[Vol. 11: 275, 2011]
PEPPERDINE DISPUTE RESOLUTION LAW JOURNAL

Waiving Rights Goodbye: Class Action Waivers in Arbitration Agreements After *Stolt-Nielsen v. AnimalFeeds International*

Diana M. Link & Richard A. Bales

I. INTRODUCTION

The popularity of arbitration as a means of alternative dispute resolution has dramatically increased since the enactment of the Federal Arbitration Act (FAA) in 1925.[1] The Act represents a strong congressional policy in favor of arbitration.[2] In arbitration, parties contractually agree to submit disputes to an arbitrator rather than pursuing them in court. Arbitration is considered preferable in many situations because it is quicker, less expensive, simpler, and less formal than the traditional judicial process.[3] Despite all of these benefits, courts have experienced problems with some specialized or uncommon issues that are not addressed by the FAA or prior arbitration jurisprudence.

In particular, courts have been inconsistent in their interpretation of arbitration agreements that prohibit parties from bringing class actions in arbitration or in court.[4] Class action waivers in arbitration agreements come in a variety of forms. Many arbitration agreements prohibit any litigation in court at all, which some courts have construed to necessarily preclude class

1. *See* Federal Arbitration Act, 9 U.S.C. §§ 1-16 (2006); 4 AM. JUR. 2D *Alternative Dispute Resolution* § 91 (2010).

2. *See* Moses H. Cone Mem'l Hosp. v. Mercury Constr. Corp., 460 U.S. 1, 24 (1983) (stating that "Section 2 is a congressional declaration of a liberal federal policy favoring arbitration agreements").

3. Leo Kanowitz, *Alternative Dispute Resolution and the Public Interest: The Arbitration Experience*, 38 HASTINGS L.J. 239, 255 (1987).

4. *See generally* Kristian v. Comcast Corp., 446 F.3d 25 (1st Cir. 2006); Johnson v. West Suburban Bank, 225 F.3d 366 (3rd Cir. 2000); Gentry v. Superior Court, 165 P.3d 556 (Cal. 2007); Discover Bank v. Superior Court, 113 P.3d 1100 (Cal. 2005).

action certification in court.[5] Other arbitration agreements expressly prohibit class arbitration in addition to prohibiting any claims in court.[6] The inconsistencies among the language of class action waivers themselves may be part of the reason courts have ruled inconsistently on their validity. While some courts have held that section 2 of the FAA allows such agreements to be disregarded under basic contract principles,[7] other courts have found that class mechanisms are merely procedural and can be waived in a valid arbitration agreement.[8] An April 2010 United States Supreme Court case, *Stolt-Nielsen v. AnimalFeeds International Corp.*, held that a party to an arbitration agreement cannot be compelled to submit to class arbitration unless there is some contractual basis demonstrating an intention to do so.[9]

Rather than resolving the class arbitration issue, *Stolt* obfuscates it even further. A main reason for the discrepancy among the courts may be the fact that the FAA is silent on the issue of class actions in arbitration.[10] As a result of this inconsistency, some parties with potentially valid claims have been effectively foreclosed from bringing an action because of the costs and risks associated with proceeding with an individual claim in a situation where a class action would arguably be more appropriate.[11]

This article first argues that to determine the enforceability of a class action waiver, courts should take a "totality of the circumstances" approach rather than adopting a bright-line rule. A set of defined factors that also allows courts to consider real-world issues facing litigants will provide a substantial framework for courts to interpret this area of the law and will lead to more consistent and well-reasoned outcomes in the future. These factors include: the probable size of each class member's individual recovery, the potential for retaliation against class members, the awareness of potential class members that their rights have been violated, and other factors such as cost and convenience.[12] Second, this article argues that the

5. *Johnson*, 225 F.3d at 369-71.

6. *Discover Bank*, 113 P.3d at 1103.

7. *Id.* at 1100; *Kristian*, 446 F.3d at 25; *Gentry*, 165 P.3d at 556.

8. *Johnson*, 225 F.3d at 366.

9. Stolt-Nielsen v. AnimalFeeds Int'l Corp., 130 S. Ct. 1758, 1775 (2010).

10. *Discover Bank*, 113 P.3d at 1110. *See* Federal Arbitration Act, 9 U.S.C. § 9 (2006). This section of the FAA concerns arbitral procedure, but does not contain a provision regarding class actions. It seems logical that if class actions were included in the Act, it would be in section 9.

11. *Johnson*, 225 F.3d at 374-75 (in which the court acknowledges that class action is more attractive to plaintiff, but denies relief by relying on the FAA's strong presumption in favor of enforcing arbitration agreements).

12. *See Gentry*, 165 P.3d at 556.

FAA should be amended to include a provision that directly addresses the issues that arise surrounding class action arbitration and class action waivers.

Part II of this article provides a general background in the jurisprudence of arbitration. The basic issues presented by the cases are (1) the enforceability of class action waivers, and (2) whether or not statutory rights are adequately vindicated in the absence of a class mechanism. After gaining an understanding of the judicial history of these two questions separately, Part II then explores the varying decisions courts have reached on class action issues in arbitration, including the recent *Stolt* decision. Some courts have found class certification inappropriate, reasoning that procession as a class is merely a procedural right that can be validly waived.[13] Other courts have held the opposite, arguing that although class mechanisms are technically procedural, they have many substantive implications and should be allowed in certain circumstances.[14]

Part III of this article argues that to synthesize these varying opinions and find a way to move forward in a more consistent way, courts should apply a set of several factors to determine whether to enforce a class action waiver. This method will allow courts to reach a well-reasoned result that is still within the limits of previous courts' decisions and the directives of the FAA.[15]

Part IV of this article proposes an amendment to the FAA that will resolve the issues that surround class action arbitration and provide courts with a statutory basis for future decisions. Before this, however, it is important to understand the way courts determine the enforceability of arbitration agreements and, more specifically, the arbitrability of statutory claims.

II. BACKGROUND

A. Common-Law Interpretation of FAA Section 2

The FAA was enacted in 1925.[16] As a holdover from the English common law courts that disfavored arbitration agreements, American courts had also disfavored arbitration agreements before the enactment of the

13. *See, e.g., Johnson*, 225 F.3d at 366.

14. *See, e.g.,* Kristian v. Comcast Corp., 446 F.3d 25 (1st Cir. 2006); *Discover Bank*, 113 P.3d at 1100.

15. *See Gentry*, 165 P.3d at 556.

16. Federal Arbitration Act, 9 U.S.C. §§ 1-16 (2006).

FAA.[17] With the enactment of the FAA, and particularly section 2 of the Act, came a congressionally mandated policy in favor of enforcing arbitration agreements.[18] However, like any contract, not all agreements to arbitrate pass muster under state contract law principles. The text of section 2 of the Act states: "An agreement in writing to submit to arbitration . . . shall be valid, irrevocable, and enforceable, [as a matter of federal law] *save upon such grounds as exist at law or in equity for the revocation of any contract.*"[19]

The Supreme Court's opinion in *Perry v. Thomas* succinctly defines when courts should and should not enforce agreements to arbitrate.[20] *Perry* interprets section 2 of the Act to mean two things. First, any state law, judge-made or statutory, that concerns the "validity, revocability and enforceability of contracts generally" may be used to invalidate an arbitration agreement.[21] Second, any state law that is specifically aimed at arbitration agreements (as opposed to all contracts generally) may not be used to abrogate or invalidate an arbitration agreement that would otherwise be valid.[22] The first holding of *Perry* requires that arbitration agreements be interpreted the same as all other contracts, and permits them to be voidable under such state-law principles as unconscionability, duress, fraud, and coercion.[23] The second holding is based on the constitutional principle of preemption, which requires that the federally enacted FAA preempts any state law that may conflict with it.[24]

At the time the FAA was enacted, class action litigation was not a common method for resolving disputes, and presumably for that reason, the FAA contains no provision expressly regarding class action in an arbitration context.[25]

B. Arbitrability of Statutory Claims Generally

Each of the cases presented in this article are based on a statutory claim arising under an arbitration agreement. In each case, the litigants argue that these statutory claims cannot be properly resolved absent a class mechanism.

---

17. Gilmer v. Interstate/Johnson Lane Corp., 500 U.S. 20, 22 (1991).
18. Federal Arbitration Act § 1.
19. Federal Arbitration Act § 2 (emphasis added).
20. Perry v. Thomas, 482 U.S. 483 (1987).
21. *Id.* at 492 & n.3.
22. *Id.*
23. Gilmer v. Interstate/Johnson Lane Corporation, 500 U.S. 20, 24 (1991); *Perry*, 482 U.S. at 492.
24. *Perry*, 482 U.S. at 484.
25. Discover Bank v. Superior Court, 113 P.3d 1100, 1110 (Cal. 2005).

Therefore, the cases generally pose a twofold inquiry: (1) Is the class action waiver contained in the agreement valid and enforceable?; and (2) Will statutory rights be vindicated as completely on an individual basis as in a class action? To fully understand the holdings of the cases in this article, a background in the arbitrability of statutory claims in general is necessary.

Before arbitration became as widespread as it is today, there was some question as to whether the FAA applied only to non-statutory contract claims.[26] The Supreme Court has held on several occasions that the FAA does not prevent parties from arbitrating statutory claims.[27] *Gilmer v. Interstate/Johnson Lane Corporation* provides a summary of the state of the law on this subject.

Gilmer, a 1991 United States Supreme Court case, determined that claims under the Age Discrimination in Employment Act (ADEA) are arbitrable.[28] Interstate Johnson/Lane Corporation hired Robert Gilmer as a Manager of Financial Services in 1981.[29] Upon being hired, Gilmer registered with the New York Stock Exchange (NYSE) as a securities representative.[30] His registration with the NYSE contained a clause that provided for arbitration of "any controversy between a registered representative and any member or member organization arising out of the employment or termination of employment of such registered representative."[31] Johnson/Lane Corporation subsequently fired Gilmer in 1987 at the age of sixty-two.[32]

In response, Gilmer filed an age discrimination claim with the Equal Employment Opportunity Commission (EEOC) and thereafter brought suit in United States District Court alleging age discrimination in violation of the ADEA, and seeking to avoid the arbitration agreement for several reasons.[33]

---

26. *Gilmer*, 500 U.S. at 26.

27. *Id.* (citing Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc., 473 U.S. 614 (1985); Shearson/American Express, Inc. v. McMahon, 482 U.S. 220 (1987); Rodriguez de Quijas v. Shearson/American Express, Inc., 490 U.S. 477 (1989)).

28. *Id.* at 23.

29. *Id.*

30. *Id.*

31. *Id.*

32. *Id.*

33. *Id.* at 27, 30-33 (finding arbitration inconsistent with the statutory framework of the ADEA; the ADEA is meant to further important social policies; discovery is inadequate in arbitration; arbitration panels will be biased; lack of public knowledge because arbitrators do not issue written opinions; judicial review is too limited; arbitration does not allow broad equitable relief and class actions; and unequal bargaining power exists between employers and employees).

Gilmer made two main arguments. First, he argued that arbitration is inconsistent with the statutory framework of the ADEA.[34] Second, he argued that the ADEA was enacted to further important social policies, which would not be served if claims were arbitrated rather than heard in court.[35]

Before this case came to the Supreme Court, United States Courts of Appeals were split in their opinions of Gilmer's first claim regarding the legislative intent and history of the ADEA.[36] Gilmer argued that the ADEA protects claimants from waiving a judicial forum in favor of arbitration.[37] In consideration of Gilmer's first argument, the Court noted the long history of judicial distaste for arbitration agreements dating back to English common law and carrying over into the United States.[38] The Court emphasized that the FAA was enacted to combat this judicial distaste and to "place arbitration agreements upon the same footing as other contracts."[39] After summarizing the history of its opinions on the particular issue of the arbitrability of statutory claims, the Court found no compelling reason why statutory rights could not be vindicated in an arbitral forum just as well as in a court.[40]

Based on a prior holding on the issue, the Court determined that no substantive rights are lost when a statutory claim is arbitrated rather than heard in a court, and that if Congress intended for certain or all statutory claims not to be arbitrated that intent would be evident in the text and legislative history of the particular statute or the FAA.[41] In applying this rule, the Court placed the burden of proof on Gilmer to establish that legislative intent or history precluded a waiver of a judicial forum for ADEA claims.[42] The Court concluded that Gilmer did not meet this burden, and that therefore his ADEA claim was properly arbitrated.[43]

Gilmer's second argument was that the ADEA was enacted to "further important social policies."[44] Gilmer argued that if his ADEA claim had been heard in an arbitral forum rather than in court, the decision would not have

---

34. *Id.* at 23.
35. *Id.*
36. *Id.* at 24.
37. *See generally id.* at 33.
38. *Id.* at 24.
39. *Id.*
40. *Id.* at 26.
41. *Id.* (citing Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc., 473 U.S. 614, 628 (1985)).
42. *Id.*
43. *Id.* at 27.
44. *Id.*

its intended social policy impact in reaching others who were discriminated against and setting future precedent for cases like his.[45] However, the Court found that the distinction between a statute's social purposes and adjudicating private grievances was irrelevant for purposes of determining whether or not to enforce an agreement to arbitrate because no inconsistency existed between the two purposes.[46] The Court reasoned that agreements to arbitrate should be upheld whenever they are validly entered into and as long as arbitration allows rights to be fully vindicated.[47] In so holding, the Court determined that "so long as the prospective litigant effectively may vindicate [his or her] statutory cause of action in the arbitral forum, the statute will continue to serve both its remedial and deterrent function."[48] The Court ultimately determined that the public policy purposes of a statute should be considered subordinate to individual vindication of rights so long as the two do not conflict.[49]

Gilmer is often cited in cases interpreting agreements to arbitrate statutory claims. There are two main holdings of *Gilmer* for purposes of later interpretation by courts. First, when a right conferred upon citizens by a statute is capable of being vindicated by arbitration, there is no public policy to support a refusal by the court to uphold an arbitration agreement.[50] Second, even though a statute may have social policy implications which might be more appropriately heard in court, a valid agreement to arbitrate will be upheld as long as litigants' individual rights will be fully vindicated in the arbitral forum regardless of any social policy purposes that may not be as well-served.[51]

C. *The Pre-*Stolt *Split*

In determining the enforceability of class action waivers, courts have been inconsistent in their holdings as well as their reasoning. Some courts have taken the stance that class mechanisms are purely procedural and have

45. *Id.* at 27-28.
46. *Id.* at 27.
47. *Id.* at 28 (citing Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc., 473 U.S. 614, 637 (1985)).
48. *Id.*
49. *Id.*
50. *Id.* at 26.
51. *Id.* at 28.

no bearing on the full vindication of litigants' rights.[52] This group reasons that the right to proceed as a class can be waived in a valid agreement to arbitrate.[53] Other courts have held that class mechanisms have significant substantive implications and that litigants' right to bring an action may be completely foreclosed absent a class mechanism.[54] The main difference between the two groups is the courts' interpretations of the role class mechanisms play in the vindication of rights.

1. Denial of Class Certification

The Third Circuit Court of Appeals denied class certification in the 2000 case *Johnson v. West Suburban Bank.*[55] In *Johnson*, the court determined under the principles announced in *Gilmer* that a claim arising from the Truth in Lending Act (TILA) was arbitrable and that the arbitration agreement at issue necessarily precluded the right to proceed as a class.[56] Terry Johnson procured a short-term loan from the County Bank of Rehoboth Beach.[57] The loan was for $250, but included a finance charge of $88, which constituted an annual percentage rate of 917% and was undisclosed by the bank in an alleged violation of the TILA.[58] Johnson sought to bring a class action suit in court against County Bank of Rehoboth Beach and other defendants who were engaging in similar practices.[59] The defendants responded that the claim was required to be arbitrated under the agreement Johnson signed when he procured the loan.[60] The agreement provided in pertinent part: "NOTICE: YOU AND WE WOULD HAVE HAD A RIGHT OR OPPORTUNITY TO LITIGATE DISPUTES THROUGH A COURT BUT HAVE AGREED INSTEAD TO RESOLVE DISPUTES THROUGH BINDING ARBITRATION."[61]

The main issue before the court was whether Johnson's statutory claims could be arbitrated when he was seeking to bring a class action in court on behalf of multiple claimants.[62] Johnson's main arguments echoed those

52. *See* Johnson v. West Suburban Bank, 225 F.3d 366, 378 (3rd Cir. 2000).

53. *Id.*

54. *See* Kristian v. Comcast Corp., 446 F.3d 25 (1st Cir. 2006); Gentry v. Superior Court, 165 P.3d 556 (Cal. 2007); Discover Bank v. Superior Court, 113 P.3d 1100 (Cal. 2005).

55. *Johnson*, 225 F.3d at 366.

56. *Id.* at 369.

57. *Id.*

58. *Id.*

59. *Id.* at 370.

60. *Id.*

61. *Id.*

62. *Id.* at 368-69.

made by Gilmer.[63] His first argument was that the statutory framework of the TILA inherently conflicted with arbitration, and therefore his statutory rights under the TILA could not be vindicated in an arbitral forum.[64] Second, Johnson argued that the TILA's public policy goals precluded enforcement of the arbitration agreement.[65]

Johnson's first argument rested on a portion of the TILA that specifically mentions class actions as a method of enforcement.[66] Based on this provision, Johnson argued that an inherent conflict existed between the arbitration agreement, which prohibited any type of litigation in court, and the TILA, which specifically mentioned class action litigation.[67] In considering his argument, the court first recognized that Johnson's claim was one of first impression in federal courts.[68] The court then noted that the arbitration agreement itself did not explicitly deny class actions, either in arbitration or in court.[69] However, relying on the strong preference for arbitration expressed in *Gilmer,* the court determined that even though the arbitration agreement made no mention of class actions, it necessarily prohibited them because it required *all* claims to be submitted to arbitration.[70]

In *Gilmer*, the Supreme Court held that statutory claims are generally arbitrable unless it appears from an analysis of the text and legislative history or an inherent conflict between arbitration and the statute's purposes that Congress intended particular statutory claims not to be arbitrable.[71] Therefore, the court in *Johnson* concluded that if Johnson were to prevail in his attempt to avoid the arbitration agreement, it would have to be based upon a finding that there was an inherent conflict between the purposes of the TILA and the arbitration of claims under the Act.[72]

To determine if there was an inherent conflict, the court analyzed the statutory language and legislative intent, noting that the TILA specifically

63. Gilmer v. Interstate/Johnson Lane Corp., 500 U.S. 20, 27 (1991).

64. *Johnson*, 225 F.3d at 368.

65. *Id.* at 369.

66. *Id.* at 371 (stating that "the statute specifically addresses the damages available in a class action, limiting the maximum potential recovery").

67. *Id.* at 368.

68. *Id.*

69. *Id.*

70. *Id.* at 370-71.

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

72. *Id.* at 371.

mentions class actions in at least one place.[73] However, the court narrowly interpreted the statutory language to find that even though the statute referentially mentioned class actions, it did not explicitly state that TILA claimants had any particular *right* to proceed on a class basis.[74] To demonstrate legislative intent, Johnson produced a Senate committee report on the TILA that expressed concerns that recovery caps might be set too low for class actions, thus frustrating the enforcement of the statute.[75] Johnson argued that this report proved the "centrality of class actions to the TILA's effective enforcement."[76] The court disagreed, finding no legislative intent to exempt class action TILA claims from the force of the FAA.[77] Although the court noted that the Senate report did promote class actions as a TILA enforcement mechanism, the report fell "short of demonstrating irreconcilable conflict between arbitration and the TILA."[78] The court determined that although Congress may have intended for class actions to be a method of enforcement of the TILA, equal weight should also be given to Congress's intent in enacting the FAA that all valid arbitration agreements be enforced in their terms.[79] The court then extended its interpretation to find that the class action mechanism is merely a procedural right and not one that is related to the vindication of claims arising under the TILA.[80]

Next, the court considered Johnson's second claim that the public policy goals of the TILA required the availability of class action litigation.[81] Johnson argued that because there are frequently minimal actual damages suffered by consumers in schemes like defendants', the goal of the TILA is not exclusively to reimburse individual consumers, but to discourage unfair credit practices in general.[82] Johnson further argued that the TILA as a whole was enacted for public policy purposes rather than to address private grievances.[83] Johnson's arguments, while forceful, were ultimately unable to persuade the court that class actions were necessary to the remedial and deterrent goals of the TILA.[84] The court relied exclusively on *Gilmer* to

---

73. *Id.* (stating that "the statute specifically addresses the damages available in a class action, limiting the maximum potential recovery").

74. *Id.*

75. *Id.* at 372-73.

76. *Id.* at 373.

77. *Id.*

78. *Id.*

79. *Id.* at 376.

80. *Id.*

81. *Id.* at 369.

82. *Id.* at 373.

83. *Id.*

84. *Id.*

determine that all of Johnson's claims about the public policy of the statute were foreclosed.[85] The court provided further support for its decision by citing to a TILA provision that allowed for administrative enforcement of TILA violations by the Federal Trade Commission.[86]

In a short footnote based on the case *Champ v. Siegel Trading Co.*,[87] the *Johnson* court determined that class actions could not be pursued in arbitral forums unless the arbitration agreement contemplated it.[88] The court came to this conclusion despite acknowledging that the Third Circuit had never addressed whether class arbitration could be pursued in a situation like Johnson's.[89]

This case presents an overwhelmingly strong preference for arbitration and a very narrow interpretation of both the statute and arbitration clause at issue. This case relies heavily on prior decisions without engaging in much original analysis. Although the issues remain largely the same throughout the circuit split, the next set of cases demonstrates the ways other courts have decided them.

2. Allowance of Class Action

The California Supreme Court and the First Circuit Court of Appeals have taken a different approach than the *Johnson* court when considering class action waivers in arbitration agreements.[90] These courts have invalidated class action waivers by relying on state contract principles and the important substantive implications of class mechanisms to the full vindication of statutory rights.

a. Allowance of Class Arbitration Founded Upon State Contract Principles

The California Supreme Court decided *Discover Bank v. Superior Court* in 2005.[91] In *Discover Bank*, the court invalidated a class action waiver

85. *Id.* at 374.
86. *Id.* at 375.
87. Champ v. Siegel Trading Co., 55 F.3d 269, 274-75 (7th Cir. 1995).
88. *Johnson*, 225 F.3d at 377.
89. *Id.*
90. *See generally* Kristian v. Comcast Corp., 446 F.3d 25 (1st Cir. 2006); Gentry v. Superior Court, 165 P.3d 556 (Cal. 2007); Discover Bank v. Superior Court, 113 P.3d 1100 (Cal. 2005).
91. *Discover Bank*, 113 P.3d at 1100.

contained in an arbitration agreement based upon state contract principles.[92] The case involved a claim under the Delaware Consumer Fraud Act and a challenge to the validity of an arbitration agreement between Discover and its cardholders that purported to completely bar any arbitration as a class.[93] The arbitration agreement said: "NEITHER YOU NOR WE SHALL BE ENTITLED TO JOIN OR CONSOLIDATE CLAIMS IN ARBITRATION BY OR AGAINST OTHER CARDMEMBERS WITH RESPECT TO OTHER ACCOUNTS, OR ARBITRATE ANY CLAIM AS A REPRESENTATIVE OR MEMBER OF A CLASS OR IN A PRIVATE ATTORNEY GENERAL CAPACITY."[94] The plaintiff cardholders alleged that Discover was engaging in a deceptive practice with regard to the imposition of late fees upon all cardholders.[95] Each cardholder suffered a minimal amount of damage as a result of this practice, but Discover profited greatly in the aggregate.[96] For this reason, the plaintiffs sought to pursue classwide arbitration despite the arbitration agreement that expressly forbade class arbitration.[97]

The court agreed with the plaintiffs that the class action waiver was invalid, and provided three reasons for this ruling.[98] First, the court found that the class action waiver was both procedurally and substantively unconscionable.[99] Second, the court cited to a California statute that prohibits any party to a contract from immunizing itself from liability.[100] Third, the court distinguished its holding from those of *Johnson* and *Gilmer* by noting the serious substantive implications of class mechanisms.[101]

First, in its determination that the class action waiver was unconscionable, the court looked to the then-recent California Court of Appeals decision in *Szetela v. Discover Bank*.[102] The facts in *Szetela* were essentially identical to the facts of *Discover Bank*.[103] The *Szetela* court held a class action waiver unenforceable on grounds of procedural and substantive unconscionability.[104] Procedural unconscionability existed

92. *Id.* at 1103.
93. *Id.* at 1103-04.
94. *Id.* at 1103.
95. *Id.*
96. *Id.*
97. *Id.*
98. *Id.* at 1104.
99. *Id.* at 1107.
100. *Id.* at 1108.
101. *Id.* at 1113-14.
102. Szetela v. Discover Bank, 118 Cal. Rptr. 2d 862 (Cal. Ct. App. 2002).
103. *Discover Bank*, 113 P.3d at 1104.
104. *Id.* at 1107 (citing *Szetela*, 118 Cal. Rptr. 2d at 867).

because the class waiver was contained in a contract of adhesion.[105] Substantive unconscionability existed because the class action waiver was one-sided and oppressive to the consumer.[106] The court noted that in both cases, Discover's class arbitration waiver provision was not the two-sided agreement that it purported to be; it would be difficult to imagine a scenario when credit card companies proceeded together as a class to sue their cardholders.[107] For this reason, it was apparent that by including the class arbitration waiver, Discover intended to effectively immunize itself from liability for any number of offenses it might commit against its cardholders.[108] The court reasoned that by imposing the class action waiver on its customers, Discover had 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."[109]

Second, the *Discover Bank* court relied on California Civil Code section 1668 to invalidate the class arbitration waiver.[110] Section 1668 provides that "[a]ll contracts *which have for their object, directly or indirectly, to exempt anyone from responsibility for his own fraud, or willful injury* to the person or property of another, or violation of law, whether willful or negligent, are against the policy of the law."[111] The court found invalidation to be acceptable under the FAA section 2, which disavows any arbitration agreements that violate principles of state contract law.[112] Even though the FAA requires the arbitration agreements' terms to be enforced, enforcement is limited by basic contract principles that would invalidate any contract.[113] Under the principles of *Perry*, if California Civil Code section 1668 pertained solely to arbitration agreements, the FAA would preempt it.[114] But because it applies to all contracts, arbitration agreements or otherwise, section 1668 constitutes a general state contract law for purposes

105. *Id.* (citing *Szetela*, 118 Cal. Rptr. 2d at 867).
106. *Id.* (citing *Szetela*, 118 Cal. Rptr. 2d at 867).
107. *Id.* at 1109.
108. *Id.* at 1107-08.
109. *Id.* at 1108.
110. *Id.*
111. *Id.* (quoting CAL. CIV. CODE § 1668 (2010)).
112. Federal Arbitration Act, 9 U.S.C. § 2 (2006).
113. *Discover Bank*, 113 P.3d at 1110.
114. *Id.* at 1111.

of section 2 of the FAA.[115] The court was careful to limit this holding by ensuring that not every class arbitration waiver is presumptively invalid, but "[s]uch one-sided, exculpatory contracts in a contract of adhesion, at least to the extent [that] they operate to insulate a party from liability that otherwise would be imposed under California law, are generally unconscionable."[116]

Third, the court distinguished its holding in *Discover Bank* from the opinions in *Johnson* and *Gilmer*.[117] In its discussion of the *Johnson* holding, the court found that the substantive implications of proceeding as a class were largely ignored and that the *Johnson* court focused too much on the procedural aspect of class actions.[118] The *Discover Bank* court disagreed with the *Johnson* rationale, finding that "[a]ffixing the 'procedural' label on such devices understates their importance and is not helpful in resolving the unconscionability issue."[119] In distinguishing its holding from that in *Gilmer*, the court relied upon a few key factual differences between the statutes at issue in the two cases.[120] The court found that claims such as Gilmer's under the ADEA commonly proceed on an individual basis with large awards.[121] In contrast, consumer fraud claims such as those made in *Discover Bank* almost never proceed on an individual basis because individual damages are simply not large enough to make up for the extremely high litigation costs associated with such complex claims.[122] In making its comparison between the two situations, the court concluded, "classwide arbitration is only justified when 'gross unfairness would result from the denial of opportunity to proceed on a classwide basis.'"[123] Gilmer's claim under the ADEA did not present the circumstances of "gross unfairness" that the court considered to be present in the consumer fraud case of *Discover Bank*.[124]

In sum, the *Discover Bank* court based its holding mainly on state contract principles espoused in both case law and in the California Civil Code.[125] The *Discover Bank* court also emphasized the serious substantive implications of a class mechanism in a consumer credit context where each

115. *Id.*
116. *Id.* at 1109.
117. *Id.* at 1109,1113-14.
118. *Id.* at 1109.
119. *Id.*
120. *Id.* at 1113-14.
121. *Id.*
122. *Id.* at 1107-08.
123. *Id.* at 1113 (quoting Keating v. Superior Court, 645 P.2d 1192, 1209 (Cal. 1982)).
124. *Id.*
125. *Id.* at 1108.

claimant suffers only minimal damages and the incentive to bring individual suit is low because of high litigation costs and low damage awards.[126]

b. Severing Class Action Waiver and Allowing Class Arbitration

The next case represents a slightly different method that courts have employed to invalidate class action waivers. This case applied the principles of *Discover Bank* and expanded them to include an analysis based on the full vindication of statutory rights on a class action versus an individual basis.[127] The First Circuit Court of Appeals decided *Kristian v. Comcast Corp.* in 2006.[128] The *Kristian* court severed a class action waiver based on a "vindication of statutory rights" framework.[129]

Kristian concerned the validity of an arbitration agreement that was provided as an insert enclosed with the bills of Comcast subscribers in the Boston area.[130] The provision of the arbitration agreement, which waived the right to proceed as a class, read as follows:

> THERE SHALL BE NO RIGHT OR AUTHORITY FOR ANY CLAIMS TO BE ARBITRATED ON A CLASS ACTION OR CONSOLIDATED BASIS OR ON BASES INVOLVING CLAIMS BROUGHT IN A PURPORTED REPRESENTATIVE CAPACITY ON BEHALF OF THE GENERAL PUBLIC (SUCH AS A PRIVATE ATTORNEY GENERAL), OTHER SUBSCRIBERS, OR OTHER PERSONS SIMILARLY SITUATED UNLESS YOUR STATE'S LAWS PROVIDE OTHERWISE.[131]

The complaints alleged that Comcast was involved in anticompetitive practices perpetrated via "swapping agreements" in which cable companies traded territories, effectively eliminating competition in certain geographical areas.[132] The plaintiffs sought to bring a class action in state court alleging violations of public policy and unconscionability, and in federal court under federal antitrust law.[133]

The plaintiffs argued that the arbitration agreement in the bill stuffer prevented them from vindicating their statutory rights because it did not

126. *Id.* at 1107-08.
127. Kristian v. Comcast Corp., 446 F.3d 25, 53-64 (1st Cir. 2006).
128. *See generally id.*
129. *Id.* at 64.
130. *Id.* at 30.
131. *Id.* at 53.
132. *Id.* at 29-31.
133. *Id.* at 31.

allow for a class mechanism.[134] The court agreed with the plaintiffs, giving three reasons for their invalidation of the class action waiver under a "vindication of statutory rights" framework. First, the court stressed the substantive implications of class action mechanisms.[135] Second, the court distinguished the *Kristian* case from the holding in *Johnson*.[136] Third, the court applied the principles of *Discover Bank* to its "vindication of statutory rights" framework.[137] Based on this analysis, the court determined that severance of the class arbitration waiver was appropriate.[138]

First, in its determination that class mechanisms have important substantive implications, the court addressed Comcast's argument that class mechanisms are a procedural rather than a substantive right and thus are capable of being validly waived.[139] In response to Comcast's arguments, the court turned to the vindication of rights analysis and cited several cases in support of the proposition that in certain circumstances, in the absence of a class mechanism, no injured parties will proceed on an individual basis.[140] The court noted that the reason for having a class mechanism in place is to address situations in which numerous plaintiffs each have small damages and therefore lack incentive to bring an action on their own, but when grouped together can effectively vindicate their rights.[141] The court quoted famous language from *Carnegie v. Household International, Inc.*, which bluntly stated, "only a lunatic or a fanatic sues for $30.00."[142] The court gave some credence to Comcast's argument that class actions are a procedural mechanism but ultimately concluded that the substantive implications of the technically procedural class mechanism could not be ignored.[143] The court compared each individual Comcast subscriber's recovery of a few hundred to a few thousand dollars to the fees for attorneys and expert witnesses in such a case, which it estimated could go into the millions.[144] This comparison brought the court to the conclusion that "the

134. *Id.* at 37 (stating that "arbitration agreements prevent them from vindicating their statutory rights because the agreements: (1) provide for limited discovery; (2) establish a shortened statute of limitations period; (3) bar recovery of treble damages; (4) prevent recovery of attorney's fees; and (5) prohibit the use of class mechanisms").

135. *Id.* at 55.

136. *Id.* at 56-57.

137. *Id.* at 60-61.

138. *Id.* at 64.

139. *Id.* at 54.

140. *Id.* (quoting Amchem Prods., Inc. v. Windsor, 521 U.S. 591, 617 (1997)).

141. *Id.* (quoting *Amchem*, 521 U.S. at 617).

142. *Id.* (quoting Carnegie v. Household Int'l, Inc., 376 F.3d 656, 661 (7th Cir. 1997)).

143. *See id.*

144. *Id.*

class mechanism ban—'particularly its implicit ban on spreading across multiple plaintiffs the costs of experts, depositions, neutrals' fees, and other disbursements'—forces the putative class member to assume financial burdens so prohibitive as to deter the bringing of claims . . . ."[145]

Second, the court acknowledged that the Third Circuit upheld an arbitration agreement that waived class actions in *Johnson v. West Suburban Bank*, but distinguished its *Kristian* holding in three ways.[146] First, the court noted that the statutes involved were different, and the importance of a class mechanism to the vindication of rights under federal antitrust law is far greater than under the TILA.[147] Second, the *Johnson* court relied on the availability of attorney's fees as an incentive to bring individual claims under the TILA, however, in the federal antitrust context attorney's fees can reach into the millions and it would be extremely unlikely for an attorney to be able to justify full recovery of those fees if the plaintiff's award was only in the hundreds or thousands of dollars.[148] Third, the court in *Johnson* relied on the administrative enforcement provisions of the TILA to justify its holding that private enforcement via class actions were to be prohibited.[149] The *Kristian* court spoke to this point in the federal antitrust context by finding that "Congress envisions a role for both types of enforcement. Otherwise, Congress would not have provided for both. Weakening one of those enforcement mechanisms seems inconsistent with the Congressional scheme. Eliminating one of them entirely is surely incompatible with Congress' choice."[150]

The *Kristian* court's third reason for invalidating the class action waiver was that the plaintiffs' statutory rights could not be completely vindicated in the absence of a class mechanism.[151] This reasoning was based on an application of the "vindication of statutory rights" analysis to the principles announced in *Discover Bank*. The court quoted *Discover Bank* in support of its finding that class arbitration should be allowed: "[C]lass actions and arbitrations are, particularly in the consumer context, often inextricably linked to the vindication of substantive rights."[152] In its application of the

145. *Id.* at 55.
146. *Id.* at 56-57.
147. *Id.* at 58.
148. *Id.* at 58-59.
149. *See id.* at 59.
150. *Id.*
151. *See id.* at 60.
152. *Id.* at 60 (quoting Discover Bank v. Superior Court, 113 P.3d 1100, 1109 (Cal. 2005)).

principles laid out the year before in *Discover Bank*, the court ultimately found that if the class action waiver were to be enforced, Comcast would effectively avoid liability for offenses perpetrated against all of its customers.[153] The court found that without a class mechanism, plaintiffs' rights would not be vindicated and the goals of the federal antitrust laws would be frustrated by the "'enforcement gap' created by the de facto liability shield."[154] The court noted that although its analysis was based on a "vindication of statutory rights" framework, it would have been identical if it had proceeded on a state law unconscionability basis, as the court in *Discover Bank* did.[155] The class action waiver in *Discover Bank* was unconscionable because it prevented the plaintiffs from vindicating their statutory rights.[156]

After explaining its reasons for invalidating the class action waiver, the court determined whether the entire arbitration agreement should be invalidated or if the offending clause could be severed.[157] The court found that the last sentence of the class arbitration waiver, "UNLESS YOUR STATE'S LAWS PROVIDE OTHERWISE," allowed for that portion of the clause to be invalidated and severed from the rest of the arbitration agreement.[158] The court acknowledged a judicial preference of either wholly invalidating contracts or enforcing them in all their terms and general judicial hesitance to sever agreements because they do not want to re-write the private contracts of the parties.[159] The court here found severance of the class waiver permissible because of the savings clause in the last line that provided for the severance of provisions not in accordance with state law.[160] Thus, the court allowed the plaintiffs to proceed as a class in the arbitral forum rather than in court, upholding as much of the arbitration agreement as was consistent with the law.[161]

c. *A Multi-Factor Analysis for Determining Enforceability of Class Action Waivers*

A recent case concerning the issue of class action waivers provided a multi-factor analysis that synthesized the various holdings of the other cases

153. *See id.* at 61.
154. *Id.*
155. *See id.* at 63-64.
156. *Id.*
157. *See id.* at 61-62.
158. *Id.*
159. *Id.* at 62.
160. *Id.* at 62-63.
161. *Id.* at 63.

in the split. In the 2007 case of *Gentry v. Superior Court*, the California Supreme Court applied a four-factor analysis to determine the validity of a class action waiver.[162] These factors include: (1) potentially modest individual recoveries, (2) the possibility of retaliation against class members, (3) the fact that some potential class members may not even know their rights were abridged, and (4) "other real world obstacles to the vindication of class members' right[s]."[163] This case differs from the others presented in this article because it arose in an employment contract rather than a consumer fraud context. *Gentry* involved an employment contract between Robert Gentry and his employer, Circuit City.[164] Gentry sought to proceed in arbitration to recover overtime pay from Circuit City with a class of workers similarly situated.[165] The arbitration agreement that Gentry signed when he began employment forbade such proceedings, stating, "The Arbitrator shall not consolidate claims of different Associates into one proceeding, nor shall the Arbitrator have the power to hear arbitration as a class action."[166]

In determining whether to enforce the class action waiver at issue, the *Gentry* court identified four factors that should be considered.[167] The court explained that if, in light of the factors, class arbitration would be more effective at vindicating the rights of employees than individual arbitration, the waiver should not be enforced.[168] The court deduced that the four most important factors in determining the validity of a class action waiver were: (1) potentially modest individual recoveries, (2) the possibility that Circuit City would retaliate against class members, (3) the fact that some Circuit City employees may not even know their rights were abridged, and (4) "other real world obstacles to the vindication of class members' right[s]."[169] After analyzing each factor individually, the court concluded that the class action waiver was procedurally unconscionable.[170] *Gentry* was decided very soon after *Discover Bank*, and it applied largely the same framework as

162. Gentry v. Superior Court, 165 P.3d 556, 558 (Cal. 2007).
163. *Id.* at 568.
164. *Id.* at 559.
165. *Id.*
166. *Id.* at 560.
167. *Id.*
168. *Id.* at 568.
169. *Id.*
170. *Id.* at 560-62.

Discover Bank to hold the waiver procedurally unconscionable.[171] The California Supreme Court then remanded the case to the Court of Appeals to determine whether or not the class action waiver was substantively unconscionable.[172]

D. The Supreme Court's Stolt *Decision*

The United States Supreme Court decided *Stolt-Nielsen v. AnimalFeeds International Corp.* on April 27, 2010.[173] In a 5-3 decision with Justice Sotomayor not participating, *Stolt* held that a party to an arbitration agreement cannot be compelled to submit to class arbitration unless the arbitration agreement itself demonstrates an intent to do so.[174] The case involved a dispute between a shipping company, Stolt-Nielsen, and one of its customers, AnimalFeeds International.[175] AnimalFeeds alleged that Stolt-Nielsen was engaging in an illegal price-fixing conspiracy.[176] When contracting to ship its goods with Stolt-Nielsen, AnimalFeeds signed a standard shipping contract which contained an arbitration clause.[177] The contract and the arbitration clause were governed by maritime law, and both parties stipulated that the arbitration clause was silent on the issue of class actions.[178]

In 2005, AnimalFeeds served Stolt-Nielsen with a demand for class arbitration.[179] The demand was thereafter submitted to a panel of arbitrators to determine whether the arbitration clause allowed for class arbitration.[180] The panel determined that nothing in the arbitration clause demonstrated an intent to preclude class arbitration, and that arbitration therefore was allowed.[181] The arbitrators then stayed the proceedings so Stolt-Nielsen could seek judicial review of the arbitrators' decision in the Southern District of New York; eventually, that court vacated the arbitrators' decision based on the conclusion that the decision was made in manifest disregard of federal maritime law.[182] The court reasoned that contracts under maritime

171. *Id.* at 560.
172. *Id.* at 575.
173. Stolt-Nielsen v. AnimalFeeds Int'l Corp., 130 S. Ct. 1758 (2010).
174. *Id.* at 1775.
175. *Id.* at 1764.
176. *Id.* at 1765.
177. *Id.*
178. *Id.* at 1766.
179. *Id.* at 1765.
180. *Id.* at 1766.
181. *Id.*
182. *Id.*

law should be construed under trade "custom and usage" and that there was no custom or usage of class arbitration in maritime law.[183] AnimalFeeds then appealed to the Second Circuit Court of Appeals which reversed, concluding that there was no custom or usage in maritime law *against* class arbitration and thus the arbitrators did not disregard maritime law.[184] The Supreme Court granted certiorari to determine "whether imposing class arbitration on parties whose arbitration clauses are 'silent' on that issue is consistent with the Federal Arbitration Act."[185]

In answering "no" to that question, Justice Alito, writing for the Court, stressed two unique facts of the case before it and ultimately concluded that the arbitrators' decision was "fundamentally at war with the foundational FAA principle that arbitration is a matter of consent."[186] The first fact the court stressed was that the contract at issue was governed by the "custom and usage" of maritime law.[187] This was the same point that the Southern District of New York relied on to vacate the arbitrators' decision.[188] The Supreme Court agreed with the Southern District of New York in its finding that there was no custom and usage of class arbitration in maritime arbitration agreements.[189] The second fact the court relied upon to deny class arbitration was that both parties were sophisticated business entities.[190]

To support its conclusion that the FAA principle of consent is fundamentally at odds with requiring a party to submit to class arbitration in absence of a contractual basis for doing so, the Court noted three key differences between bilateral and class arbitration.[191] First, the Court pointed out that class arbitration resolves disputes between many parties instead of only two.[192] Second, class arbitration does not provide the same presumption of "privacy and confidentiality" that bilateral arbitration does.[193] Third, class arbitration binds not only the two parties to the

183. *Id.*
184. *Id.*
185. *Id.* at 1764.
186. *Id.* at 1775.
187. *Id.*
188. *Id.*
189. *Id.*
190. *Id.*
191. *Id.* at 1776.
192. *Id.*
193. *Id.*

contested agreement, but other absent parties as well.[194] The Court concluded that these differences were too great for "arbitrators to presume, consistent with their limited powers under the FAA, that the parties' mere silence on the issue of class-action arbitration constitutes consent to resolve their disputes in class proceedings."[195] Despite this conclusion, the Court noted that its decision did not determine precisely what contractual basis would support a conclusion that the parties had agreed to class arbitration.[196]

Justice Ginsburg, joined by Justices Stevens and Breyer, dissenting, argued that "[w]hen adjudication is costly and individual claims are no more than modest in size, class proceedings may be 'the thing' *i.e.*, without them, potential claimants will have little, if any, incentive to seek vindication of their rights."[197] She then pointed out two "stopping points" in the majority's holding.[198] First, the Court did not require an *express* contractual authorization of class action arbitration.[199] Second, by noting that the parties in this case were sophisticated business entities, the Court apparently spared consumer contracts of adhesion from its holding.[200]

Although this case did not concern a class arbitration waiver, it has strong implications for all issues surrounding class action arbitration. It presents a narrow interpretation of the FAA that seems to mark a step back in the Court's stated policy of encouraging arbitration.

III. ANALYSIS

Each case presented above has taken a different approach in its interpretation of class action issues in arbitration. For this reason, this section will evaluate the strengths and weaknesses of each to establish a cohesive approach for future courts to apply. The first section of Part III will analyze the arguments in favor of upholding class action waivers. The next section will explore the arguments in favor of invalidating class action waivers. The final section of Part III will propose a four-factor analytical framework for future cases.

194. *Id.*
195. *Id.*
196. *Id.*
197. *Id.* at 1783.
198. *Id.*
199. *Id.*
200. *Id.*

A. Arguments in Favor of Upholding Class Action Waivers

Both the FAA and subsequent Supreme Court decisions have expressed a strong presumption in favor of the validity of arbitration agreements in general.[201] The *Johnson* court enforced the arbitration agreement at issue exactly as it was written and agreed to by the parties, even though it did not contain a class action waiver and was silent on the issue of class arbitration.[202] The *Stolt* court employed a very similar analysis.[203] There are three reasons why courts may want to follow this approach in future cases: (1) the ease of application, (2) the legislative intent of the FAA, and (3) minimal judicial role.

First, a per se rule upholding all class action waivers or denying class actions when the agreement is silent on the issue would be simple and easy to apply. It simplifies the court's role in the arbitration process and arguably stays true to the principle that contracts should be enforced on their terms. Thomas Wilmowski argues in favor of this approach in an article discussing the validity of class action waivers.[204] Wilmowski contends that courts regularly enforce contracts of adhesion and should not apply special rules to class action waivers.[205] This approach puts class action waivers on the same footing as all other contract terms and would invalidate a class action waiver only when it found the arbitration agreement as a whole invalid.

Second, this approach seems truest to Congress's intent in enacting the FAA because it embodies the strong presumption in favor of enforcing arbitration agreements that Congress wished to achieve with the FAA. Because Congress has expressed such a clear intent in favor of arbitration, it can be argued that courts that invalidate class action waivers are dispensing with congressional intent. However, the FAA is silent on the specific issue of class arbitration, so some room is left for debate.[206] The alternative argument could be made that, as Justice Ginsburg suggests in her *Stolt* dissent, class action waivers may make it impossible for consumers to pursue small-dollar claims in any forum at all.[207] This does not result in

201. *See supra* Part II.A-B; Federal Arbitration Act, 9 U.S.C. §§ 1-16 (2006).

202. Johnson v. West Suburban Bank, 225 F.3d 366 (3rd Cir. 2000).

203. *Stolt*, 130 S. Ct. at 1758.

204. Thomas Wilmowski, *A Little Fish in a Big Sea: Should Consumer Protection Statutes Override Class Arbitration Waivers?*, 2007 J. DISP. RESOL. 313, 322.

205. *Id.*

206. *Johnson*, 225 F.3d at 366.

207. *Stolt*, 130 S. Ct. at 1776.

more arbitrations as Congress intended with the FAA; rather, these claims go nowhere at all. Wilmowski argues that if Congress wishes to take a position on the issue, it should amend the FAA to either allow or prohibit class action waivers.[208]

Third, the decisions by the courts in *Johnson* and *Stolt* fully embody a judicial hands-off policy in the arena of arbitration agreement, which was Congress' intent in enacting the FAA.[209] The *Johnson* court analyzed Johnson's claims on an individual level and found that his rights would be no better vindicated in litigation than they would be in arbitration.[210] Because the arbitration agreement was also found to be valid and enforceable, the court determined that proceeding with class litigation was merely a procedural right that did not interfere with the vindication of Johnson's personal statutory rights.[211] The *Stolt* Court concluded that because the parties did not manifest an intent to submit to class action arbitration, an arbitration panel could not impose it upon them.[212] The merit in this approach is in its simplicity and ease of application to cases with varying fact scenarios.

B. Arguments in Favor of Invalidating Class Action Waivers

Although there are several arguments in favor of upholding class action waivers, there are also compelling arguments in favor of invalidating class action waivers. The *Discover Bank* and *Kristian* cases taken together represent a strong argument that class action waivers in arbitration agreements may be unconscionable because they do not allow for the full vindication of statutory rights.[213] Unlike the court in *Johnson,* the court in *Discover Bank* and *Kristian* viewed the class action waivers at issue as waivers of *substantive* rights and not as waivers of *procedural* rights. In viewing the agreements through this lens, the courts came to predictably different conclusions than did the *Johnson* court.

The courts in *Discover Bank* and *Kristian* based their conclusions on three main arguments. The first argument is that section 2 of the FAA requires arbitration agreements to be invalidated if they violate state contract principles.[214] The second argument is that class action mechanisms have

208. Wilmowski, *supra* note 204, at 323.
209. *Johnson*, 225 F.3d 366 at 376.
210. *See supra* Part II.C.1.
211. *Johnson*, 225 F.3d at 376.
212. *See supra* Part II.D.
213. *See supra* Part II.C.2.a-b.
214. *See supra* Part II.C.2.a-b.

important substantive implications and rights may not be fully vindicated in their absence.[215] The third argument is that class waivers should be severed instead of invalidating the agreement as a whole.[216]

The courts' first argument is that section 2 of the FAA requires arbitration agreements to be invalidated if they violate state contract principles.[217] This is a straightforward interpretation of the FAA, which states that agreements to arbitrate should be enforceable "save upon such grounds as exist at law or in equity for the revocation of any contract."[218] Although the act does represent a strong policy in favor of arbitration generally, section 2 was written to provide relief to parties who entered into an agreement that did not comply with state-law contract principles. Many of the class action waivers discussed in this article were presented on a take-it-or-leave-it basis by a large company with significantly greater bargaining power than its customers.[219] For this reason, courts have applied section 2 to deem class action waivers of this nature unconscionable and therefore unenforceable.[220]

The second argument, that class mechanisms are a substantive right, focuses on real-world concerns instead of applying a strict construction of arbitration agreements that were not freely bargained for. The argument, relied upon in *Discover Bank* and *Kristian*, posits that even though class mechanisms can be viewed as merely procedural mechanisms, substantive rights can be violated without any remedy in their absence.[221] The *Gilmer* decision has been criticized by the D.C. Circuit Court for placing too heavy an emphasis on the *procedural* and *substantive* labels.[222] The D.C. Circuit Court concluded that substantive rights depend for their enforcement upon the existence of at least minimal procedures.[223] At a minimum, then, "statutory rights include both a substantive protection and access to a neutral forum in which to enforce those protections."[224] A lopsided arbitration

215. *See supra* Part II.C.2.a-b.
216. *See supra* Part II.C.2.a-b.
217. *See supra* Part II.C.2.a-b.
218. Federal Arbitration Act, 9 U.S.C. § 2 (2006).
219. *See supra* Part II.C.2.a-b.
220. *See supra* Part II.C.2.a-b.
221. *See supra* Part II.C.2.a-b.
222. Cole v. Burns Int'l Sec. Servs., 105 F.3d 1465 (D.C. Cir. 1997).
223. *Id.* at 1482.
224. *Id.* (citing Graham Oil Co. v. ARCO Prods. Co., 43 F.3d 1244, 1246-48 (9th Cir. 1994); JEROLD S. AUERBACH, JUSTICE WITHOUT LAW? 144-45 (1983)).

agreement that effectively waived the employee's ability to enforce the statutory law would effectively waive the employee's substantive rights, contrary to the Supreme Court's prescription in *Gilmer*.[225]

Furthermore, the Supreme Court has stated on several occasions that arbitration is not a waiver of substantive rights—it is just an agreement to have those rights resolved in a different forum.[226] In the context of a group of consumers each with a small dollar claim, being forced to arbitrate on an individual rather than a class basis does require a waiver of substantive rights. In that situation, there is no ability to pursue the claim at all.

Viewing the right to proceed as a class as substantive rather than procedural creates a more flexible approach that allows courts to meaningfully weigh the options of the potential class members. Both the court in *Discover Bank* and the court in *Kristian* found that the plaintiffs' statutory rights would effectively be left unaddressed if they were not allowed to proceed on a class basis in some form.[227] In taking a realistic view of the individual facts of each case, the courts found that it would not be economically feasible for the plaintiffs to proceed on an individual basis for the following reasons: the high attorneys' and expert fees associated with the type of claim involved, the low amount of actual damages, or some combination of those and other factors.[228]

The third argument, that class waivers should be severed instead of invalidating the agreement as a whole, also serves the purposes of the FAA and minimizes judicial interference.[229] Severing only an unconscionable class action waiver while upholding the rest of the arbitration agreement is consistent with the intent of the FAA to promote arbitration.[230] The courts in *Discover Bank* and *Kristian* took pains not to invalidate the arbitration agreements in their entirety; instead, the courts severed only those portions incompatible with state contract principles.[231] This approach is attractive because it evaluates claims on an individual basis and arguably produces a more fair result.[232]

---

225. *Id.*

226. *See* Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc., 473 U.S. 614, 628 (1985); Shearson/American Express, Inc. v. McMahon, 482 U.S. 220, 229 (1987); Rodriguez de Quijas v. Shearson/American Express, Inc., 490. U.S. 477, 481 (1989).

227. *See* Kristian v. Comcast Corp., 446 F.3d 25 (1st Cir. 2006); Discover Bank v. Superior Court, 113 P.3d 1100, 1109 (Cal. 2005).

228. *See supra* Part II.C.2.a-b.

229. *See Discover Bank*, 113 P.3d at 1111.

230. *See id.* at 1110-11.

231. *See id.* at 1104; *Kristian*, 446 F.3d at 61-62.

232. *See Discover Bank*, 113 P.3d at 1104-05.

C. *Courts Should Apply a Multi-Factor Test to Determine the Validity of Class Action Waivers*

Although the *Discover Bank* and *Kristian* courts reached well-reasoned results, both courts came to their conclusions in a piecemeal and inconsistent way.[233] In an article discussing the enforceability of class action waivers, Heather Bromfield argues that all class action waivers should be invalidated on principles of unconscionability.[234] However, this approach suffers from many of the same defects as arguments in favor of blindly enforcing all class action waivers. Invalidating all class action waivers would defeat the purpose of arbitration—that two parties may contract to resolve their disputes in a way that is mutually agreeable to them.[235] If courts were to simply invalidate every class action waiver, it would impose judicial constraints on the subject matter of personal contracts, something that is most certainly not the intention of the FAA. The best approach to take is not all-or-nothing in either direction, but rather an easily applied test that can be customized to the individual facts of a case while still maintaining consistent results across the board.

The California Supreme Court case *Gentry v. Superior Court* provides a solid framework of analysis that courts should apply in future challenges to the validity of class action waivers.[236] This framework applies the principles of *Discover Bank* and *Kristian* in a more easily accessible and methodical way by utilizing a set of four factors to determine the validity of class action waivers in arbitration agreements.[237]

The first factor the *Gentry* court identified was the probable size of each individual class member's recovery.[238] The smaller the individual recovery, the less likely a person is to go through the hassle and expense of pursuing arbitration on an individual level.[239] This factor can be easily applied to the cases discussed in the pre-*Stolt* split. In *Gilmer*, the court found that individual recovery in ADEA claims is typically substantial; therefore, it was not a significant hindrance to proceed individually rather than on a

233. *See generally id.* at 1100; *Kristian*, 446 F.3d at 25.

234. Heather Bromfield, *The Denial of Relief: The Enforcement of Class Action Waivers in Arbitration Agreements*, 43 U.C. DAVIS L. REV. 315, 332 (2009).

235. *See* Kanowitz, *supra* note 3, at 255.

236. *See* Gentry v. Superior Court, 165 P.3d 556, 568-70 (Cal. 2007).

237. *See id.* at 560-70.

238. *Id.* at 564.

239. *See id.* at 561.

classwide basis.[240] In *Discover Bank* and *Kristian*, the arbitration agreements at issue arose from consumer contracts between creditors and their customers.[241] These cases involved allegations that the creditor's practices were unfair to all of their customers, but no single customer incurred substantial monetary loss.[242] In these cases, the court found that the likely small recovery for individual claimants would not outweigh the hassle and expense of proceeding on an individual basis.[243] A similar situation occurred in *Stolt*, but between parties to a shipping contract rather than a consumer transaction.[244]

The second factor the *Gentry* court identified was the potential for retaliation against members of the class.[245] Because *Gentry* was an employment case, the court considered whether an individual who proceeded against his employer alone would face more potential future retaliation than a group of employees who proceeded together.[246] Although this does not directly parallel the consumer credit context, consumers could reasonably contemplate retaliation against them either by having credit revoked or being unable to secure future loans. It would seem significantly less likely that these negative consequences would materialize if the plaintiffs had the benefit of proceeding as a class. This could also occur in the shipping context, as presented in *Stolt*. If one shipping company is engaging in allegedly anti-competitive practices and only one of its customers challenges it in arbitration, that customer could simply be blacklisted by the shipper. However, if all of the company's customers were able to proceed as a class, the company would be forced to comply with the law or face losing all of its business.

The third *Gentry* factor to be considered is whether potential class members exist that may be "unaware that their legal rights have been violated."[247] The court reasoned that if there are people who are unaware that their rights have been violated, they might never get a remedy in the absence of a class action because they will never know to pursue an individual claim.[248] This factor can be applied in even more consumer credit situations than employment situations. Particularly in the cases of *Kristian*

---

240. *See supra* Part II.C.1.

241. *See* Kristian v. Comcast Corp., 446 F.3d 25, 29 (1st Cir. 2006); Discover Bank v. Superior Court, 113 P.3d 1100, 1103 (Cal. 2005).

242. *See Kristian*, 446 F.3d at 58; *Discover Bank*, 113 P.3d at 1122.

243. *See supra* Part II.C.2.a-b.

244. *See supra* Part II.D.

245. Gentry v. Superior Court, 165 P.3d 556, 565 (Cal. 2007).

246. *See id.* at 579.

247. *Id.* at 566.

248. *Id.* at 566-67.

and *Discover Bank,* the defendant companies engaged in practices that affected all or nearly all of their customers.[249] Most likely, a large portion of those customers had no knowledge that their rights were being violated. Similarly in *Stolt*, the shipping company's customers may not all have been aware of the anti-competitive practices that were driving up shipping costs. If the arbitrators had determined that potential class members did exist, they could have ordered that class representatives give notice to all potential class members, which Federal Rule of Civil Procedure 23 requires in traditional litigation, before commencing class arbitration.[250]

The fourth factor that *Gentry* identifies acts as a catchall for any other circumstances that the individual facts of a case might present. The court described this fourth category as "other real world obstacles to the vindication of a class members' rights."[251] These real world obstacles are likely to include those discussed in the circuit split cases, such as the amount of attorney's fees associated with bringing an individual claim, the cost to hire expert witnesses, and the public policy goals of the statute that the plaintiff argues was violated. This fourth category presents a flexible way for the court to consider circumstances that are not easily addressed by rigid rules and formulas, and it could tip the scale either in favor of or against procession as a class.

Each of these factors should be considered in light of the statutory requirements of the FAA and the individual statute at issue in the case. By no means should a court fashion its own version of justice by ignoring the relevant statutory requirements. These factors are meant to aid the court in its interpretation of section 2 of the FAA and the overall legislative intent of both the FAA and the statute at issue in a case.

In addition to the application of the four *Gentry* factors, courts should always seek to uphold the portions of the arbitration agreement that do not violate state contract law. For this reason, it is unlikely that courts will face many situations where proceeding with class *litigation* is appropriate. Only in situations where the court finds the entire arbitration agreement unenforceable should the court allow a group of plaintiffs to proceed with a class action in court. Instead, in most situations, the court will determine whether or not to sever an unconscionable class arbitration waiver from an

249. Kristian v. Comcast Corp., 446 F.3d 25 (1st Cir. 2006); Discover Bank v. Superior Court, 113 P.3d 1100 (Cal. 2005).

250. *See* FED. R. CIV. P. 23(c)(2).

251. *Gentry*, 165 P.3d at 567.

otherwise valid arbitration agreement. In those situations, the court should apply the *Gentry* factors. If it determines that class arbitration would be the only way to fully vindicate the rights of the plaintiffs, and that individual arbitration would give the plaintiffs less-comprehensive vindication of their rights, it should sever the class action waiver and compel arbitration on a classwide basis.

IV. PROPOSED FAA AMENDMENT

Although the multi-factor framework will provide courts with a way to fairly and lawfully settle class arbitration issues, it is only a band-aid for a larger problem. The FAA does not currently contain any provision addressing class action issues in arbitration.[252] To fully correct the problem presented by this article, Congress should amend the FAA to include a provision addressing these issues. This provision should accomplish three goals. First, it should establish class action arbitration as an accepted mode of arbitration under the FAA. Second, it should provide instruction to parties and courts on how to interpret class action waivers. Third, it should set a standard for arbitration agreements that are silent on the issue of class arbitration.

A. What the Amendment Should Accomplish

The proposed amendment should be added to the end of Chapter One as section 17 of the FAA. The first subsection should contain a general statement endorsing class arbitration and providing a procedural structure for arbitrators to follow. This section would be the foundation for courts and parties to point to when seeking to proceed with class arbitration. It would also allow class arbitration to be conducted in a uniform manner, thus avoiding the need for judicial review of procedural mechanisms.

The second subsection would address how courts and arbitrators should interpret varying class action waivers. This section should be broken down into agreements between sophisticated bargaining parties and contracts of adhesion presented on a take-it-or-leave-it basis. For parties that are sophisticated business entities or for individuals who engage in meaningful bargaining, the waiver should be upheld. This flows from the principle emphasized in *Stolt* that arbitration is fundamentally founded upon the consent of two parties.[253]

---

252. *See* Federal Arbitration Act, 9 U.S.C. §§ 1-16 (2006).

253. Stolt-Nielsen v. AnimalFeeds Int'l Corp., 130 S. Ct. 1758, 1775 (2010).

The rules for contracts of adhesion should be considerably more flexible. The amendment should give arbitrators discretion to allow or deny class arbitration based on the four *Gentry* factors. Because contracts of adhesion are not freely bargained for, class action waivers could potentially disadvantage parties to the point of extinguishing their claims entirely. Contracts of adhesion are typically found in consumer transactions between a large business entity and its several customers. If the business perpetrates a small fraud on all of its customers, it could profit greatly in the aggregate while only disadvantaging each customer minimally. This leaves the customer in the position of mounting a potentially costly action against the company to recover a comparably small amount. In these situations, class actions are necessary to vindicate the rights of any of the wronged consumers. Here, the proposed amendment should presume the unconscionability of the waiver and adopt the four *Gentry* factors. The arbitral panel should decide whether an application of the *Gentry* factors overcomes the presumption of unconscionability. If the presumption of unconscionability is overcome, the class action waiver should be upheld. If the presumption is not overcome, the class action waiver should be severed from the agreement, leaving intact as much of the agreement as remains conscionable. This process would be consistent with principles of section 2 of the FAA, allowing arbitration agreements to be invalidated if they violate basic state contract principles.[254]

The third section of the proposed FAA amendment should provide guidance for arbitration agreements that are silent with respect to class arbitration. Here, the arbitrator should be required to determine whether the arbitration agreement was freely bargained for or presented as a contract of adhesion. Then, the arbitrator should analyze each of the four *Gentry* factors, but without the presumption of unconscionability that is in place for class action waivers. This section of the amendment should seek to uphold the arbitration agreement as written as much as possible, only departing from it if justice so requires.

B. Proposed Language

The amendment should contain the following provisions:

254. Federal Arbitration Act § 2.

§ 17. Class Arbitration

(a) Class arbitration is an acceptable mode of arbitration under this Act. The procedure for class arbitration shall be the same as the procedure proscribed in Federal Rule of Civil Procedure 23. The decision of whether and when to move forward with arbitration shall be made only by the arbitrator. Only upon complete resolution of the class arbitration process may a decision of the arbitrator be appealed to a court pursuant to §16 of this Act.

(b) Class action waivers

(1) Class action waivers that are freely bargained for between sophisticated parties shall be upheld on their terms.

(2) Class actions waivers presented on a take-it-or-leave-it basis as part of a contract of adhesion will be presumed to be unenforceable. Arbitrators shall apply the following four factors to determine if the presumption of unenforceability is overcome:

(i) the probable size of each class member's individual recovery,

(ii) the potential for retaliation against members of the class,

(iii) whether potential class members may be unaware that their rights have been violated,

(iv) real world obstacles to the full vindication of rights by class members.

(3) If after applying the four factors listed in (b)(2)(i)-(iv), the arbitrators find that the presumption of unenforceability has been overcome, the class action waiver shall be upheld. If the arbitrators find that the presumption of unenforceability has not been overcome, the arbitrators shall deem the class action waiver unenforceable, sever it from the arbitration agreement, and enforce the remaining conscionable portions of the agreement.

(c) Arbitration agreements silent on the issue of class actions

(1) When an arbitration agreement is silent on the issue of class actions, arbitrators shall determine whether the arbitration agreement was freely bargained for or presented as a contract of adhesion.

(2) Once the determination in (c)(1) is made, arbitrators shall apply the factors listed in (b)(2)(i)-(iv), but without the presumption of unenforceability.

(3) Arbitrators shall determine whether to allow or deny class arbitration based on the factors listed in (b)(2)(i)-(iv).

V. CONCLUSION

This article has highlighted the split of authority between circuit courts on the issue of class action waivers in arbitration agreements. The April 2010 Supreme Court case *Stolt-Nielsen v. AnimalFeeds International* did little to resolve this split of authority, and it actually obfuscated the issue even further.[255] Class action waivers in arbitration agreements can come in many forms, and some agreements do not contain them at all. These inconsistencies in language and form may be a large part of the reason courts have held so inconsistently on their validity. Some courts have allowed class action waivers to be invalidated under section 2 of the FAA, which disavows any agreement that does not comport with basic contract principles such as unconscionability.[256] Others have found that class mechanisms are merely procedural and can be waived in a valid agreement to arbitrate.[257]

By applying the *Gentry* factors enumerated above and with the enactment of the proposed FAA amendment, courts will have more definitive guidelines to aid in their interpretation of class action waivers. By severing a class action waiver that does not comport with the factorial analysis instead of invalidating the entire arbitration agreement, courts will continue to serve the statutory purposes of the FAA without sacrificing state contract principles applicable to all contracts. This approach provides courts with a meaningful framework of analysis that remains within the bounds of both federal and state law while also allowing for more consistent judicial treatment of class action waivers in the future.

255. *See generally Stolt*, 130 S. Ct. at 1758.

256. *See* Kristian v. Comcast Corp., 446 F.3d 25 (1st Cir. 2006); *Gentry*, 165 P.3d at 556; Discover Bank v. Superior Court, 113 P.3d 1100 (Cal. 2005).

257. *See* Johnson v. West Suburban Bank, 225 F.3d 366 (3rd Cir. 2000).