

Banning class action bans

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Class action limitations, embedded in contracts for cars to phones to jobs, amount to a 'get out of jail free' card for corporations. By building a strong factual record and choosing the right legal strategy, you can battle the ban—and win.

Imagine that a long-distance phone company collects a tax that amounts to a few dollars per month from all its customers in one area—even though many of them do not owe the tax. Very few realize they've been cheated, and none can bring an individual lawsuit to recover a few dollars. Without being able to file a class action, those consumers will be left with no legal recourse—and the phone company will get away with cheating them.

This situation, based on a case that we are handling,¹ illustrates the central problem of bans on class action lawsuits. Unfortunately, a large and ever-growing number of corporations—including most cell phone carriers, credit card issuers, new car dealers, and major computer manufacturers—are inserting terms in their standard contracts that bar their customers and employees from ever bringing, or participating in, a class action. Such bans are usually embedded in arbitration clauses but apply to class actions in court or arbitration.

Two principal legal theories exist for challenging class action bans: contract law and statutory law.

Contract law challenges. In cases where a ban on class actions serves as a corporate exculpatory clause, a number of courts have held that they are unenforceable because either they are unconscionable or they violate a state's public policy by undermining state consumer protection or civil rights statutes. In some cases, this has led courts to invalidate entire arbitration clauses con-

taining the class action bans; in others, courts have struck down the ban and sent the case to arbitration without the provision.

In early litigation, most plaintiffs bringing contract law challenges to class action bans were not successful.² More recently, courts in a growing number of states have ruled in favor of plaintiffs.³

For example, the high courts in California, Illinois, New Jersey, and Washington—as well as intermediate appellate courts in Missouri, Ohio, Oregon, Pennsylvania, and Wisconsin—have all struck down class action bans in cases where they were deemed unconscionable (because the bans were effectively exculpatory and/or because they were one-sided).⁴ Some other courts have struck down class action bans on the grounds that they violated public policy by undermining the enforcement of important consumer protection statutes.⁵

When challenging a ban either on an unconscionability theory or based on a state's public policy against adhesive exculpatory clauses, it is best to have a strong factual record. In one recent case, a court struck down a class action ban after a two-day evidentiary hearing where the plaintiffs presented expert testimony that no consumer lawyer in the state would take similar cases on an individual basis because the cost of bringing them would outweigh the likely remuneration.⁶

Similarly, in *Scott v. Cingular Wireless*, Washington's high court struck down a class action ban when the factual record included both testimony from consumer law experts and materials obtained through discovery that established that no consumers had brought in arbitration any individual cases in the state against that defendant.⁷ Although many courts have struck down class action bans without such evidence, a lawyer takes a big chance relying heavily on the experience and ideas of the court and not setting out an evidentiary record.

Statutory law challenges. Plaintiff lawyers have had less success arguing that class action bans violate statutes. In early cases, plaintiffs argued that various

statutes endowed consumers or employees with unwaivable rights to bring class actions, but most courts rejected these theories.⁸

More recently, however, some plaintiff lawyers have argued that class action bans effectively violate federal statutes by frustrating their purpose, when the evidence in a particular case would establish that the ban has the effect of

would violate a "fundamental policy" of the forum state; and if the forum state has a greater interest in the outcome of the case.

The key test is whether enforcing the choice-of-law clause—and thereby replacing the forum state's law with the law of a state that would enforce all class action bans—would violate a fundamental public policy of the state. Courts are di-

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making it impossible for individuals to vindicate their rights. The First Circuit has embraced this theory in the context of antitrust litigation,⁹ and a number of similar challenges are pending in other courts. As with contract law challenges, the key to statutory challenges probably lies in the development of a robust factual record.¹⁰

Choice-of-law clauses

In light of these successful challenges to class action bans, some changes have occurred. For one, corporations have tried to write their contracts differently, embedding choice-of-law clauses that provide that any contract disputes will be governed by the law of states that are inclined to enforce class action bans, such as Texas or Utah. For another, a few courts have begun to accept the corporate argument that the Federal Arbitration Act (FAA) preempts any limits that state law might place on class action bans embedded in arbitration clauses. Plaintiff lawyers need to know the best arguments for responding to each change.

When faced with a contract that contains a choice-of-law clause, most states follow the framework set out in §187 of the *Restatement (Second) of Conflict of Laws*. According to that provision, a choice-of-law clause is invalid if without it, the local forum state's law would apply; if applying the other state's law

provided on this. A number have held that it would violate fundamental public policy of the state.¹¹ Others have enforced such clauses, although several of those decisions are currently on appeal.¹²

When attacking choice-of-law clauses, take care how the particular public policy at issue is defined. Some lawyers have argued that there is a general public policy under state law in support of a right to bring class actions.

But this approach is not recommended. In the leading cases striking down class action bans, the policy the courts relied on was articulated by laws barring exculpatory clauses that make it impossible for consumers or employees to effectively vindicate their statutory rights.¹³ This characterization of the public policy at issue is not only more accurate than portraying the policy as a general right to bring class actions, but it is also more in keeping with the popular view that issues of public policy are best addressed by legislatures rather than courts.

Preemption pressure

For years, corporations have argued that the FAA preempts the application of any state law invalidating a class action ban embedded in an arbitration clause. Most courts hearing this argument have

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rejected it.¹⁴ For one thing, the invalidation of a class action ban does not necessarily mean that a case will proceed in court, as several courts striking such bans have nonetheless enforced the remainder of the arbitration clause and have left it to the arbitrator to determine if the case should proceed on either a class or individual basis.¹⁵

Nonetheless, last year many members of the defense bar gained greater confidence in the corporate theory when the Third Circuit suggested in *Gay v. Credit-Inform* that at least some state laws limit-

Gay case were read to apply to the laws of other states, it would be unlikely to prevail in many courts. State laws striking down contract terms embedded in exculpatory arbitration clauses are entirely consistent with the Supreme Court's own decisions. The Court has directed that arbitration clauses are enforceable under the FAA only if they permit claimants to effectively enforce their rights.¹⁸

The Court has recognized, for example, that "the existence of large arbitration costs may well preclude a litigant

the FAA says nothing. This is, in part, because the FAA was passed in 1924, long before class actions existed. It is also true because the Court has held that class actions can proceed in arbitration,²³ demonstrating that nothing in the FAA requires that parties be stripped of their opportunity to vindicate their statutory rights on a classwide basis.

Finally, a sweeping preemption rule in this context is counter to the Supreme Court's directions that generally applicable rules of contract law apply to arbitration clauses just as they do to any other contract term.²⁴ If a state's laws would normally enforce exculpatory clauses that strip individuals of their rights under consumer protection and civil rights statutes, then the FAA would preempt the state from striking contract terms embedded in arbitration clauses that did the same thing. In most states, however, the rule is to the contrary.

This does raise an important practice point, however: To effectively challenge exculpatory class action bans, a plaintiff must demonstrate that he or she is relying on a general body of state contract law forbidding exculpatory clauses in such circumstances. Plaintiff lawyers who fail to do basic contract law research in their state and rely on cases from other jurisdictions that involve challenges to arbitration clauses may make a grave error. Their arguments need to be grounded in the contract law of the state whose law governs, not in generalizations about arbitration clauses.

All of the foregoing may be changed dramatically if Congress passes the Arbitration Fairness Act, S. 1782 (introduced by Sen. Russ Feingold (D-Wis.)) and H.R. 3010 (introduced by Rep. Hank Johnson (D-Ga.)). This legislation would ban pre-dispute binding arbitration clauses in all consumer, employment, medical, securities, and franchise contracts. Hearings have been held in both the House and the Senate. At press time, a House Judiciary subcommittee had voted to send the bill to the full House Judiciary Committee for its consideration.

Corporations often try to use class action bans to insulate themselves from all

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ing class action bans may be preempted by the FAA.¹⁶ For a couple of reasons, though, the significance of this decision will likely prove negligible.

First, the FAA preemption discussion in *Gay* was based on an interpretation of Pennsylvania contract law that differs enormously from the contract law of most other states. In particular, the court interpreted Pennsylvania law as prohibiting any provision in an arbitration clause that would not permit a party to bring a class action in court. If it were true that Pennsylvania law insisted that parties have a right to a judicial class action, the Third Circuit would almost certainly be correct that this law was preempted.

Even if that is an accurate description of Pennsylvania law, however, most courts that have ruled against class action bans have been very clear that their decisions are not based on an insistence on judicial proceedings (as opposed to arbitration), but rather are based on the rule that no contract term (in an arbitration clause or otherwise) may bar individuals from effectively vindicating their rights under consumer protection and civil rights statutes.¹⁷

Second, even if the reasoning of the

... from effectively vindicating [its] rights," and that this would not be permissible.¹⁹ While the Supreme Court has acknowledged that arbitral forums may have somewhat different and simplified rules from court rules, the Court has insisted that arbitration must permit a party to "effectively vindicate" his or her statutory rights.²⁰

Arguing that the FAA preempts all state laws limiting class action bans is also inconsistent with the basic rule that the FAA preempts only state laws that conflict with it. The Supreme Court has held that the FAA has no express preemption provision and does not reflect Congress's intent to occupy the entire field of arbitration or contract law.²¹

Simply put, there is no plausible argument that state laws that limit exculpatory class action bans conflict with the purposes of the FAA. As the Court has made clear in a variety of contexts, a federal law does not impliedly preempt a body of state law where the federal law says nothing about the subject. Where federal law is silent on a subject, there is no implied conflict preemption of state law based on frustration of federal policy.²²

And in the context of class actions,

liability for certain types of wrongdoing. Many jurisdictions have rejected these efforts, but corporations are tirelessly looking for end-runs around these pro-consumer decisions.

Advocates for consumers and employees need to be alert to developments in this rapidly evolving area of law. Successful challenges to class action bans will be based on sound factual records that recognize that these bans are unenforceable when they prevent individuals from effectively vindicating their statutory rights and on strong arguments against corporate ploys, such as sweeping choice-of-law clauses and overly broad theories of federal preemption. ■

Notes

1. *McKee v. AT&T Corp.*, No. 03-2-00133-8 (Wash., Chelan Co. Super. July 19, 2005), *review granted sub nom. AT&T Corp. v. McKee*, No. 81006-1 (Wash. Jan. 2, 2008).
2. *E.g. Snowden v. CheckPoint Check Cashing*, 290 F.3d 631 (4th Cir. 2002); *Strand v. U.S. Bank Natl. Assn. ND*, 693 N.W.2d 918 (N.D. 2005); *Walther v. Sovereign Bank*, 872 A.2d 735 (Md. 2005); *Forrest v. Verizon Commun., Inc.*, 805 A.2d 1007 (D.C. 2002).
3. *E.g. Ting v. AT&T*, 319 F.3d 1126 (9th Cir. 2003); *Leonard v. Terminix Intl. Co.*, 854 So. 2d 529 (Ala. 2002). *See also Dunlap v. Berger*, 567 S.E.2d 265, 278-79 (W. Va. 2002) (holding that a class action ban embedded in an arbitration clause in a consumer contract was unconscionable, noting that class action bans permit "those who commit illegal activity to go unpunished, undeterred, and unaccountable").
4. *Discover Bank v. Super. Ct.*, 113 P.3d 1100, 1108-09 (Cal. 2005); *Kinkel v. Cingular Wireless, LLC*, 857 N.E.2d 250, 268 (Ill. 2006); *Muhammad v. Co. Bank of Rehoboth Beach, Del.*, 912 A.2d 88, 99-100 (N.J. 2006); *Scott v. Cingular Wireless*, 161 P.3d 1000, 1008 (Wash. 2007); *Whitney v. Alltel Commun., Inc.*, 173 S.W.3d 300, 308-09 (Mo. App. 2005); *Eagle v. Fred Martin Motor Co.*, 809 N.E.2d 1161, 1171 (Ohio App. 2004); *Vasquez-Lopez v. Beneficial Oregon*, 152 P.3d 940, 950 (Or. App. 2007); *Thibodeau v. Comcast Corp.*, 912 A.2d 874, 885-86 (Pa. Super. 2006); *Coady v. Cross Country Bank*, 729 N.W.2d 732, 745 (Wis. App. 2007).
5. *See e.g. S.D.S. Autos, Inc. v. Chrzanowski*, 976 So. 2d 600, 606 (Fla. App. 2007) (class action ban unconscionable under Florida law because it "deprive[s] the plaintiff of the ability to obtain meaningful relief for alleged statutory violations").
6. *Reuter v. Davis*, 2006 WL 3743016 at *4 (Fla. Cir. Dec. 12, 2006). Several illustrations of the kinds of affidavits and evidence that can be used in such challenges are available from Public Justice at www.publicjustice.net, on the page

"Briefs and Documents," under "Mandatory Arbitration Abuse Prevention Project."

7. 161 P.3d at 1003-04.
8. *See e.g. Johnson v. W. Suburban Bank*, 225 F.3d 366 (3d Cir. 2000) (rejecting the idea that the Truth in Lending Act conflicts with the Federal Arbitration Act by creating an unwaivable right to a class action in court); *Randolph v. Green Tree Fin. Corp. Ala.*, 244 F.3d 814 (11th Cir. 2001).
9. *Kristian v. Comcast Corp.*, 446 F.3d 25, 59-60 (1st Cir. 2006) (finding that portions of the arbitration agreement that were in conflict with federal statutes were invalid. However, the court held that the arbitration clause was written so that any invalid clauses could be severed without invalidating the arbitration agreement as a whole).
10. In the *Kristian* case, for example, the plaintiffs placed before the court extensive evidence of the high cost of arbitrating or litigating the claims on an individual basis, establishing that the ban on class actions gutted the antitrust laws.
11. *See e.g. Oestreicher v. Alienware Corp.*, 502 F. Supp. 2d 1061, 1069 (N.D. Cal. 2007) (currently on appeal to the Ninth Circuit); *Klussman v. Cross Country Bank*, 36 Cal. Rptr. 3d 728, 736 (App. 2005).
12. *See e.g. Homa v. Am. Express Co.*, 496 F. Supp. 2d 440, 446-47 (D.N.J. 2007), *appeal filed*, No. 07-2921 (3d Cir. June 26, 2007).
13. *See e.g. Muhammad*, 912 A.2d at 99-100; *Scott*, 161 P.3d at 1008.
14. *See e.g. Dale v. Comcast Corp.*, 498 F.3d 1216, 1219 n. 2 (11th Cir. 2007) (striking a class action ban embedded in an arbitration clause as unconscionable under Georgia law and noting that "we look to state law to determine whether a provision in a contract is unenforceable"); *Shroyer v. New Cingular Wireless*, 498 F.3d 976, 988 (9th Cir. 2007) ("the principle that class action waivers are, under certain circumstances, unconscionable as unlawfully exculpatory is a principle of California law that does not specifically apply to arbitration agreements, but to contracts generally") (citation omitted); *Kinkel*, 857 N.E.2d at 263 (the "FAA neither expressly nor impliedly preempts a state court from holding that an arbitration clause or a specific provision within an arbitration clause is unenforceable"); *Muhammad*, 912 A.2d 88 at 94 (the FAA "does not preclude an examination into whether the arbitration agreement at issue is unconscionable under state law"); *Scott*, 161 P.3d at 1008 (striking a class action waiver in an arbitration clause does not violate the FAA because "the FAA favors arbitration, not exculpation").
15. *See e.g. Muhammad*, 912 A.2d 88 (striking the class action ban and then sending the case to arbitration, with the arbitrator to decide if the case should proceed on a class action or individual basis); *Reuter*, 2006 WL 3743016.
16. 511 F.3d 369, 388-89 (3d Cir. 2007).
17. One court has already distinguished *Gay* on this basis. *See Loudon v. T-Mobile USA, Inc.*, 512 F.3d 1213, 1221 n. 3 (9th Cir. 2008) ("Unlike the Third Circuit's conclusion as to the applica-

ble state law in *Gay*, we determine that the Washington Supreme Court in *Scott* does not hold 'that an agreement to arbitrate may be unconscionable simply because it is an agreement to arbitrate.'")

18. *See e.g. Gilmer v. Interstate/Johnson Lane Corp.*, 500 U.S. 20, 26 (1991) ("[B]y agreeing to arbitrate a statutory claim, a party does not forgo the substantive rights afforded by the statute; it only submits to their resolution in an arbitral, rather than a judicial, forum.") (citation omitted).
19. *Green Tree Fin. Corp. v. Randolph*, 531 U.S. 79, 81 (2000).
20. *See e.g. EEOC v. Waffle House, Inc.*, 534 U.S. 279, 295 n. 10 (2002).
21. *Volt Info. Sciences, Inc. v. Bd. of Trustees of Stanford U.*, 489 U.S. 468, 477 (1989).
22. *Cf. Freightliner Corp. v. Myrick*, 514 U.S. 280, 289-90 (1995) ("A finding of liability against petitioners would undermine no objectives or purposes with respect to ABS devices, since none exist.").
23. *See Green Tree Fin. Corp. v. Bazzle*, 539 U.S. 444, 451 (2003).
24. *See Doctor's Assocs., Inc. v. Casarotto*, 517 U.S. 681, 687 (1996) ("[G]enerally applicable contract defenses such as fraud, duress, or unconscionability may be applied to invalidate arbitration agreements without contravening [9 U.S.C. §2].").

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