these individual court challenges a satisfactory way to regulate the elimination of class actions? Some might say "yes," arguing that mandatory arbitration should be permitted unless it has been proven to be unfair.¹⁵⁵ The Supreme Court itself has seemingly accepted this position, holding in such cases as *Gilmer* and *Randolph* that the employee or consumer bears the burden of showing that the arbitration clause should be voided on a statutory or contractual ground.¹⁵⁶

While this position may sound reasonable, at first blush, it fails to take into consideration the costs and logistical realities of challenging an arbitration provision. Courts

that the federal Truth in Lending Act guarantees a right to proceed by class action. *See, e.g., Johnson v. West Suburban Bank*, 225 F.3d 366 (3d Cir. 2000).

¹⁵¹ *See case cites supra*

¹⁵² *See Szetela v. Discover Bank*, 97 Cal. App. 4th 1094 (Cal. App. 2002).

¹⁵³ *See supra*

¹⁵⁴ *See supra*

¹⁵⁵ *See Estreicher, supra* note _____. *See also Neesemann, supra* note _____ (arguing that arbitration clauses should not be voided merely for containing class action prohibitions, where they are otherwise fair).

¹⁵⁶ *See, e.g., Green Tree Fin. Corp.-Alabama v. Randolph*, 531 U.S. 79, 92 (2000) ("[W]here... a party seeks to invalidate an arbitration agreement on the ground that arbitration would be prohibitively expensive, that party bears the burden of showing the likelihood of incurring such costs."); *Gilmer v. Interstate/Johnson Lane Corp.*, 500 U.S. 20, 26 (1991) (stating that the party seeking to avoid arbitration bears the burden of establishing that Congress intended to preclude arbitration of the statutory claims at issue); *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*, 473 U.S. 614, 627 (1985) ("Of course, courts should remain attuned to well-supported claims that the agreement to arbitrate resulted from the sort of fraud or overwhelming economic power that would provide grounds 'for the revocation of any contract.'"). For examples of how this presumption affects class action unconscionability challenges *see, e.g. Adkins v. Labor Ready Inc.*, 303 F.3d 496, (4th Cir. 2002) (holding that plaintiff had failed to meet burden of proof of showing that prohibition on class actions would render litigation under Fair Labor Standards Act prohibitively expensive); *Lytle v. Citifinancial Services, Inc.*, 2002 Pa. Super. 327, *18 (Pa. Super. 2002) (stating that unless plaintiffs can present evidence showing that they cannot feasibly present claim individually, their claim will fail).

Four Justices, dissenting in *Randolph* in an opinion written by Justice Ginsberg, recognized the significance of this burden of proof issue and suggested that it is not necessarily appropriate to place the burden of proving the inaccessibility of the arbitral forum on the challenger, merely because the challenger to arbitration has been required to bear the burden of showing that the arbitral remedies are inadequate. 531 U.S.

do not simply plug their electrodes in to evaluate the fairness of a particular arbitration clause. Rather, courts wait to review evidence and legal arguments, and plaintiffs challenging an arbitration provision bear a substantial burden of proof. Plaintiffs were able to convince the court to throw out the arbitration clause in *Ting* only because plaintiffs did an immense amount of discovery and presented large quantities of factual information at trial. In particular, plaintiffs' attorneys expended more than 2,000 hours in the pre-trial, trial, and immediate post-trial portions of the case.¹⁵⁷ While this number alone is huge, consider that this comes out to hundreds of thousands of dollars using an hourly rate of just \$200 per hour. The defendants, in responding to these challenges, similarly had to expend large sums of money amassing their facts, for trial. Plaintiffs' attorney Paul Bland notes that "[a]t one point we counted that AT & T and AAA between them had at least 17 lawyers enter appearances or engage in discovery battles in the case."¹⁵⁸

Because the costs of challenging a class action prohibition are very high, many plaintiffs and plaintiffs' attorneys likely opt not to even try to challenge such prohibitions.¹⁵⁹ In fact, the costs of challenging arbitration clauses, more generally, may deter many plaintiffs and plaintiffs' attorneys. Does this mean that the arbitration clauses are fair and legal? Not

79, 93-96 (2000) (observing that repeat player defendant may be in better position to make showing regarding costs of arbitration).

¹⁵⁷ See Time Reports from Sturdevant Law Firm and Trial Lawyers for Public Justice reflecting hours expended on *Ting* litigation from May 2001-February 25, 2002 (on file with authors); Bland E-mail, *supra* note ____ (stating plaintiffs' attorneys "put in well over 2,000 hours of lawyer time during the trial phase" of the suit). These time records reflect that hundreds of additional hours were expended by paralegals and law clerks. See also James C. Sturdevant, *The Critical Importance of Creating an Evidentiary Record to Prove that a Mandatory, Pre-Dispute Arbitration Clause is Unconscionable*, __ Forum __ (2000) (describing substantially discovery undertaken by plaintiffs' attorneys in *Ting*).

¹⁵⁸ Bland E-mail, *supra* note ____ . Note that AAA, the American Arbitration Association, became involved in the suit because it was the designated provider of arbitration services.

¹⁵⁹ Note that the *Ting* case was brought as a collaborative effort by San Francisco attorney Jim Sturdevant and the public interest firm, Trial Lawyers for Public Justice. *Ting*, 182 F. Supp. 2d at 906 (list of the counsel in the case). The latter has devoted substantial resources to fighting mandatory arbitration throughout the country, and likely did not take on this suit as a profit-making venture. See Trial Lawyers for Public Justice, *at* <http://www.tlpj.org>.

necessarily. The decision not to bring a challenge may simply reflect a dollars and cents determination that, given the cost of a successful challenge, the likelihood of success, and the likely payoff, it does not make sense to try.¹⁶⁰ From the perspective of individual plaintiffs or plaintiffs' attorneys, it will often be rational not to challenge a class action prohibition.

Policy makers should take the costs of bringing unconscionability and other challenges into account as they decide how to handle companies' attempts to use arbitration clauses to eliminate class actions. On the one hand, as one of us has suggested elsewhere, it might appear that courts can adequately protect the class action using existing law such as unconscionability doctrines.¹⁶¹ The case-by-case approach will allow courts to distinguish between those class action prohibitions that have been proven to substantially limit plaintiffs' ability to bring claims, and those that do not.¹⁶² This may seem fair and appropriate. On the other hand, putting the unconscionability argument to use comes at a high cost. In order for courts to be able to distinguish between those class action prohibitions that are and are not unconscionable, both plaintiffs and defendants must expend lots of time and money. As set out in Section I of this Article, plaintiffs are winning class action challenges only when they can present substantial evidence on various sub-arguments, such as that individual suits are not feasible or that government enforcement is not effective.¹⁶³ These arguments cannot

¹⁶⁰ Economists refer to the costs associated with negotiating, reaching, and enforcing contracts as transaction costs. See OLIVER E. WILLIAMSON, *THE ECONOMIC INSTITUTIONS OF CAPITALISM* (1985) (which gives an overview of transaction cost economics and its behavioral assumptions and discusses the implications of transaction costs for topics as diverse as the structure of firms, contract relations, and antitrust law). See also Oliver Hart, *An Economist's Perspective on the Theory of the Firm* 89 COLUMBIA LAW REVIEW 1757-1774 (1989) and Oliver Williamson, *Transaction Cost Economics* in RICHARD SCHMALENSEE AND ROBERT WILLIG, EDS., *HANDBOOK OF INDUSTRIAL ORGANIZATION* 135-182 (1989) (for additional explanation of transaction costs).

¹⁶¹ Sternlight, *As Mandatory Binding Arbitration Meets the Class Action*, *supra* note __, at 121 (“[C]ourts can adequately protect the policies underlying both class actions and arbitration using existing case law.”).

¹⁶² As Professor Sternlight noted previously, “Plaintiffs who have large claims or who are independently wealthy might be less successful in using the unconscionability argument [to challenge a class action prohibition] than would be poorer plaintiffs with smaller claims.” *Id.* at 107.

¹⁶³ See *supra*

successfully be made on a generalized basis, but rather must be tailored to the specific facts of each case.¹⁶⁴ Plaintiffs' costs deter many challenges,¹⁶⁵ and defendants' costs may well cause the price of their products or services to rise, for all consumers.¹⁶⁶

The alternative to using a case-by-case approach would be for Congress simply to prohibit companies from using arbitration clauses to eliminate class actions. If Congress thought such a general prohibition too broad, it could at least prohibit the practice with respect to arbitration agreements imposed on consumers or employees.¹⁶⁷ Switching to such a legislative approach would create both costs and benefits that must be weighed. The primary advantage of switching to a legislative approach would be that it would substantially reduce the cost of challenging class action prohibitions. To defeat an arbitration clause containing a class action prohibition, plaintiffs would only need to file that clause with the court. This would be a far quicker, easier and cheaper burden for plaintiffs to meet.

In addition, such a legislative prohibition would support interests in preserving the class action that are held by persons other than the plaintiffs. While we tend to assume that class actions are valued only, or primarily, by plaintiffs, in fact those procedural devices may serve other interests as well. For example, one court recognized that courts themselves have an efficiency interest in permitting class actions to exist.¹⁶⁸ As well, it can be argued that class actions serve the public interest, and not merely the interest of class members, by helping to ensure that laws are enforced. Yet, under our current system, because class action prohibitions can be defeated only if challenged by the plaintiffs, only their interests are

¹⁶⁴ See *supra*

¹⁶⁵ See *supra*

¹⁶⁶ See *Ware*, *supra* note __, at 94.

¹⁶⁷ As one of us has discussed elsewhere, the securities industry typically requires individual claims to be arbitrated, but allows class actions to be litigated. See *Sternlight, As Arbitration Meets the Class Action*, *supra* note __ at 45-49.

¹⁶⁸ See *Szetela v. Discover Bank*, 97 Cal. App. 4th 1094, 1101-1102 (Cal. App. 2002).

typically taken into account.¹⁶⁹ This inevitably leads to an undervaluing of other interests favoring class actions, and also possibly to an under-bringing of challenges to class action prohibitions.

At the same time, it could also be argued that the bringing of class actions is detrimental not only to defendants, but also to the court system or the public at large. Some academics as well as corporate interests have pointed to ethical and efficiency issues, and urged that class actions should be limited or reformed, if not eliminated.¹⁷⁰

To date, however, having weighed all these positive and negative features, Congress has determined that the benefits of class actions outweigh any costs. They remain a crucial element of our federal and state rules of civil procedure, and of our litigation system in the United States. While legislation is being considered that would further regulate class actions, no one has seriously proposed wholesale elimination of the important procedural device.¹⁷¹ The question Congress should address is not whether class actions can and should be regulated, but rather whether companies should be permitted to use arbitration clauses to eliminate class actions, except to the extent plaintiffs can prove such clauses are unconscionable. Many, including those representing consumers, have recognized that class

¹⁶⁹ Of course, as noted earlier, plaintiffs' interests in challenging a class action can be taken into account only to the extent that plaintiffs can afford to mount a challenge or can convince a public interest organization to represent their interests.

¹⁷⁰ For a summary of some of the criticisms of class actions *see* Sternlight, *When Mandatory Binding Arbitration Meets the Class Action*, *supra* note __, at 34-37.

¹⁷¹ Class Action Fairness Act of 2002, H.R. 2341, 107th Cong. (2002) (a bill to amend the procedures that apply to consideration of interstate class actions to assure fairer outcomes for class members and defendants, to outlaw certain practices that provide inadequate settlements for class members, to assure that attorneys do not receive a disproportionate amount of settlements at the expense of class members, to provide for clearer and simpler information in class action settlement notices, to assure prompt consideration of interstate class actions, to amend title 28, United States Code, to allow the application of the principles of Federal diversity jurisdiction to interstate class actions, and for other purposes—passed in the House on Mar. 13, 2002, as amended; now under consideration by the Senate as of August 2002, as S. 1712). **JS: update cite.**

actions can be abused.¹⁷² Trial Lawyers for Public Justice runs a “class action abuse prevention project” just as it runs a project to oppose mandatory arbitration.¹⁷³ However, it is not necessary to allow companies to eliminate class actions, at will, in order to support reform of that procedural device.

Although we have focused, here, on legislation that might be enacted by the U.S. Congress, we certainly do not rule out the possibility that state legislatures might separately prohibit companies from proscribing the use of class actions. While it is clear that state legislation that targets arbitration unfavorably will be preempted by the Federal Arbitration Act,¹⁷⁴ it is not evident that state efforts to protect class actions would be void. First, such legislation would not need to focus on arbitration, alone. Rather, states might well choose to prohibit companies from eliminating consumers’ right to proceed by class action either in litigation or in arbitration. Second, state legislation that prohibited companies from eliminating the opportunity to proceed by class action would not eliminate but rather merely regulate arbitration. As numerous courts have now recognized, arbitral class actions are a viable procedural device.¹⁷⁵ Thus, state legislation that protects the right to proceed by class action should not be held preempted by the Federal Arbitration Act.

Companies are increasingly using arbitral class action prohibitions to insulate themselves from any class action liability whatsoever. Such prohibitions are detrimental not only to the potential members of those classes, but to the public at large, in that they are

¹⁷² See, e.g., Brian Wolfman, *Forward: The National Association of Consumer Advocates’ Standards and Guidelines for Litigating and Settling Class Actions*, 176 F.R.D. 370, 370-74 (1998).

¹⁷³ See Trial Lawyers for Public Justice, *supra* note ____.

¹⁷⁴ *Doctor’s Assocs., Inc. v. Casarotto*, 517 U.S. 681, ____ (1996)

¹⁷⁵ See, e.g., *Keating v. Superior Court*, 31 Cal. 3d 584, 612-613 (Cal. 1982) (recognizing possibility of classwide arbitration); *Bazzle v. Green Tree Financial Corp.*, No. 25523, 2002 WL 1955753 (S. Car. Aug. 26, 2002) (permitting arbitrators to certify arbitral class action); *Brennan v. ACE INA Holdings, Inc.*, No. 00-CV-2730, 2002 WL 1804918 *3 (Aug. 1, 2002) (stating that arbitrator should be free to certify class action); *Dickler*

preventing the laws passed by Congress from being adequately enforced. In essence, by eliminating class actions, companies are engaging in “do it yourself tort reform,” freeing themselves from liability without having to convince legislatures to change the substantive law.¹⁷⁶ The unconscionability attacks, while sometimes successful, are themselves too expensive and unwieldy to adequately regulate companies’ attempts to elude class action liability. Thus, as a matter of fairness, efficiency and justice, Congress should prevent companies from exempting themselves from potential class action liability.

v. Shearson Lehman Hutton Inc., 596 A.2d 860 (Pa. Super. 1991) (recognizing possibility of arbitral class action).

¹⁷⁶ One of us coined this phrase in an attack on the practice of using arbitration to eliminate class actions. Sternlight, *As Mandatory Binding Arbitration Meets the Class Action*, *supra* note __ at 11. Paul D. Carrington has employed a similar phrase, “self-deregulation.” While one commentator has suggested that “do it yourself tort reform” is commendable, *see* Roger S. Haydock, *The Supreme Court Creates Real Civil Justice Reform*, 9 Metropolitan Corporate Counsel # 11 at 45 (Nov. 2001), we maintain that the legislature, not individual companies, should be the one to determine whether companies should be allowed to avoid the strictures of substantive law.