

NECESSITY NEVER MADE A GOOD BARGAIN:  
WHEN CONSUMER ARBITRATION AGREEMENTS  
PROHIBIT CLASS RELIEF

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I. INTRODUCTION

The American system of arbitration is constantly evolving.<sup>1</sup> From the first formal arbitration tribunal in 1786—established by the New York Chamber of Commerce<sup>2</sup>—to the creation of the Federal Arbitra-

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1. See FRANCES KELLOR, AMERICAN ARBITRATION 3-8 (1948).

2. *Id.* at 4. Arbitration played an obscure and humble role in early American history. “It did not become an integral part of the early social and economic development of the

tion Act in 1925—passed to suppress judicial hostility towards arbitration<sup>3</sup>—the system has continuously adapted to accommodate changing business practices and rising judicial concerns over the legitimacy of the institution. In fact, the system’s adaptation has been so effective that the Supreme Court now recognizes a “national policy favoring arbitration.”<sup>4</sup>

This “national policy” is the most recent phase of the arbitration evolution, and it raises several concerns. Most significantly, lower courts are relying on it to effectively eliminate any review of arbitration agreements under state laws of unconscionability.<sup>5</sup> Consequently, banks, phone companies, and other consumer businesses are implementing mandatory arbitration clauses that provide complete immunization from both class actions and classwide arbitration. As potential defendants, these companies hope that courts will force individual resolution of all consumer claims against them by upholding their agreements to arbitrate. Such an exercise raises an important, yet unanswered, question: To what extent should courts use the “national policy favoring arbitration”<sup>6</sup> to protect consumer arbitration agreements that prohibit *all* class relief?<sup>7</sup>

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country nor a recognized institution of any consequence and its impact was negligible upon the growth of justice in the country.” *Id.* at 6.

3. *Allied-Bruce Terminix Cos. v. Dobson*, 513 U.S. 265, 272 (1995); *see also* Federal Arbitration Act, 9 U.S.C. §§ 1-307 (2000).

4. *Southland Corp. v. Keating*, 465 U.S. 1, 10 (1984).

5. *See, e.g., Metro E. Ctr. for Conditioning & Health v. Qwest Communications Int’l, Inc.*, 294 F.3d 924, 927 (7th Cir. 2002), *cert. denied*, 537 U.S. 1090 (2002) (stating that arguments to overturn agreements based on the costs of individual arbitration and the preclusion of class actions—the typical unconscionability arguments—are “the sort of litany that the Federal Arbitration Act is supposed to silence”); *Hutcherson v. Sears Roebuck & Co.*, 793 N.E.2d 886, 896 (Ill. App. Ct. 2003) (“Although we recognize the importance of class actions as a tool for protecting consumers, we cannot ignore the strong policy that favors enforcement of arbitration provisions.”).

6. *Southland*, 465 U.S. at 10.

7. In June of 2003, the U.S. Supreme Court avoided making a decision on whether classwide arbitration is permissible when an arbitration agreement is silent on the matter. *Green Tree Fin. Corp. v. Bazzle*, 123 S. Ct. 2402 (2003). Instead, the Court remanded the case to the South Carolina Supreme Court with instructions that would allow the arbitrator to make the class relief determination. *Id.* at 2407. At the very least, this decision proves that the Supreme Court is not completely hostile to classwide arbitration and it preserves a limited state role in deciding what arbitration policies are acceptable in that state. What the decision does not tell us, however, is how the Court will react when faced with an arbitration agreement that expressly prohibits *all* class activity. Will it defer to the “national policy favoring arbitration” and grant defendants virtual immunity from having to provide class relief? *Southland*, 465 U.S. at 10. Or, will it recognize the growing dissent among states, and several Supreme Court Justices, who favor taking some arbitration oversight out of the federal sphere? As stated by the American Arbitration Association, “[t]he arbitrability of class arbitrations where the parties’ agreement precludes such relief is a developing area of the law.” American Arbitration Association Policy on Class Arbitration, at <http://www.adr.org/index2.1.jsp?JSPssid=15753&JSPaid=43408> (last visited Feb. 29, 2004). For information on the lower court’s decision in *Bazzle*, see Andrea Lockridge,

The Supreme Court will have an opportunity to address this question when it resolves a split between the Seventh and Ninth Circuits on the interplay of the Federal Arbitration Act (FAA), the Federal Communications Act (FCA), and state laws of unconscionability.<sup>8</sup> Essentially, the Court will have to revisit previous decisions on what type of role states play, if any, in determining arbitration policy within their borders. Part II of this paper discusses the history of federal preemption under the FAA and the growing dissatisfaction with the Supreme Court's federal preemption jurisprudence. Part III addresses federal preemption under the Federal Communications Act and how companies now use the FCA to shield arbitration agreements from review under state laws of unconscionability. Part III also discusses how the Supreme Court can develop a new federal preemption policy—and suppress some of the dissension over its prior preemption decisions—when it resolves the split between the Seventh and Ninth Circuits. This new proposal still recognizes the “national policy favoring arbitration,”<sup>9</sup> and requires courts to respect arbitration agreements accordingly. However, it returns greater authority over arbitration procedure to the states. Thus, when faced with an arbitration agreement that prohibits both class actions and classwide arbitration, courts may uphold the parties' decision to arbitrate, but review state law to determine whether to permit arbitration to proceed on a classwide basis. Finally, Parts IV and V discuss the justifications for such a proposal and suggest several safeguards that states may want to enact to ensure that class arbitration proceedings are an efficient and effective method of alternative dispute resolution.

## II. FEDERAL PREEMPTION AND THE FEDERAL ARBITRATION ACT

When the Supreme Court announced the “national policy favoring arbitration”<sup>10</sup> nearly twenty years ago, it started a process of significantly federalizing the arbitration system.<sup>11</sup> Soon, the “national” pol-

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*The Silent Treatment: Removing the Class Action from the Plaintiff's Toolbox Without Ever Saying a Word*, 2003 J. DISP. RESOL. 255, 264-65.

8. *Compare* *Ting v. AT&T Corp.*, 319 F.3d 1126 (9th Cir. 2003), *cert. denied*, 124 S. Ct. 53 (2003) (holding (1) that the Federal Communications Act does not preempt state laws of unconscionability, and (2) that the FAA does preempt the California Consumer Legal Remedies Act's ban on waivers of class actions, but that the FAA makes arbitration agreements subject to state laws of unconscionability, which the 9th Circuit used to invalidate the parties' agreement in this case), *with* *Boomer v. AT&T Corp.*, 309 F.3d 404 (7th Cir. 2002) (holding that the Federal Communication Act preempts state laws of unconscionability).

9. *Southland*, 465 U.S. at 10.

10. *Id.*

11. Stephen L. Hayford & Alan R. Palmiter, *Arbitration Federalism: A State Role in Commercial Arbitration*, 54 FLA. L. REV. 175, 176 (2002). Hayford and Palmiter argue for allowing state law to control any areas of law outside the FAA's “strong preemptive core.”

icy became an “emphatic” policy,<sup>12</sup> and other courts—both federal *and* state—were expected to respect arbitration agreements to a point where state law became almost insignificant. However, even though federal preemption under the Federal Arbitration Act has expanded significantly over the last two decades, the true extent of the FAA’s preemptive effect is not entirely clear.

Section 2 of the FAA provides that all arbitration agreements are “valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract.”<sup>13</sup> Explaining what constitutes “grounds as exist at law or in equity,” the Supreme Court has emphasized that “[g]enerally applicable contract defenses, such as fraud, duress, or unconscionability, may be applied to invalidate arbitration agreements without contravening § 2 [of the FAA].”<sup>14</sup> Nevertheless, courts easily disagree over how far they may go in using these generally applicable defenses to overturn parties’ arbitration agreements.<sup>15</sup> After all, even the members of the Supreme Court have not reached a unanimous decision on when states should defer to the national policy and uphold agreements under the FAA.<sup>16</sup> And, some of the Supreme Court’s statements on preemption under the

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*Id.* at 177. “[S]tate law in the form of default procedural rules holds out great promise, limited only by the gravitational pull of the FAA’s pro-arbitration imperative.” *Id.* at 178.

12. See *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*, 473 U.S. 614, 631 (1985).

13. Federal Arbitration Act, 9 U.S.C. § 2 (2000).

14. See *Doctor’s Assocs., Inc. v. Casarotto*, 517 U.S. 681, 682 (1996).

15. See *Mandel v. Household Bank (Nevada), Nat’l Ass’n*, 129 Cal. Rptr. 2d 380, 386 (Ct. App. 2003) (citations omitted):

Certainly, if a state’s law disfavors arbitration and creates unreasonable hurdles to the enforcement of arbitration agreements governed by the FAA, it is preempted. But Nevada law favors arbitration of disputes, and therefore federal preemption is inapplicable. . . . [T]he proper course is to sever the ban on class actions and enforce the remainder of the arbitration agreement.

Compare *id.*, with *Discover Bank v. Superior Court*, 129 Cal. Rptr. 2d 393, 396 (Ct. App. 2003) (holding that “where a valid arbitration agreement governed by the FAA prohibits classwide arbitration, section 2 of the FAA preempts a state court from applying state substantive law to strike the class action waiver from the agreement”), *review granted en banc*, No. S113725, 2003 Cal. LEXIS 2105, at \*1 (Cal. Rptr. Apr. 9, 2003); see also *Hutcherson v. Sears Roebuck & Co.*, 793 N.E.2d 886, 896 (Ill. App. Ct. 2003) (“Although we recognize the importance of class actions as a tool for protecting consumers, we cannot ignore the strong policy that favors enforcement of arbitration provisions.”).

16. See *Doctor’s Assocs.*, 517 U.S. at 689 (Thomas, J., dissenting); *Allied-Bruce Terminix Cos. v. Dobson*, 513 U.S. 265, 284 (1995) (Scalia, J., dissenting); *id.* at 285 (Thomas, J., dissenting); *Southland Corp. v. Keating*, 465 U.S. 1, 21 (1984) (O’Connor, J., dissenting). Justice Rehnquist joined O’Connor’s dissent in *Southland*. Notably, Justices O’Connor, Rehnquist, Scalia, and Thomas are not alone in their displeasure over the Supreme Court’s expansion of the FAA. In *Allied-Bruce*, twenty state attorneys general signed an amicus brief asking the Court to overturn *Southland*. *Allied-Bruce*, 513 U.S. at 284 (Scalia, J., dissenting).

FAA have created uncertainty about the extent of a state lawmaking role in the new arbitration system.<sup>17</sup>

Recently, lower courts have examined these questions quite frequently. The reason is that national consumer companies are hiding behind federal laws—namely, the FAA and the FCA—in an attempt to protect arbitration provisions that preclude all forms of class relief.<sup>18</sup> Not surprisingly, these lower courts differ on what role federal preemption should play in protecting such clauses from review under state laws of unconscionability.<sup>19</sup> This Section will give a brief description of the federal preemption doctrine, discuss federal preemption under the FAA, and then address the growing discontent over the Supreme Court's FAA preemption jurisprudence.

### A. Background on the Federal Preemption Doctrine

Article VI of the U.S. Constitution sets forth the principle that federal law is supreme,<sup>20</sup> and the preemption doctrine outlines the boundaries of that principle when federal legislation leaves any doubt. Therefore, “[t]he purpose of preemption doctrine . . . is to define the sphere of control between federal and state law when they conflict, or appear to conflict.”<sup>21</sup>

Under the doctrine, federal law can displace state law in one of three ways: (1) express preemption, (2) field preemption, or (3) con-

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17. Hayford & Palmiter, *supra* note 11, at 176. On one hand, the Court interprets the FAA to trump state laws that undermine the enforcement of arbitration. On the other, the court recognizes states' ability to employ generally applicable contract defenses to invalidate parties' agreements. *Id.* at 176-77.

18. Some courts protect companies' arbitration agreements under the guise of the Federal Arbitration Act, holding that the FAA completely preempts state efforts to reform contracts through their state laws of unconscionability. *See, e.g., Discover Bank*, 129 Cal. Rptr. 2d at 396; *see also Hutcherson*, 793 N.E.2d at 896. Some find that other federal laws, such as the Federal Communications Act, have this same effect. *See Boomer v. AT&T Corp.*, 309 F.3d 404 (7th Cir. 2002).

19. *Compare Ting v. AT&T Corp.*, 319 F.3d 1126 (9th Cir. 2003) (holding (1) that the Federal Communications Act does not preempt state laws of unconscionability, and (2) that the FAA does preempt the California Consumer Legal Remedies Act's ban on waivers of class actions, but that the FAA makes arbitration agreements subject to state laws of unconscionability, which the 9th Circuit used to invalidate the parties' agreement in this case), *cert. denied*, 124 S. Ct. 53 (2003), *with Boomer*, 309 F.3d at 404 (holding that the Federal Communications Act preempts state laws of unconscionability); *see also Hutcherson*, 793 N.E.2d at 896 (“Although we recognize the importance of class actions as a tool for protecting consumers, we cannot ignore the strong policy that favors enforcement of arbitration provisions.”).

20. U.S. CONST. art. VI, cl. 2.

21. Mary J. Davis, *Unmasking the Presumption in Favor of Preemption*, 53 S.C. L. REV. 967, 968 (2002). “To the extent that the Supreme Court has something to say about the power struggle of federalism, it speaks, partially at least, through its preemption decisions.” *Id.* at 969. “True preemption doctrine . . . was in its infancy until the unprecedented legislative activity of the post-Depression era. Until that time, the Court was faced with little truly comprehensive legislation of the kind that the 1930s and 1940s produced.” *Id.* at 973-74.

flict preemption.<sup>22</sup> *Express* preemption exists where a federal statute explicitly withdraws specific powers from the states.<sup>23</sup> The Supreme Court favors a narrow reading of statutes that attempt to keep power in the federal sphere, believing that courts should apply a presumption against preemption when the statutes interfere with the states' traditional powers.<sup>24</sup> An inquiry under the principle of express preemption requires a court to interpret the meaning of the preemptive clause and determine whether Congress actually had the power to pass such legislation.<sup>25</sup>

Absent explicit preemptive text, courts may still conclude that a federal statute is so comprehensive that Congress left no room for supplementary state regulation.<sup>26</sup> This so-called *field* preemption occurs when a statute or regulation reflects a dominant federal interest that precludes enforcement of any similar state laws on the subject.<sup>27</sup> Since the statute contains no explicit statement of preemption, a field preemption inquiry requires the court to find preemption implicit within the federal law.<sup>28</sup> Because of the uncertainty in finding an implied statutory intent, courts hesitate to read preemption into a federal statute.<sup>29</sup>

Finally, even when Congress has not completely occupied the field, courts may still infer preemption when federal law and state law conflict. *Conflict* preemption exists when "compliance with both federal and state regulations is a physical impossibility,"<sup>30</sup> or where

22. Caleb Nelson, *Preemption*, 86 VA. L. REV. 225, 226 (2000); see also *Pac. Gas & Elec. Co. v. Energy Res. Conservation & Dev. Comm'n*, 461 U.S. 190, 203-04 (1983).

23. Nelson, *supra* note 22, at 226.

24. *Id.* at 227. *But see* Davis, *supra* note 21, at 968 (arguing that the Supreme Court actually holds a presumption in favor of preemption).

25. Nelson, *supra* note 22, at 226-27. In cases involving the FAA and FCA, for example, courts examine Congress' regulatory powers under the Commerce Clause. See, e.g., *Southland Corp. v. Keating*, 465 U.S. 1, 11 (1984) (stating that the FAA rested "on the authority of Congress to enact substantive rules under the Commerce Clause").

26. Nelson, *supra* note 22, at 227 (citing *English v. General Elec. Co.*, 496 U.S. 72, 79 (1990)).

27. *Id.* (citing *Rice v. Santa Fe Elevator Corp.*, 331 U.S. 218, 230 (1947)).

28. *Id.*

29. *Id.* The Supreme Court developed the field preemption doctrine in *Southern Railway Co. v. Reid*, 222 U.S. 424 (1912). *Reid* involved freight regulations under the Interstate Commerce Act. Mrs. Reid asked Southern Railway to ship several packages from North Carolina to West Virginia, but Southern refused to ship the packages until it could establish a rate for the shipment (no federal regulation existed to establish rates for that route). Mrs. Reid sued under a North Carolina statute that awarded damages—\$25 a day—against rail companies that refused to accept packages, and she won. *Id.* at 431-34. Southern appealed the decision all the way to the Supreme Court, which concluded that even though no federal law specifically applied to the plaintiff's claim, the Interstate Commerce Act's broad regulatory authority was enough to evidence that Congress had occupied the field. It did not matter that the state regulation complemented the federal scheme. *Id.* at 437-38.

30. *Fla. Lime & Avocado Growers, Inc. v. Paul*, 373 U.S. 132, 142-43 (1963). "The test of whether both federal and state regulations may operate, or the state regulation must

state law “stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress.”<sup>31</sup> While the “physical impossibility” portion of this test is fairly narrow, the “obstacle” half is fairly broad.<sup>32</sup> It potentially applies not only in cases where state and federal law conflict, but also where courts think that the effects of state law obstruct the intended accomplishments of federal law.<sup>33</sup> In fact, the Supreme Court relies on obstacle preemption to uphold arbitration agreements under the FAA, even when such agreements are offensive to state law or policies.<sup>34</sup>

### B. *The Expanding Preemptive Effect of the FAA*

When Congress enacted the Federal Arbitration Act in 1925, it attempted to overcome a history of judicial hostility toward predispute arbitration agreements.<sup>35</sup> The FAA has been an undeniable success in that regard. Supreme Court decisions over the last seventy-five years have relied on broad interpretations of the FAA to establish arbitration as a near sacred institution for dispute resolution in the United States.<sup>36</sup> In fact, the Court has employed these broad interpretations to make the FAA applicable in both federal *and* state courts, effectively expanding the preemptive scope of the FAA far beyond Congress’ original intent.<sup>37</sup>

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give way, is whether both regulations can be enforced without impairing the federal superintendence of the field, not whether they are aimed at similar or different objectives.” *Id.* at 142.

31. *Hines v. Davidowitz*, 312 U.S. 52, 67 (1941).

32. *Nelson*, *supra* note 22, at 228.

33. *Id.* at 228-29.

34. *See, e.g., Doctor’s Assocs., Inc. v. Casarotto*, 517 U.S. 681 (1996) (invalidating a Montana statutory notice requirement). The Court holds that inconsistent state laws should not apply when they pose obstacles to the implementation of comprehensive federal legislation such as the FAA. *See id.* at 688.

35. *See Hayford & Palmiter*, *supra* note 11, at 180. Although arbitration is an extremely old form of dispute resolution—dating back to ancient Greece—the judicial hostility grew out of the lack of available records of how parties used arbitration and a lack of any organizing arbitral body. *See KELLOR*, *supra* note 1, at 3-5.

36. According to the Supreme Court, the FAA’s support for arbitration is even more powerful when dealing with international disputes. *See Scherk v. Alberto-Culver Co.*, 417 U.S. 506 (1974).

37. *See Prima Paint Corp. v. Flood & Conklin Mfg.*, 388 U.S. 395, 420 (1967) (Black, J., dissenting) (stating that “there are clear indications in the legislative history that the Act was not intended to make arbitration agreements enforceable in state courts”); *Southland Corp. v. Keating*, 465 U.S. 1, 25 (1984) (O’Connor, J., dissenting).

One rarely finds a legislative history as unambiguous as the FAA’s. That history establishes conclusively that the 1925 Congress viewed the FAA as a procedural statute, applicable only in federal courts, derived, Congress believed, largely from the federal power to control the jurisdiction of the federal courts.

In 1925[,] Congress emphatically believed arbitration to be a matter of “procedure.” At hearings on the Act congressional Subcommittees were told: “The theory on which you do this is that you have the right to tell the Federal courts how to proceed.”

Originally, Congress passed the FAA as a procedural statute that applied only in federal courts.<sup>38</sup> “State arbitration law continued to govern in state courts, even if the contract involved interstate commerce.”<sup>39</sup> However, to develop a “national policy favoring arbitration,”<sup>40</sup> the Supreme Court had to adopt a more liberal interpretation of the FAA after its 1938 decision in *Erie Railroad v. Tompkins*.<sup>41</sup> *Erie* eliminated the federal courts’ power to create national commercial policy in diversity cases, and held that only state procedural law applied in state courts.<sup>42</sup> Therefore, after *Erie*, if the Court interpreted the FAA as a procedural statute that was based on Congress’ power to regulate federal courts, then the FAA could not apply in state courts or federal diversity actions. However, if the Court interpreted the FAA as substantive federal law that was based on Congress’ Commerce Clause powers, for example, then the Court would make it possible for the FAA to apply in both.<sup>43</sup> Thus, after *Erie*, the Supreme Court had to decide: (1) whether the FAA was procedural or substantive federal law, and (2) whether Congress passed the FAA under its authority to regulate federal courts or under its powers to regulate interstate commerce.<sup>44</sup>

The Court addressed these issues for the first time in 1945 when it decided *Guaranty Trust Co. v. York*.<sup>45</sup> In *York*, the Supreme Court held that federal courts sitting in diversity should not apply federal rules that substantially affect the enforcement of rights given by the state.<sup>46</sup> Accordingly, outcome determinative state arbitration standards would trump the FAA’s arbitration mandate in diversity cases.<sup>47</sup> Thus, the Court’s decision in *York* made it seem like the Court would continue with a narrow interpretation of the FAA.

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*Id.* (citing *Arbitration of Interstate Commercial Disputes: Joint Hearings on S. 1005 and H.R. 646 Before the Subcomms. of the Comms. on the Judiciary*, 68th Cong. 17 (1924) (testimony of Mr. Cohen, American Bar Association)); see also Christopher R. Drahozal, “Unfair” Arbitration Clauses, 2001 U. ILL. L. REV. 695, 701.

38. Drahozal, *supra* note 37, at 701. Notably, the FAA does not create independent federal question jurisdiction. *Southland*, 465 U.S. at 16 n.9; Hayford & Palmiter, *supra* note 11, at 184.

39. Drahozal, *supra* note 37, at 701 (citing 1 IAN R. MACNEIL, ET AL., FEDERAL ARBITRATION LAW § 14.1 n.1 (Supp. 1999)). Currently, if an arbitration agreement even *affects* interstate commerce then the FAA governs. See *Allied-Bruce Terminix Cos. v. Dobson*, 513 U.S. 265, 273-74 (1995). Thus, state courts deciding arbitration cases have to perform a “reverse-*Erie*” analysis to determine when they have to apply the FAA.

40. *Southland*, 465 U.S. at 10.

41. 304 U.S. 64 (1938).

42. *Id.* at 78.

43. Jean R. Sternlight, *Panacea or Corporate Tool?: Debunking the Supreme Court’s Preference for Binding Arbitration*, 74 WASH. U. L.Q. 637, 651 (1996).

44. *Id.*

45. 326 U.S. 99 (1945).

46. *Id.* at 109.

47. See Hayford & Palmiter, *supra* note 11, at 186-87.

Twelve years later, however, the Court applied *York's* “outcome determinative” test in *Bernhardt v. Polygraphic Co. of America* and reached a slightly different conclusion.<sup>48</sup> In *Bernhardt*, the Court found that the FAA was substantive federal law under *York*—which presumably would trump outcome determinative state arbitration standards—because it substantially affected causes of action created by the state.<sup>49</sup> However, the Court refused to apply the FAA in this case because the underlying transaction did not involve interstate commerce.<sup>50</sup> Writing for the majority, Justice Douglas emphasized that courts should interpret the FAA narrowly to avoid intruding on a state’s right to regulate substantive law.<sup>51</sup> Nevertheless, even though the Court did not apply the FAA, by characterizing the FAA as *substantive* federal law, *Bernhardt* opened the door for the Court to apply the FAA to future diversity cases and state court actions as well.<sup>52</sup>

The progressive federalization of the FAA continued when, eight years after *Bernhardt*, in 1965, the Supreme Court decided that federal policy *would* in fact overrule conflicting state policy, even if federal policy would determine the outcome of the case.<sup>53</sup> The Court soon applied this new rule in *Prima Paint Corp. v. Flood & Conklin Manufacturing*, a federal diversity action that was a significant piece of the FAA federalization process.<sup>54</sup> In *Prima Paint*, the majority stated that “it is clear beyond dispute that the federal arbitration statute is based upon and confined to the incontestable federal foundations of control over interstate commerce.”<sup>55</sup> Thus, since the Court decided that Congress passed the FAA under the Commerce Clause, FAA standards—not conflicting state standards—would thereafter

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48. 350 U.S. 198 (1956). *Bernhardt* was also a diversity action. *Id.* at 199.

49. *Id.* at 199; see also *Moses H. Cone Mem'l Hosp. v. Mercury Constr. Corp.*, 460 U.S. 1, 26 n.32 (1983) (stating that the FAA creates a body of federal substantive law).

50. *Bernhardt*, 350 U.S. at 200-02. The FAA only applies to maritime contracts or contracts involving interstate commerce. See 9 U.S.C. § 2 (2000). However, the Supreme Court recently interpreted § 2's involving interstate commerce requirement to include any contract that *affected* interstate commerce. See *Allied-Bruce Terminix Cos. v. Dobson*, 513 U.S. 265, 273-74 (1995). This liberal interpretation of § 2 essentially expands the FAA to cover even contracts that only affect intrastate commerce. See *id.*; see also *Wickard v. Filburn*, 317 U.S. 111 (1942) (sustaining the federal power to regulate production of wheat where production was not intended in any part for interstate commerce but wholly for consumption on the individual's farm).

51. *Bernhardt*, 350 U.S. at 202-04.

52. Sternlight, *supra* note 43, at 651-52.

53. *Hanna v. Plumer*, 380 U.S. 460, 473 (1965) (“The purpose of the Erie doctrine, even as extended in *York* and *Ragan*, was never to bottle up federal courts with ‘outcome-determinative’ and ‘integral-relations’ stoppers—when there are ‘affirmative countervailing [federal] considerations’ and when there is a Congressional mandate . . . supported by constitutional authority.”) (quoting *Lumbermen's Mutual Casualty Co. v. Wright*, 322 F.2d 759, 764 (5th Cir. 1973)).

54. See 388 U.S. 395 (1967).

55. *Id.* at 405.

govern the legitimacy of arbitration clauses in federal diversity cases involving interstate commerce.<sup>56</sup> Moreover, as Justice Black noted in his dissent, “when Congress exercises its authority to enact substantive federal law under the Commerce Clause, it normally creates rules that are enforceable in state as well as federal courts.”<sup>57</sup> Therefore, even though *Prima Paint* was a diversity action, and could not expressly find that the FAA should apply in state court, “the conclusion that the FAA was substantive law based on the Commerce Clause would predictably require application of the FAA in state court under the Supremacy Clause.”<sup>58</sup>

Accordingly, *Prima Paint* signaled two fundamental changes in the Supreme Court’s view on federal preemption under the FAA.<sup>59</sup> First, making the FAA applicable in federal diversity cases—even if it affected the outcome of a case—reflected a willingness to draw jurisdictional lines that strongly favored arbitration.<sup>60</sup> Second, the decision eliminated all possibilities of applying state arbitration law in federal court.<sup>61</sup> However, forum selection was still extremely important after *Prima Paint*.<sup>62</sup> Since the FAA did not apply in state court, and since state arbitration law did not apply in federal court, an arbitration clause might be valid in federal court under the FAA but worthless in state court under state law.<sup>63</sup> This would eventually change with the Supreme Court’s 1984 decision in *Southland Corp. v. Keating*.<sup>64</sup>

*Southland* is perhaps the most controversial case in the Supreme Court’s history of arbitration jurisprudence. It involved individual and class actions brought by 7-Eleven franchisees against the franchisor—Southland—for fraud, breach of contract, and violation of disclosure requirements under the California Franchise Investment Law (CFIL).<sup>65</sup> Southland moved to compel arbitration according to a clause in the franchise agreement which stated that “[a]ny . . . claim arising out of or relating to this Agreement . . . shall be settled by arbitration in accordance with the Rules of the American Arbitration Association.”<sup>66</sup> The California Supreme Court granted the motion to compel arbitration on all issues except for those arising under the

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56. *See id.*

57. *Southland Corp. v. Keating*, 465 U.S. 1, 12 (1984) (citing *Prima Paint*, 388 U.S. at 420).

58. Sternlight, *supra* note 43, at 657.

59. Hayford & Palmiter, *supra* note 11, at 189.

60. *Id.*

61. *Id.*

62. *Id.*

63. *Id.*

64. 465 U.S. 1 (1984).

65. *Id.* at 4.

66. *Id.*

CFIL, interpreting California's Franchise Investment Law to require judicial consideration of claims arising under that statute.<sup>67</sup> The court also concluded that the CFIL did not conflict with the FAA.<sup>68</sup>

The United States Supreme Court, however, disagreed and found that even claims under the CFIL were subject to the arbitration agreement. The Court stated that if the CFIL rendered arbitration agreements involving commerce unenforceable, then it would conflict with § 2 of the FAA.<sup>69</sup> "In enacting § 2 of the federal Act, Congress declared a national policy favoring arbitration and withdrew the power of the states to require a judicial forum for the resolution of claims which the contracting parties agreed to resolve by arbitration."<sup>70</sup> Therefore, according to the Court, the FAA now applied in state courts as long as the underlying contract involved interstate commerce.<sup>71</sup>

In subsequent decisions, the Court would rely on the new "national policy" from *Southland* as the underpinning of its preemption jurisprudence.<sup>72</sup> In *Allied-Bruce Terminix Cos. v. Dobson*, the Supreme Court completed its revision of the FAA by interpreting § 2's coverage of transactions involving interstate commerce<sup>73</sup> to also include transactions *affecting* commerce.<sup>74</sup> This expansive interpretation of § 2 significantly increased the scope of the FAA and arguably eliminated the need for making a distinction between interstate and intrastate transactions.<sup>75</sup> Thus, *Allied-Bruce* completed the Supreme Court's fifty-year expansion of the FAA. Almost any arbitration

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67. *Id.* Based on the superior court's decision, the franchisees petitioned the California Court of Appeal to allow arbitration to proceed on a classwide basis. *Id.* at 4. The court of appeal found that no "insurmountable obstacle" existed to prevent classwide arbitration and it issued a writ of mandate ordering the superior court to conduct class certification proceedings. *Id.* at 5. On appeal from the court of appeal's decision, the California Supreme Court agreed that classwide arbitration is feasible and it also remanded the case to the superior court for class certification procedures. *Id.* at 5. The U.S. Supreme Court, however, refused to hear the classwide arbitration issue, stating that *Southland* did not contend, and the California Courts did not decide, whether classwide arbitration would conflict with the FAA. *Id.* at 8-9.

68. *Id.* at 5.

69. *Id.* at 10.

70. *Id.*

71. *See id.*

72. *See* Hayford & Palmiter, *supra* note 11, at 192 (citing *Mastrobuono v. Shearson Lehman Hutton, Inc.*, 514 U.S. 52, 56 (1995); *Perry v. Thomas*, 482 U.S. 483, 489 (1987)).

73. *See* Federal Arbitration Act, 9 U.S.C. § 2 (2000). The FAA applies to any "maritime transaction or a contract evidencing a transaction involving commerce." *Id.*

74. 513 U.S. 265, 273-74 (1995); *see also* *Citizens Bank v. Alafabco, Inc.*, 123 S. Ct. 2037 (2003) (accepting an equally broad definition of transactions involving commerce in a dispute between an Alabama builder and an Alabama lender).

75. *See Allied-Bruce*, 513 U.S. at 273-74; *see also* *Wickard v. Filburn*, 317 U.S. 111 (1942) (sustaining the federal power to regulate production of wheat where production was not intended in any part for interstate commerce but wholly for consumption on the individual's farm).

agreement—regardless of judicial forum or interstate/intrastate nature—may now fall under the FAA and its national policy in favor of arbitration.<sup>76</sup>

### C. *Fifty Years of Dissent*

Justice Frankfurter was one of the first Supreme Court Justices to recognize the Court's attempt at expanding the preemptive effect of the Federal Arbitration Act beyond Congress' original intent.<sup>77</sup> He believed that the FAA—which Congress passed in 1925—rested solely on Congress' ability to pass general federal law that would be applicable in federal diversity actions.<sup>78</sup> However, since the Supreme Court's 1938 decision in *Erie* negated Congress' power to pass such laws, Frankfurter believed that the FAA was unconstitutional as applied in diversity cases.<sup>79</sup> Justice Black, in a dissent joined by Justices Douglas and Stewart, picked up on this line of reasoning in his *Prima Paint* dissent when he criticized the majority for "statutory mutilation."<sup>80</sup> Disapproving of the majority's opinion that Congress created substantive federal law when it drafted the FAA, Justice Black stated:

[T]here are clear indications in the legislative history that the Act was not intended to make arbitration agreements enforceable in state courts or to provide an independent federal-question basis for jurisdiction in federal courts apart from diversity jurisdiction. The absence of both of these effects—which normally follow from legislation of federal substantive law—seems to militate against the view that Congress was creating a body of federal substantive law.<sup>81</sup>

Justice Stevens, in a concurring opinion almost twenty years later in *Southland*, agreed that Congress passed the FAA as a procedural measure; however, Stevens also believed that intervening developments compelled a finding that the FAA was now substantive federal

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76. See *Allied-Bruce*, 513 U.S. at 282 (O'Connor, J., concurring) ("The reading of § 2 adopted today will displace many state statutes carefully calibrated to protect consumers . . ."). In *Allied-Bruce*, twenty state attorneys general signed an amicus brief asking the Court to overturn *Southland*. *Id.* at 284 (Scalia, J., dissenting).

77. See *Bernhardt v. Polygraphic Co. of Am.*, 350 U.S. 198, 208 (1956) (Frankfurter, J., concurring) (arguing that the Court should construe the FAA so as to avoid its application in diversity cases).

78. See *id.*

79. See *Prima Paint Corp. v. Flood & Conklin Mfg.*, 388 U.S. 395, 416-18 (1967) (Black, J., dissenting).

80. See *id.* at 416 (Black, J., dissenting). "[I]t is clear that Congress in passing the Act relied primarily on its power to create general federal rules to govern federal courts." *Id.* at 418 (Black, J., dissenting).

81. *Id.* at 420 (Black, J., dissenting).

law.<sup>82</sup> Nevertheless, Justice Stevens did advocate leaving a role in developing arbitration policies to the states, finding that the FAA “leaves room for the implementation of certain substantive state policies that would be undermined by enforcing certain categories of arbitration clauses.”<sup>83</sup> Justices O’Connor and Rehnquist, dissenting in *Southland*, agreed. However, they took it a step further, arguing that the FAA should not apply in state court at all, and declaring that the majority opinion, “utterly fail[ed] to recognize the clear congressional intent underlying the FAA.”<sup>84</sup>

Ever since *Southland*, Justice O’Connor has continuously expressed her distaste for the Court’s preemption jurisprudence. In *Allied-Bruce*, for example, she noted that “over the past decade, the Court has abandoned all pretense of ascertaining congressional intent with respect to the Federal Arbitration Act, building instead, case by case, an edifice of its own creation.”<sup>85</sup> Notably, other current members of the Court recognize the validity of O’Connor’s position and have expressed a desire to preserve a greater state role in deciding arbitration policies. Justices Rehnquist, Scalia, and Thomas, for example, all agree that the FAA should not apply in state courts, and they support the idea of reversing *Southland*.<sup>86</sup>

Thus, given the growing dissatisfaction with the Supreme Court’s preemption decisions,<sup>87</sup> it seems likely that something will soon change. As it stands, four Justices support overturning *Southland*.<sup>88</sup>

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82. *Southland Corp. v. Keating*, 465 U.S. 1, 17 (1984) (Stevens, J., concurring in part and dissenting in part). “Although Justice [O’Connor]’s review of the legislative history of the Federal Arbitration Act demonstrates that the 1925 Congress that enacted the statute viewed the statute as essentially procedural in nature, I am persuaded that the intervening developments in the law compel the conclusion that the Court has reached.” *Id.*

83. *Id.* at 18. Justice Stevens also stated that courts “should not refuse to exercise independent judgment concerning the conditions under which an arbitration agreement . . . can be held invalid as contrary to public policy simply because the source of the substantive law to which the arbitration agreement attaches is a State rather than the Federal Government.” *Id.* at 21.

84. *Id.* at 22-23 (O’Connor, J., dissenting). Justice Rehnquist joined Justice O’Connor’s dissent. *See id.*

85. *Allied-Bruce Terminix Cos. v. Dobson*, 513 U.S. 265, 283 (1995) (O’Connor, J., concurring). *Allied-Bruce* involved the Court’s interpretation of “transactions involving commerce.” O’Connor stated her belief that the FAA should only apply in federal court, but concurred with the Court’s judgment to maintain a uniform FAA application standard in state and federal courts. *Id.* at 282.

86. *See id.* at 284 (Scalia, J., dissenting); *id.* at 285-86 (Thomas, J., dissenting); *Southland*, 465 U.S. at 22 (Rehnquist, J., dissenting); *see also* *Doctor’s Assocs., Inc. v. Casarotto*, 517 U.S. 681, 689 (1996) (Thomas, J., dissenting).

87. Justices O’Connor, Rehnquist, Scalia, and Thomas are not alone in their displeasure over the Supreme Court’s expansion of the FAA. In *Allied-Bruce*, twenty state attorneys general signed an amicus brief asking the Court to overturn *Southland*. *Allied-Bruce*, 513 U.S. at 284 (Scalia, J., dissenting).

88. *See Doctor’s Assocs.*, 517 U.S. at 689 (1996) (Thomas, J., dissenting); *Allied-Bruce*, 513 U.S. at 284 (1995) (Scalia, J., dissenting); *id.* at 285-86 (Thomas, J., dissenting); *South-*

While the Court might not go that far, it might reach a compromise, leaving intact the “national policy favoring arbitration,”<sup>89</sup> but returning some limited power over arbitration procedure to the states. Part III discusses a split between the Seventh and Ninth Circuits that provides the opportunity for the Court to make this change.

### III. FEDERAL PREEMPTION AND THE FEDERAL COMMUNICATIONS ACT

The Supreme Court will have an opportunity to address some of the problems with *Southland* and answer some important questions about waivers of class relief, when it resolves a circuit split over the preemptive effect that the Federal Communications Act (FCA) may or may not have over the FAA and state laws of unconscionability.<sup>90</sup> The split arises from an AT&T Consumer Services Agreement that prohibited its customers from pursuing class actions and classwide arbitration.<sup>91</sup> The Seventh Circuit upheld the agreement under the FCA,<sup>92</sup> and the Ninth Circuit invalidated the agreement under the FAA.<sup>93</sup>

Resolving this split will allow the Supreme Court to develop a new preemption policy that respects the interests of both plaintiffs and defendants by: (1) encouraging courts to respect the parties’ decision to arbitrate, yet (2) returning limited powers to the states to regulate the procedural aspects of arbitration. Essentially, the new policy will continue to recognize the “national policy favoring arbitration,”<sup>94</sup> while allowing state law to decide whether to permit arbitration to proceed on a classwide basis.

#### A. *The Federal Communications Act and the Filed Rate Doctrine*

Congress passed the Federal Communications Act of 1934<sup>95</sup> partially in an effort to address AT&T’s virtual monopoly over the nation’s telephone services industry.<sup>96</sup> Under the Act, long distance car-

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*land*, 465 U.S. at 22 (O’Connor, J., dissenting). Justice Rehnquist joined O’Connor’s dissent in *Southland*. *Id.*

89. *Southland*, 465 U.S. at 10.

90. Compare *Ting v. AT&T Corp.*, 319 F.3d 1126 (9th Cir. 2003) (holding (1) that the Federal Communications Act does not preempt state laws of unconscionability, and (2) that the FAA does preempt the California Consumer Legal Remedies Act’s ban on waivers of class actions, but that the FAA makes arbitration agreements subject to state laws of unconscionability, which the 9th Circuit used to invalidate the parties’ agreement in this case), *cert. denied*, 124 S. Ct. 53 (2003), with *Boomer v. AT&T Corp.*, 309 F.3d 404 (7th Cir. 2002) (holding that the Federal Communication Act preempts state laws of unconscionability).

91. See *Ting*, 319 F.3d at 1130; *Boomer*, 309 F.3d at 408.

92. *Boomer*, 309 F.3d at 408.

93. *Ting*, 319 F.3d at 1130.

94. *Southland*, 465 U.S. at 10.

95. Federal Communications Act of 1934, 47 U.S.C. §§ 151-615 (2000).

96. See *Ting*, 319 F.3d at 1130.

riers—namely, AT&T—had to file all terms and conditions of their customer service agreements with the Federal Communications Commission (FCC).<sup>97</sup> Widely known as the “filed rate doctrine,”<sup>98</sup> this provision of the FCA ensured that “all purchasers of communications services receive[d] the same federally regulated rates” by prohibiting regulated entities from charging rates other than those listed in their duly filed tariff.<sup>99</sup> In other words, the filed rate doctrine prevented consumers from having to pay unequal or discriminatory rates based on their geographic location.<sup>100</sup>

By the late 1970s, however, technological advances had reduced entry costs into the telecommunications market, and some of AT&T’s new competitors began voicing concerns that a continuation of the filed rate doctrine imposed unnecessary costs on new entrants.<sup>101</sup> Based on these complaints, the FCC adopted a policy of “detariffing”<sup>102</sup> and—over a fifteen year period<sup>103</sup>—began exempting “non-dominant carriers” from the FCA filing requirement.<sup>104</sup> However, the Supreme Court ultimately concluded that the FCA did not give the FCC the power to issue these exemptions.<sup>105</sup> As a result of the Supreme Court’s decision, the FCC had to wait for Congress to act if it wanted to suspend the filed rate doctrine.<sup>106</sup>

Two years after the Supreme Court denied the FCC the power to exempt certain carriers,<sup>107</sup> Congress responded by passing the Telecommunications Act of 1996.<sup>108</sup> The purpose of the Act was to open all telecommunications markets and provide for a pro-competitive, *deregulated* national policy framework.<sup>109</sup> Through the Act, Congress gave the FCC express authority to refrain from applying the filed

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97. See *Boomer*, 309 F.3d at 408; see also 47 U.S.C. § 203 (2000) (“filed rate doctrine”).

98. The filed rate doctrine is the common name for the section of the Federal Communications Act that was codified in § 203 of the United States Code. See Federal Communications Act of 1934, 47 U.S.C. § 203 (2000).

99. See *Ting*, 319 F.3d at 1130-31 (alteration in original) (quoting *ICOM Holding, Inc. v. MCI Worldcom, Inc.*, 238 F.3d 219, 221 (2d Cir. 2001)).

100. See *id.* at 1131.

101. *Id.*

102. *Id.* at 1132-33. The FCC’s new policy started off as “mandatory detariffing” for all nondominant carriers, but the District of Columbia Circuit Court of Appeals held that the FCC did not have such powers under the FCA. See *id.* at 1132; *MCI Telecomms. Corp. v. FCC*, 765 F.2d 1186, 1193 (D.C. Cir. 1985). Afterwards, the FCC attempted to enact a policy of “permissive detariffing,” but the Supreme Court invalidated this new policy as well. See *Ting*, 319 F.3d at 1132; *MCI Telecomms. Corp. v. AT&T Corp.*, 512 U.S. 218, 234 (1994).

103. *Ting*, 319 F.3d at 1132.

104. *Boomer v. AT&T Corp.*, 309 F.3d 404, 408 (7th Cir. 2002).

105. See *MCI*, 512 U.S. at 234.

106. *Ting*, 319 F.3d at 1132.

107. See *MCI*, 512 U.S. at 234.

108. Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (codified as amended in scattered sections of 47 U.S.C.).

109. See H.R. CONF. REP. NO. 104-458, at 113 (1996) (emphasis added).

rate doctrine if the FCC determined that enforcement of the provision was not necessary to ensure that the charges and practices of carriers were just and reasonable.<sup>110</sup>

Under its new authority, the FCC issued a series of orders notifying AT&T—and the other long distance carriers—that they no longer had to comply with the filed rate doctrine.<sup>111</sup> Instead, carriers had to establish contracts covering rates, terms, and conditions of service directly with their customers.<sup>112</sup> Unclear on the effects of the order, AT&T asked the FCC to clarify whether it intended to subject telecommunication contracts to state contract law.<sup>113</sup> In response, the FCC stated that the FCA “continues to govern determinations as to whether rates, terms, and conditions for interstate . . . services are just and reasonable.”<sup>114</sup> However, the Commission went on to state that “consumers *may* have remedies under state consumer protection and contract laws as to issues regarding the legal relationship between the carrier and customer.”<sup>115</sup>

Soon after the FCC’s response, AT&T started mailing its customers a Consumer Services Agreement (CSA) containing all rates, terms, and conditions of service for AT&T’s state-to-state and international long distance plans.<sup>116</sup> The CSA also described AT&T’s new binding arbitration process.<sup>117</sup> This provision of the CSA spawned the litigation in the Seventh and Ninth Circuits.<sup>118</sup>

The CSA’s binding arbitration provision barred all of AT&T’s long distance customers from pursuing claims against the company through either class action or classwide arbitration.<sup>119</sup> Several consumers in the Seventh and Ninth Circuits sued AT&T, alleging that the company’s elimination of potential class relief through mandatory arbitration clauses violated their respective state laws of unconscionability.<sup>120</sup> AT&T claimed that the Federal Communications Act mandated federal regulation of long distance contracts, and there-

110. Federal Communications Act of 1934, 47 U.S.C. § 160(a)(1) (2000).

111. See *Interstate, Interexchange Marketplace*, 14 F.C.C.R. 6004 (1999); *Interstate, Interexchange Marketplace*, 12 F.C.C.R. 15,014 (1997); *Interstate, Interexchange Marketplace*, 11 F.C.C.R. 20,730 (1996).

112. See *Boomer v. AT&T Corp.*, 309 F.3d 404, 409 (7th Cir. 2002).

113. *Interstate, Interexchange Marketplace*, 12 F.C.C.R. 15,014, 15,056 (1997) (order on reconsideration). AT&T’s request for clarification was based on one statement in the original FCC order: “[C]onsumers will also be able to pursue remedies under state consumer protection and contract laws.” *Id.*

114. *Id.* at 15,057.

115. *Id.* (emphasis added).

116. *Boomer*, 309 F.3d at 409.

117. *Id.*

118. See *Ting v. AT&T Corp.*, 319 F.3d 1126, 1130 (9th Cir. 2003), *cert. denied*, 124 S. Ct. 53 (2003); *Boomer*, 309 F.3d at 408.

119. See *Ting*, 319 F.3d at 1130; *Boomer*, 309 F.3d at 408.

120. See *Ting*, 319 F.3d at 1130; *Boomer*, 309 F.3d at 408.

fore, that the FCA preempted state laws that would undermine their Consumer Services Agreement.<sup>121</sup> The Seventh Circuit agreed and upheld the parties' agreement to arbitrate.<sup>122</sup> The Ninth Circuit, however, decided that the FAA, and its exception for applying state laws of general applicability (i.e., unconscionability), should prevail over the FCA.<sup>123</sup> Based on this reasoning, the Ninth Circuit invalidated the arbitration agreement under California's laws of unconscionability.<sup>124</sup>

As the following Sections explain, the Seventh Circuit came to the appropriate substantive conclusion by upholding the parties' agreement to arbitrate. However, it followed the wrong procedure by basing its decision on the preemptive power of the FCA. It should have taken the path of the Ninth Circuit and reviewed the validity of the parties' agreement under the FAA. Unlike the Ninth Circuit, however, it should have stricken any unconscionable provisions rather than invalidating the entire agreement.

*B. The Seventh & Ninth Circuits' Views on the Preemptive Effect of the Federal Communications Act*

AT&T insisted that a state law challenge to the legality of the CSA violated Congress' objective in creating the Communications Act, and that it specifically conflicted with the objectives of sections 201 and 202 of the FCA.<sup>125</sup> Sections 201 and 202 place substantive prohibitions on a carrier's ability to employ unreasonable or discriminatory rates,<sup>126</sup> and AT&T claimed that these provisions preempt any state law challenges because they show a congressional in-

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121. See *Ting*, 319 F.3d at 1130; *Boomer*, 309 F.3d at 408.

122. *Boomer*, 309 F.3d at 418 n.6.

123. *Ting*, 319 F.3d at 1152; see also Note, *State Regulation of Radio and Television*, 73 HARV. L. REV. 386, 388-89 (1959) (arguing that when the FCA does not specifically cover an activity, "state regulation should be permitted at least until the federal government chooses to act").

124. *Ting*, 319 F.3d at 1152.

125. See *id.* at 1137; *Boomer*, 309 F.3d at 417.

126. See Federal Communications Act of 1934, 47 U.S.C. §§ 201-202 (2000). Section 201(b) states:

All charges, practices, classifications, and regulations for and in connection with such communication service, shall be just and reasonable, and any such charge, practice, classification, or regulation that is unjust or unreasonable is declared to be unlawful.

Section 202(a) provides:

It shall be unlawful for any common carrier to make any unjust or unreasonable discrimination in charges, practices, classifications, regulations, facilities, or services for or in connection with like communication service, directly or indirectly, by any means or device, or to make or give any undue or unreasonable preference or advantage to any particular person, class of persons, or locality, or to subject any particular person, class of persons, or locality to any undue or unreasonable prejudice or disadvantage.

tent for federal law to regulate telecommunications contracts.<sup>127</sup> The Seventh Circuit agreed for three reasons.

First, it stated that sections 201 and 202, and the FCA in general, demonstrate a congressional intent that long-distance customers should “receive uniform rates, terms[,] and conditions of service.”<sup>128</sup> Allowing state law challenges to the arbitration agreement would result in customers in different states “receiving different terms based on their locality.”<sup>129</sup> According to the Seventh Circuit, this violates § 202’s prohibition of providing preferences based on geographic location.<sup>130</sup> Second, AT&T’s implementation of an arbitration clause *supposedly* allows it to offer lower rates to customers.<sup>131</sup> Accordingly, allowing state law challenges to the arbitration agreement might result in varying rate structures for customers in different states, and the court felt that this would also be a violation of § 202.<sup>132</sup> Finally, § 201 declares any rates, terms, and conditions that are unjust and unreasonable to be unlawful.<sup>133</sup> According to the Seventh Circuit, this demonstrates Congress’ intent that federal law should govern terms and conditions of telecommunication service contracts.<sup>134</sup> Based on this reasoning, the court upheld the parties’ agreement to arbitrate.<sup>135</sup>

While the Seventh Circuit’s decision to send the parties to arbitration was substantively correct, it was procedurally inaccurate because it held that the FCA preempts state laws of unconscionability. The court should have upheld the parties’ agreement to arbitrate under the FAA, and then reviewed state law to determine whether to allow the arbitration to proceed on a classwide basis.<sup>136</sup> As the Ninth Circuit held, the Federal Communications Act does not preempt state laws.<sup>137</sup> While sections 201 and 202 of the 1934 Act unquestionably demonstrate a congressional intent that customers should receive

127. See *Ting*, 319 F.3d at 1137-38; *Boomer*, 309 F.3d at 418.

128. *Boomer*, 309 F.3d at 418.

129. *Id.*

130. *Id.* at 419.

131. See *id.* at 418. AT&T did not offer any empirical evidence to support this claim.

132. *Id.*

133. Federal Communications Act of 1934, 47 U.S.C. § 201(b) (2000).

134. *Boomer*, 309 F.3d at 418.

135. *Id.* at 424.

136. On this point, the Ninth Circuit also made an inappropriate decision; it invalidated the parties’ entire agreement. *Ting v. AT&T Corp.*, 319 F.3d 1126, 1152 (9th Cir. 2003), *cert. denied*, 124 S. Ct. 53 (2003). The Ninth Circuit should have sent the parties to arbitration and let state law determine whether arbitration may proceed on a classwide basis. California, by the way, is one of only a few states that so far has explicitly accepted classwide arbitration as a legitimate form of alternative dispute resolution. See *Blue Cross of Cal. v. Superior Court*, 78 Cal. Rptr. 2d 779, 794 (Ct. App. 1998) (concluding that the FAA does not preempt California’s state law that allows classwide arbitration when the arbitration agreement is silent on the issue).

137. *Ting*, 319 at 1152.

reasonable rates, terms, and services,<sup>138</sup> these provisions have no preemptive effect without the filed rate doctrine.<sup>139</sup> When Congress passed the Telecommunications Act of 1996 and gave the FCC the power to eliminate the filed rate doctrine<sup>140</sup>—which was the procedural mechanism for enforcing sections 201 and 202—it eliminated the preemptive effect of the FCA.<sup>141</sup> While the substantive principles of sections 201 and 202 remain intact, consumers may now rely on state law to enforce these provisions.<sup>142</sup> Even the FCC admitted that “consumers *may* have remedies under state consumer protection and contract laws.”<sup>143</sup>

*C. Using the Circuit Split to Define the State’s Role in Proscribing Contractual Prohibitions of Classwide Arbitration*

Because the FCA does not preempt state laws, the Seventh Circuit should have reviewed the arbitration agreement under the Federal Arbitration Act. Based on the Supreme Court’s “national policy favoring arbitration,”<sup>144</sup> the court still could have upheld the parties’ decision to arbitrate. The only difference is that the court could also have allowed state laws—Illinois laws in this case—to determine whether the arbitration should proceed on a classwide basis, regardless of the contractual prohibition on class relief.<sup>145</sup>

If the Supreme Court follows this reasoning when it resolves the circuit split, it can eliminate a great deal of the dissension over *Southland* and prevent companies from using mandatory arbitration

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138. *Id.* at 1138.

139. *Id.* at 1138-40.

140. See Federal Communications Act of 1934, 47 U.S.C. § 203 (2000).

141. See *Ting*, 319 F.3d at 1139. The substantive effects of sections 201-202 remain after the 1996 Act. The only difference is that parties may now enforce these provisions in state court. *Id.* at 1138-43.

142. *Id.* at 1138-43.

143. Interstate, Interexchange Marketplace, 12 F.C.C.R. 15,014, 15,057 (1997) (order on reconsideration) (emphasis added).

144. *Southland Corp. v. Keating*, 465 U.S. 1, 10 (1984).

145. Generally, courts refer to arbitration as a matter of contract and they respect the parties’ agreements accordingly. See, e.g., *Randolph v. Green Tree Fin. Corp.*, 244 F.3d 814, 819 (11th Cir. 2001) (holding that under the congressional policy embodied in the FAA, parties may contractually waive their right to class action litigation). However, in situations where companies are completely prohibiting class relief through restrictive arbitration clauses in adhesion contracts, courts should not defer to the parties’ right to contract. Placing complete prohibitions on class relief in an arbitration agreement is against public policy because, among other things, it allows companies to avoid accountability for corporate misdeeds. See *Szetela v. Discover Bank*, 118 Cal. Rptr. 2d 862, 867-68 (Ct. App. 2002); *State ex rel. Dunlap v. Berger*, 567 S.E.2d 265, 279-80 (W. Va. 2002). In this type of situation, courts should defer to state law to determine whether arbitration should proceed on a classwide basis. See generally *Hayford & Palmiter*, *supra* note 11, at 176 (arguing for a greater state role in commercial arbitration); see also, Note, *supra* note 123, at 388-89.

to create “virtual immunity”<sup>146</sup> from class proceedings. While this approach still recognizes *Southland’s* “national policy” in favor of arbitration,<sup>147</sup> and requires courts to respect arbitration agreements accordingly, it returns power over arbitration procedure to the states. Therefore, under this approach, states still may not enact substantive rules that undermine the enforceability of the parties’ decision to arbitrate, but states *may* enact procedural rules dealing with the fairness of the arbitration process itself. Thus, when faced with an arbitration agreement that prohibits both class actions and classwide arbitration, courts may uphold the parties’ decision to arbitrate, but review state law to determine whether to permit arbitration to proceed on a classwide basis, regardless of any contractual prohibitions on class relief. Such a solution serves the dual interest of advancing the parties’ decision to arbitrate—thereby respecting the “national policy” in favor of arbitration<sup>148</sup>—while preserving some authority over arbitration procedure for the states.<sup>149</sup> Consequently, if states accept classwide arbitration as an effective method of dispute resolution, companies will no longer be able to use binding arbitration to avoid class relief.<sup>150</sup>

#### IV. JUSTIFYING STATE CONTROL AND CLASSWIDE ARBITRATION THROUGH PUBLIC POLICY AND ECONOMICS

Currently, only California, Pennsylvania, and South Carolina have explicitly accepted classwide arbitration as an effective method of dispute resolution.<sup>151</sup> However, when faced with a choice of accepting classwide arbitration or allowing companies to avoid class relief, presumably most—if not all—states will accept classwide arbitration. This Section explains the justifications for allowing states to prohibit

146. *Szetela*, 118 Cal. Rptr. 2d at 867 (stating that class relief prohibitions create “virtual immunity from class or representative actions despite their potential merit”).

147. *Southland*, 465 U.S. at 10.

148. *Id.*

149. See generally Hayford & Palmiter, *supra* note 11 (arguing for a greater state role in commercial arbitration); see also, Note, *supra* note 123, at 388-89.

150. The draft reporter’s notes for the Revised Uniform Arbitration Act, which was recently adopted by the National Conference of Commissioners on Uniform State Laws, indicates that it may be appropriate for courts to invalidate arbitration provisions that use the elimination of class relief to undermine consumer rights. See NATIONAL CONFERENCE OF COMMISSIONERS ON UNIFORM STATE LAWS, PROPOSED REVISIONS OF THE UNIFORM ARBITRATION ACT, DRAFT FOR APPROVAL 36-37 (2000), available at <http://www.law.upenn.edu/bll/ulc/uarba/arb0500.pdf> (last visited Feb. 29, 2004); see also Thomas E. Carbonneau, *Arbitral Justice: The Demise of Due Process in American Law*, 70 TUL. L. REV. 1945, 1955-67 (1996) (arguing that companies are exploiting arbitration in ways that are detrimental to the system).

151. See *Bazzle v. Green Tree Fin. Corp.*, 569 S.E.2d 349, 360 (S.C. 2002), *overturned on other grounds*, 123 S. Ct. 2402 (2003); *Blue Cross of Cal. v. Superior Court*, 78 Cal. Rptr. 2d 779, 781 (Ct. App. 1998); *Dickler v. Shearson Lehman Hutton, Inc.*, 596 A.2d 860, 867 (Pa. Super. Ct. 1991).

preclusions of class relief, discredits the justification that consumer businesses use to validate their use of class relief preclusions, and leads into a discussion on some aspects of classwide arbitration that states may want to consider when adopting the classwide arbitral system.

*A. Maintaining the “National Policy” while Proscribing Prohibitions on Class Relief*

An important aspect of the proposal for returning greater powers over arbitration procedure to the states is that it respects the “national policy favoring arbitration.”<sup>152</sup> The Supreme Court spent seventy-five years developing this policy and it will not abandon it overnight. However, several justices, and many states, disagree with the Court’s expansion of the FAA, and it seems likely that the Court’s policy will soon change.<sup>153</sup> Adopting an approach that requires states to respect the parties’ decision to arbitrate while allowing state law to determine whether arbitration should proceed on a classwide basis is a practical compromise. It maintains the “national policy”<sup>154</sup> while granting limited procedural powers to the states.<sup>155</sup> More importantly, it also respects general public policy in favor of allowing parties to proceed on a classwide basis.

*B. Public Policy as Justification for Reform*

“Classwide arbitration, as Sir Winston Churchill said of democracy, must be evaluated, not in relation to some ideal but in relation to its alternatives.”<sup>156</sup> If the alternative is to force hundreds of con-

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152. *Southland*, 465 U.S. at 10.

153. See *supra* notes 77-89.

154. *Southland*, 465 U.S. at 10.

155. In *Arbitration Federalism*, Professors Hayford and Palmiter suggest a two-part “blueprint” for determining what role state law should have in the arbitration process. Hayford & Palmiter, *supra* note 11, at 203. “First, [the blueprint] is prohibitive: state law can neither be hostile to arbitration nor undermine the parties’ agreement. Second, [the blueprint] is hortatory: state law must seek to facilitate arbitration and to give content and effect to the parties’ choice.” *Id.* This Comment’s proposal meets both criteria by respecting the “national policy” in favor of arbitration, by respecting the parties’ decision to arbitrate, and by facilitating classwide arbitration. *Southland*, 465 U.S. at 10; see Hayford & Palmiter, *supra* note 11, at 203.

156. Jean R. Sternlight, *As Mandatory Binding Arbitration Meets the Class Action, Will the Class Action Survive?*, 42 WM. & MARY L. REV. 1, 44 (2000) (quoting Keating v. Superior Court, 183 Cal. Rptr. 360, 377 (1982)). At least nine courts—most of which are in California—have held that arbitration clauses precluding class relief contributed to a finding of unconscionability or to a finding that the arbitration clause must be severed. See *Ting v. AT&T Corp.*, 319 F.3d 1126, 1150 (9th Cir. 2003), *cert. denied*, 124 S. Ct. 53 (2003); *Ingle v. Circuit City Stores, Inc.*, 328 F.3d 1165, 1175-76 (9th Cir. 2003); *Comb v. PayPal, Inc.*, 218 F. Supp. 2d 1165, 1175-76 (N.D. Cal. 2002); *Acorn v. Household Int’l, Inc.*, 211 F. Supp. 2d 1160, 1170-71 (N.D. Cal. 2002); *Luna v. Household Fin. Corp.*, 236 F. Supp. 2d 1166, 1182-83 (W.D. Wash. 2002); *Lozada v. Dale Baker Oldsmobile, Inc.*, 91 F. Supp. 2d

sumers to try their claims individually in arbitration, then classwide arbitration undoubtedly offers a superior option.<sup>157</sup> There are at least three reasons why this is true.

### 1. Corporate Accountability

The West Virginia Supreme Court recently stated that permitting consumer companies to employ arbitration clauses that prohibit class relief “would go a long way toward allowing those who commit illegal activity to go unpunished, undeterred, and unaccountable.”<sup>158</sup> While deterrence is a questionable rationale for promoting classwide arbitration,<sup>159</sup> holding consumer businesses accountable for illegal conduct is a definite benefit of protecting and developing the class arbitration system.<sup>160</sup> Companies employ mandatory arbitration clauses that preclude all class relief to discourage consumers from seeking legal redress. Any arbitration clause that attempts to avoid corporate accountability through a complete prohibition on class relief deserves judicial invalidation. Companies should not be able to create “virtual immunity”<sup>161</sup> from class relief, and permitting states to proscribe this activity will hold corporations accountable for their actions.

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1087, 1104-05 (W.D. Mich. 2000); *In re Knepp*, 229 B.R. 821, 843 (Bankr. N.D. Ala. 1999); *Szetela v. Discover Bank*, 118 Cal. Rptr. 2d 862, 867-68 (Ct. App. 2002); *Powertel, Inc. v. Bexley*, 743 So. 2d 570, 576 (Fla. 1st DCA 1999); *State ex rel. Dunlap v. Berger*, 567 S.E.2d 265, 280 (W. Va. 2002). *But see* Alan S. Kaplinsky & Mark J. Levin, *The Gold Rush of 2002: California Courts Lure Plaintiffs' Lawyers (but Undermine Federal Arbitration Act) by Refusing to Enforce "No-Class Action" Clauses in Consumer Arbitration Agreements*, 58 BUS. LAW. 1289, 1290-91 (2003) (arguing that courts should respect parties' arbitration agreements even if they are adhesive in nature and citing several courts that have done so).

157. Sternlight, *supra* note 156, at 44; *see also* *Lewis v. Prudential Bache Secs., Inc.*, 225 Cal. Rptr. 69, 75 (Ct. App. 1986):

The alternative . . . is to force each . . . customer to individually arbitrate claims, most of which probably cannot justify the time and money required to prove. This case appears to offer no great difficulty in adapting arbitration to fit the class action mold, with adequate judicial supervision over the class aspects.

*Id.* at 75.

158. *Berger*, 567 S.E.2d at 278-79.

159. *See* John Braithwaite & Toni Makkai, *Testing an Expected Utility Model of Corporate Deterrence*, 25 LAW & SOC'Y REV. 7 (1991) (questioning the deterrent effect of corporate regulations); Cass R. Sunstein et al., *Do People Want Optimal Deterrence?*, 29 J. LEGAL STUD. 237 (2000) (questioning the role of deterrence in jury awards).

160. *See Berger*, 567 S.E.2d at 278-79; *see also Szetela*, 118 Cal. Rptr. 2d at 868:

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

161. *Szetela*, 118 Cal. Rptr. 2d at 867 (stating that class relief prohibitions create “virtual immunity from class or representative actions despite their potential merit”); *Keating*, 183 Cal. Rptr. at 375 (“If the right to a classwide proceeding could be automatically elimi-

## 2. *Imperfect Information*

Individual suits cannot serve the accountability function because many consumers are unaware of their potential claims against a company. If they do not know about the potential claims, then they cannot bring the individual suit. Therefore, allowing consumer companies to force individual resolution of consumer claims will significantly reduce their exposure to liability from corporate wrongdoing. One of the benefits of classwide arbitration is that it requires the parties to give notice to all potential class members.<sup>162</sup> Thus, a single informed consumer can initiate a class proceeding and inform all class members about the potential recovery.<sup>163</sup>

## 3. *Economic Feasibility*

Even if individual consumers could easily learn of potential claims that they might have against consumer businesses, it is economically impractical for them to individually initiate the typical consumer action because most claims of this nature have a “negative value.”<sup>164</sup> The potential recovery to the individual would be too small and the potential costs of the litigation would be too large to give the consumer an adequate incentive to file the claim.<sup>165</sup> Most attorneys would refuse to accept a case with such a minimal potential return, and “the vast majority of consumer claims involving relatively small sums of money . . . will be left without a remedy.”<sup>166</sup> Classwide arbitration solves this problem by “provid[ing] small claimants with a method of obtaining redress for claims which would otherwise be too small to warrant individual litigation.”<sup>167</sup>

### C. *The Defendant’s Economic Justification for Class Relief Prohibitions*

Defendants in consumer actions have an economic argument of their own. They claim that arbitration clauses allow consumer businesses to lower their operating costs and pass those savings on to

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nated in relationships governed by adhesion contracts through the inclusion of a provision for arbitration, the potential for undercutting these class action principles, and for chilling the effective protection of interests common to a group, would be substantial.”)

162. See AM. ARBITRATION ASSOC., SUPPLEMENTARY RULES FOR CLASS ARBITRATIONS (effective Oct. 8, 2003), at [http://www.adr.org/index2.1.jsp?JSPssid=15747&JSPsrc=upload\LIVESITE\Rules\\_Procedures\National\\_International\..\Topics\\_Interest\AAAClassaction.htm](http://www.adr.org/index2.1.jsp?JSPssid=15747&JSPsrc=upload\LIVESITE\Rules_Procedures\National_International\..\Topics_Interest\AAAClassaction.htm) (last visited Feb. 29, 2004) [hereinafter AAA CLASS RULES].

163. Jean R. Sternlight & Elizabeth J. Jensen, *Using Arbitration to Eliminate Consumer Class Actions: Efficient Business Practice or Unconscionable Abuse?*, 67 LAW & CONTEMP. PROBS. (forthcoming March 2004) (manuscript at 19, on file with author).

164. *Id.* (manuscript at 18) (citing affidavit of Professor Edward F. Sherman).

165. *Id.*

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

167. *Keating v. Superior Court*, 183 Cal. Rptr. 360, 374 (1982).

customers.<sup>168</sup> Essentially, these businesses advocate that prohibitions on class relief benefit consumers. This Section examines the efficient market theory and behavioralism in an effort to judge the legitimacy of the consumer businesses' stance that lower costs to consumers should be the overriding concern in determining whether to allow prohibitions on class relief.

### 1. *Efficient Markets?*

Ultimately, the degree to which prohibitions on class relief result in lower costs to consumers is an empirical question, and, so far, no empirical data exists.<sup>169</sup> Nevertheless, one can make assumptions about the extent that companies return savings to consumers based on general economic theory.<sup>170</sup> Stated simply, whether a company will return savings to consumers rather than keep them as profits depends on the level of competition in that company's market. The only time consumers can *absolutely* expect to see such a return is when perfect competition exists.<sup>171</sup> However, perfect competition rarely exists, especially among national consumer companies.<sup>172</sup> Barriers to entry, dominant sellers, and heterogeneous products—factors that evidence imperfect competition—all exist in the major consumer markets.<sup>173</sup> Thus, taking the position that consumer businesses return savings to consumers is a questionable position at best, and it

168. See, e.g., *Boomer v. AT&T Corp.*, 309 F.3d 404, 419 (7th Cir. 2002) (“[A]rbitration offers cost-saving benefits to telecommunication providers and ‘these benefits are reflected in a lower cost of doing business that in competition are passed along to customers.’”) (citing *E. Ctr. for Conditioning & Health v. Qwest Communications Int’l, Inc.*, 294 F.3d 924, 927 (7th Cir. 2002), *cert. denied*, 537 U.S. 1090 (2002)); see also Stephen J. Ware, *Paying the Price of Process: Judicial Regulation of Consumer Arbitration Agreements*, 2001 J. DISP. RESOL. 89, 91 (“Assuming that consumer arbitration agreements lower the dispute-resolution costs of businesses that use them, competition will (over time) force these businesses to pass their cost-savings to consumers.”).

169. Drahozal, *supra* note 37, at 764; see also Sternlight & Jensen, *supra* note 163 (manuscript at 28) (“It is not surprising that, to date, no published studies show that the imposition of mandatory arbitration leads to lower prices.”).

170. Sternlight & Jensen, *supra* note 163 (manuscript at 24-33); see also Drahozal, *supra* note 37, at 765:

In the absence of empirical evidence, whether one believes that individuals benefit from arbitration through reduced prices and higher wages, or instead that corporations use arbitration to take advantage of individuals and avoid their legal obligations, depends largely on one's faith in the market as a means of allocating resources.

171. Sternlight & Jensen, *supra* note 163 (manuscript at 25).

172. See *id.* (manuscript at 26-27). Perfect competition only exists when four factors are present. First, there must be a sufficient amount of small buyers and small sellers so that one buyer or seller cannot manipulate the market. Second, the goods should be homogeneous, so that no company sells a unique product. Third, barriers to entry in the market must be very low. Finally, the market should be efficient in terms of information availability. *Id.* (manuscript at 25-26).

173. See *id.* (manuscript at 26-27). *But see* Ware, *supra* note 168, at 91 (assuming without discussion that no barriers to entry exist in a market economy).

provides a weak argument for allowing companies to preclude all class relief.

Even if consumer businesses *did* return savings to consumers in the form of lower costs, lower costs are not the primary concern. Based on the accountability and economic rationales discussed above, courts should not allow consumer businesses to create “virtual immunity”<sup>174</sup> from class relief. In fact, “the notion that it is to the public’s advantage that companies be relieved of legal liability for their wrongdoing . . . is contrary to a century of consumer protection laws.”<sup>175</sup> Thus, slightly higher costs are worthwhile if the alternative is allowing consumer businesses to continue with the illegal activity.

## 2. *Recognizing Behavioralism as a Legitimate Concern?*

While some consumers might be willing to pay slightly higher prices to preserve an opportunity to vindicate their rights, others might be willing to trade that opportunity for potentially lower costs, regardless of whether the lower costs will actually materialize and regardless of whether they will ever be in a situation where they would want to vindicate their rights. Essentially, consumers tend to be overoptimistic, believing—perhaps irrationally—that such a situation will never occur. Thus, even assuming that consumers would accept binding arbitration in return for a lower price—which itself assumes that consumers accept the doubtful proposition that consumer companies return reduced costs to their customers—regulation to prevent companies from completely precluding class relief may be necessary to protect consumers from their own behavior.<sup>176</sup>

Should regulations be based *solely* on the basis of protecting consumers from their own (potentially irrational) behavior? The answer is debatable.<sup>177</sup> Ultimately, however, legal rules should not be created *exclusively* on (potentially false) assumptions about the rationality of consumers.<sup>178</sup> Nevertheless, this does not mean that companies should be able to preclude all forms of class relief if a group of consumers is willing to (perhaps irrationally) go along with it. Parallel concerns—namely, accountability for illegal conduct—exist to reinforce the need for placing a prohibition on companies from participat-

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174. See *Szetela v. Discover Bank*, 118 Cal. Rptr. 2d 862, 867 (Ct. App. 2002) (stating that class relief prohibitions create “virtual immunity from class or representative actions despite their potential merit”).

175. *Ting v. AT&T*, 182 F. Supp. 2d 902, 931 n.16 (N.D. Cal. 2002), *rev’d in part*, *Ting v. AT&T*, 319 F.3d 1126 (9th Cir. 2003).

176. Sternlight & Jensen, *supra* note 163 (manuscript at 29-30).

177. Compare Jon D. Hanson & Douglas A. Kysar, *Taking Behavioralism Seriously: Some Evidence of Market Manipulation*, 112 HARV. L. REV. 1420 (1999), with Gregory Mitchell, *Taking Behavioralism Too Seriously? The Unwarranted Pessimism of the New Behavioral Analysis of the Law*, 43 WM. & MARY L. REV. 1907 (2002).

178. See Mitchell, *supra* note 177, at 2021.

ing in such activities. Thus, while basing regulation solely on assumptions about consumers' rationality is problematic, additional overriding concerns justify preventing companies from proscribing class relief.

#### D. States as Testing Grounds

The FAA does not provide detailed coverage of the arbitration process or the role that arbitrators play in that process.<sup>179</sup> For example, it does not specify how arbitrators should handle discovery, the availability of injunctive relief, requests for summary judgment, or—most significantly in terms of this Comment—consolidation of multiple arbitrations.<sup>180</sup> Clarification on these issues must come from the states.

Since classwide arbitration is a relatively new phenomenon, states will want to develop rules and procedures to ensure the system is fair and efficient. This is a perfect role for the states as they can act as testing grounds to determine which procedures work and which do not.<sup>181</sup> Indeed, states should start adopting procedures for classwide arbitration as soon as possible. This will give the Supreme Court an additional incentive to return greater authority over arbitration procedures to the states when it resolves the split between the Seventh and Ninth Circuits. The following Section describes some of the procedures that are particularly relevant for classwide arbitration that states should consider.

### V. PROCEDURAL SAFEGUARDS FOR CLASSWIDE ARBITRATION

One of the most widely debated “obstacles” to classwide arbitration is the extent of judicial oversight that may be necessary to protect the due process rights of the parties.<sup>182</sup> Essentially, courts and

179. Hayford & Palmiter, *supra* note 11, at 200.

180. *Id.* at 200. According to Hayford & Palmiter, “the Supreme Court’s decision in *Volt* can be seen as an invitation for greater state participation in areas outside the FAA preemptive core.” *Id.* at 211-12; *see also* *Volt Info. Scis., Inc. v. Bd. of Trs. of Leland Stanford Junior Univ.*, 489 U.S. 468, 477 (1989) (stating that the FAA does not “reflect a congressional intent to occupy the entire field of arbitration”).

181. *See* Hayford & Palmiter, *supra* note 11, at 211-12. How should states go about developing the classwide arbitration system? Relying on courts to develop classwide arbitration rules on a case-by-case basis through judicial interpretation of existing state arbitration acts may take years or even decades to create a coherent set of procedures. Asking state legislatures, on the other hand, to adopt bright line rules that would assist in the development and institutionalization of the classwide arbitration system seems like a more efficient approach. *Id.*

182. *See* *Keating v. Superior Court*, 167 Cal. Rptr. 481, 491-92 (Ct. App. 1980) (stating that there are “no insurmountable obstacle[s]” to classwide arbitration and that limited judicial oversight is necessary to make the system work), *vacated*, 183 Cal. Rptr. 360 (1982), *overturned on other grounds*, *Southland Corp. v. Keating*, 465 U.S. 1 (1984); *see also* Sternlight, *supra* note 156, at 111-13 (arguing that courts must make the class certification

commentators disagree over the court's involvement in the classwide arbitration process. Should the court select the arbitrator, certify the class, and assist in providing adequate notice to the class members? Or, may the arbitrator and parties perform these tasks? Earlier this year, the American Arbitration Association (AAA) adopted a set of supplemental rules on classwide arbitration that accept the latter alternative and place all of the procedural responsibilities in the hands of the parties and the arbitrator.<sup>183</sup> The remainder of this Section examines the AAA rules and discusses whether states may want to adopt these rules outright or adopt additional safeguards that may better protect both defendants and the class.

#### A. *Selecting the Arbitrator*

Unlike litigation, arbitration allows the parties to select the decision maker.<sup>184</sup> If the parties agree to have only one arbitrator, then the procedure employed by the AAA is a common method of selecting

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decision and assist in providing adequate notice to class members); Note, *Classwide Arbitration: Efficient Adjudication or Procedural Quagmire?*, 67 VA. L. REV. 787, 806-808 (1981) (arguing that arbitrators should make the class certification decision). The Virginia Law Review Note proposes that due process may not even apply in arbitration because there is no requisite state action. *Id.* at 800. However, this is unlikely because (1) parties cannot easily waive due process rights, and (2) some state action will probably be essential in classwide arbitration. See *Fuentes v. Shevin*, 407 U.S. 67, 94-96 (1972) (discussing considerations relevant to waiver of due process); Sternlight, *supra* note 156, at 111-13 (arguing that courts must make the class certification decision and assist in providing adequate notice to class members).

183. AAA CLASS RULES, *supra* note 162, at Rule 2. The AAA adopted these rules after the Supreme Court's 2003 decision in *Green Tree Financial Corp. v. Bazzle*, 123 S. Ct. 2402 (2003). In *Bazzle*, the U.S. Supreme Court had to decide whether an arbitration agreement that is silent regarding the availability of classwide arbitration actually permits the parties to proceed on a classwide basis. *Id.* at 2404. The South Carolina Supreme Court originally decided (1) that the arbitration agreement was silent as to whether parties could proceed with a classwide arbitration, and (2) that, given this silence, South Carolina law interprets the contracts as permitting class arbitration proceedings. *Id.* The U.S. Supreme Court, in a plurality opinion, decided that this was essentially an issue of contract interpretation and that the arbitrator, and not the court, must make the decision. *Id.* at 2408. Therefore, the Court vacated the judgment of the South Carolina Supreme Court and remanded the case to be resolved by the arbitrator. *Id.* Only three Justices joined Justice Breyer's plurality opinion. Justice Stevens—solely in order to have a controlling opinion—concurred in the judgment, but dissented on the Court's decision to vacate the decision of the South Carolina Supreme Court. See *id.* at 2408-09. Stevens concluded that nothing in the FAA precluded the South Carolina Supreme Court from making the determination that the contract permitted classwide arbitration. *Id.* at 2408. Justice Thomas offered his standard dissent that the FAA should not apply in state courts and that the Court should have respected the decision of the South Carolina Supreme Court. *Id.* at 2411.

184. Drahozal, *supra* note 37, at 708-09. This discussion assumes that the original contract did not name the arbitrator or arbitrators in advance. If the parties named the arbitrator(s) in advance, this raises another ethical concern. The arbitrator(s) may be biased in favor of the company that drafted the contract. However, even if the parties did name the arbitrator(s) in advance, the conflict checks required by the AAA rules—along with the arbitrator's and arbitration institution's financial incentive to avoid any appearance of bias—are sufficient to ensure a fair award.

that person.<sup>185</sup> Parties must agree on an arbitrator from a list provided by the AAA, and submit that name to the AAA for approval.<sup>186</sup> If the parties cannot agree on one name, they must strike all objectionable names and rank the remainder in order of preference.<sup>187</sup> The highest ranking arbitrator wins.<sup>188</sup> For a panel of three arbitrators, the parties each choose one, and those two choose the third.<sup>189</sup> The same principles apply in classwide arbitrations, but the procedure is slightly different. The Supplementary Rules for Class Arbitrations require parties to select at least one arbitrator from the AAA's "national roster of class arbitration arbitrators."<sup>190</sup>

Since the class attorney makes the selection for the class, an important due process concern arises in the selection process.<sup>191</sup> The class attorney may attempt to choose an arbitrator who will act in the best interest of the class attorney rather than that of the class. Professor Sternlight contends that courts must occupy a role in selecting the arbitrator in classwide proceedings to protect absent class members.<sup>192</sup> "Without court supervision of the formation and treatment of the arbitral class action, this means that the absent class members will ultimately be bound by the ruling of an arbitrator they had absolutely no role in selecting."<sup>193</sup>

While it may be true that the class attorney and class members have potentially conflicting interests,<sup>194</sup> Professor Sternlight's concerns are slightly overstated. The class attorney has an ethical duty to act in the best interest of the class as a whole by selecting a fair and unbiased arbitrator. The arbitrator, in turn, has a duty to dis-

185. See AM. ARBITRATION ASSOC., COMMERCIAL ARBITRATION RULES AND MEDIATION PROCEDURES Rule 11 (amended and effective July 1, 2003), available at [http://www.adr.org/index2.ljsp?JSPssid=15747&JSPsrc=upload\LIVESITE\Rules\\_Procedures\National\\_International\...\focusArea\commercial\AAA235current.htm](http://www.adr.org/index2.ljsp?JSPssid=15747&JSPsrc=upload\LIVESITE\Rules_Procedures\National_International\...\focusArea\commercial\AAA235current.htm) (last visited Feb. 29, 2004) [hereinafter AAA COMMERCIAL RULES].

186. *Id.* at Rule 11(a).

187. *Id.* at Rule 11(b).

188. *Id.*

189. *Id.* at Rule 13(c).

190. AAA CLASS RULES, *supra* note 162, at Rule 2(a).

191. Sternlight, *supra* note 156, at 111-12.

192. *Id.* Another common argument against arbitration in general is the effect that "repeat player" status may have on the outcome of the arbitration. Essentially, some commentators argue that corporations, as "repeat players" in arbitration, have a distinct advantage because arbitrators have an incentive to award in favor of the corporation so that the corporation will repeatedly choose that arbitrator. However, such an argument ignores three important facts. First, both parties to an arbitration participate in the selection process. Second, plaintiff's attorneys may also be "repeat players." Finally, arbitration institutions go to great lengths to remove any possibility of bias, including the enactment of disclosure rules that arbitrators must comply with before being approved for a particular case. See Drahozal, *supra* note 37, at 709-10, 751, 769-70.

193. Sternlight, *supra* note 156, at 112.

194. See generally John C. Coffee, Jr., *Class Wars: The Dilemma of the Mass Tort Class Action*, 95 COLUM. L. REV. 1343, 1417-21 (1995).

close any conflicts of interest that may prevent him or her from rendering a fair opinion.<sup>195</sup> Additionally, arbitration institutions have great financial incentives to avoid any appearance of bias. If an institution obtains a reputation for bias, it risks losing credibility, which courts rely upon to enforce arbitral awards.<sup>196</sup> “There is little reason to use an institution whose awards are not enforced by the courts.”<sup>197</sup> Accordingly, arbitration organizations take special precautions to ensure that their arbitrators are fair and unbiased.

Based on this reasoning, requiring courts to oversee the selection of the arbitrator in a class arbitration proceeding seems unnecessary. Sufficient safeguards exist to ensure that all parties—defendants, named plaintiffs, and absent class members—receive a fair decision-maker. Thus, states should be satisfied with the current level of protections in the selection process.

### B. *Contract Interpretation & Class Certification*

Under Rule 3 of the AAA’s Supplementary Rules for Class Arbitrations, the first duty of the arbitrator is to determine, in a written opinion, whether the arbitration agreement permits the arbitration to proceed on a classwide basis.<sup>198</sup> Essentially, the arbitrator interprets the contract and then issues what the rules call a “Clause Construction Award.”<sup>199</sup> Following the issuance of the award, parties have thirty days to ask a court of competent jurisdiction to confirm or vacate the arbitrator’s decision.<sup>200</sup> After the court confirms or vacates the decision, it returns the case to the arbitrator who then has to decide—under Rule 4 of the AAA’s Supplementary Rules—whether to

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195. See AAA COMMERCIAL RULES, *supra* note 185, at Rule 16(a):

Any person appointed or to be appointed as an arbitrator shall disclose to the AAA any circumstance likely to give rise to justifiable doubt as to the arbitrator’s impartiality or independence, including any bias or any financial or personal interest in the result of the arbitration or any past or present relationship with the parties or their representatives. Such obligation shall remain in effect throughout the arbitration.

196. Drahozal, *supra* note 37, at 752.

197. *Id.* at 769.

198. AAA CLASS RULES, *supra* note 162, at Rule 3. By allowing the arbitrator to make the contract interpretation, the rules are consistent with *Bazzle*, but *Bazzle* is only a plurality opinion. 123 S. Ct. 2402 (2003). Justices Breyer, Scalia, Souter, and Ginsburg felt that the arbitrator should make the contract interpretation. *Id.* at 2408. Justices Rehnquist, O’Connor, and Kennedy felt that the South Carolina Supreme Court was the correct body to make the contract interpretation, but that the South Carolina Court made an incorrect ruling. *Id.* at 2409. Justice Stevens felt that the court should not disturb the decision of the South Carolina Supreme Court, but voted to allow the arbitrator to interpret the contract so that the court would have a controlling opinion. *Id.* at 2408-09. Justice Thomas issued his standard dissent that the FAA does not apply in state courts and that the Court should let the decision of the South Carolina Supreme Court stand. *Id.* at 2411.

199. AAA CLASS RULES, *supra* note 162, at Rule 3.

200. *Id.*

certify the class.<sup>201</sup> Rule 4 essentially mirrors Rule 23 of the Federal Rules of Civil Procedure by outlining the conditions that the arbitrator should consider when making the certification decision.<sup>202</sup> If the arbitrator chooses to certify the class, each party again has thirty days to ask a court of competent jurisdiction to confirm or vacate the award.<sup>203</sup>

There are three concerns with the AAA's certification process. First, it creates a potential financial conflict of interest for the arbitrator. Also, it may not adequately protect the due process rights of the parties. Finally, it may be more complicated and time-consuming than necessary. Each is a legitimate concern that states should consider before adopting similar rules.

### 1. *A Financial Conflict of Interest?*

Arbitrators may have a financial incentive to certify a class because the longer the arbitrator spends on the case the more money the arbitrator receives. This seems like a fairly strong argument in favor of letting the court certify the class. However, the concern is misplaced. As discussed in Part V.A, arbitration institutions, and arbitrators as well, have incredibly strong financial incentives to avoid any appearance of bias. They simply cannot survive economically if they cannot maintain an impartial appearance.<sup>204</sup> Thus, the existence of a potential financial conflict of interest should not prevent the arbitrator from making the certification decision because sufficient safeguards exist to neutralize the potential conflict.

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201. *Id.* at Rule 4(a).

202. *See id.* Rule 4(a) of the AAA's Supplementary Rules for Class Arbitration requires the following elements:

- (1) the class is so numerous that joinder of separate arbitrations on behalf of all members is impracticable;
- (2) there are questions of law or fact common to the class;
- (3) the claims or defenses of the representative parties are typical of the claims or defenses of the class;
- (4) the representative parties will fairly and adequately protect the interests of the class;
- (5) counsel selected to represent the class will fairly and adequately protect the interests of the class; and
- (6) each class member has entered into an agreement containing an arbitration clause which is substantially similar to that signed by the class representative(s) and each of the other class members.

*Id.* at Rule 4(a); *see also* FED. R. CIV. P. 23.

203. AAA CLASS RULES, *supra* note 162, at Rule 5(d).

204. *See* Drahozal, *supra* note 37, at 709, 752, 769-70. If an institution obtains a reputation for bias, it risks losing credibility, which courts rely upon to enforce arbitral awards. *Id.* at 752. "There is little reason to use an institution whose awards are not enforced by the courts." *Id.* at 769.

## 2. *Protecting Due Process?*

The process of certification is critical because it determines not only whether plaintiffs may initiate a representative suit, but also how that suit will be structured to ensure that the class members' interests are adequately represented.<sup>205</sup> Thus, "[w]hether a class is certified and how its membership is defined can often have a decisive effect not only on the outcome of the litigation[,] but also on its management."<sup>206</sup> Because of this, Professor Sternlight believes that allowing arbitrators to decide the certification issue will not comply with the Due Process Clause.<sup>207</sup> According to Sternlight, "judges are substantially burdened by the responsibility of protecting the interests of absent class members, and . . . [arbitrators] may not yet have reached the point at which they are deemed equally capable of protecting individuals' critical due process interests."<sup>208</sup> However, some evidence contrary to Professor Sternlight's view exists. Arbitrators often handle large, complex disputes.<sup>209</sup> The AAA, for example, has a "national roster of class arbitration arbitrators" who are especially skilled to handle classwide arbitration cases.<sup>210</sup> Additionally, arbitrators handling class arbitrations will have the assistance of the parties' counsel and the parties' experts during the certification stage. Finally, Rule 23 of the Federal Rules of Civil Procedure and Rule 4 of the AAA's Supplementary Rules for Class Arbitrations provide sufficient guidance to assist the arbitrator in making the class determination.<sup>211</sup> Thus, given arbitrators' training and experience, and the various means of assistance available to arbitrators during the certification process, arbitrators are sufficiently capable of protecting the due process interests of absent class members.<sup>212</sup>

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205. Sternlight, *supra* note 156, at 112.

206. *Id.* (citing MANUAL FOR COMPLEX CIVIL LITIGATION § 30.1 (3d ed. 1995)).

207. *Id.* at 112-14.

208. *Id.* at 113-14.

209. *See, e.g.,* Shearson/Am. Express v. McMahon, 482 U.S. 220, 232 (1987) (stating that "arbitral tribunals are readily capable of handling the factual and legal complexities of antitrust claims, notwithstanding the absence of judicial instruction and supervision"); *see also* Note, *supra* note 182, at 806-08 (arguing that arbitrators should make the class certification decision).

210. *See* AAA CLASS RULES, *supra* note 162, at Rule 2(a).

211. *See* FED. R. CIV. P. 23; AAA CLASS RULES, *supra* note 162, at Rule 4.

212. *See* Note, *supra* note 182, at 806-08; *see also* Green Tree Fin. Corp. v. Bazzle, 123 S. Ct. 2402, 2408 (2003) (remanding the case to allow the arbitrator to determine whether the arbitration agreement permitted class actions). In *Bazzle*, the arbitrator already had made one class determination and a class award. *Id.* at 2405. However, the Court remanded the case for the arbitrator to make the decision again because the Court believed the first decision may have been influenced by the lower court. *Id.* at 2408.

### 3. *Streamlining the Procedures*

Even though arbitrators are qualified to interpret the contract and make the class certification decision, the AAA's procedure regarding these decisions seems unnecessarily excessive and time-consuming. After both the Clause Construction Award and the Class Determination Award, the arbitrator issues a thirty day stay to allow parties to appeal the decision to a court of competent jurisdiction.<sup>213</sup> Instead of issuing a thirty day stay after each award, why not have the arbitrator make both decisions at the same time and let the court review them simultaneously? This would reduce both the length of the arbitration and the burden on the reviewing court. Alternatively, the arbitrator could issue the Clause Construction Award, send it to the reviewing court for confirmation, and allow the court to make the class certification decision while it reviews the arbitrator's decision on the Construction Award. This might alleviate some of the due process and financial conflicts of interest concerns discussed in Parts V.B.1 & V.B.2 above. However, allowing the court to become so intricately involved at this stage "might infringe on the procedural flexibility traditionally accorded to arbitrators."<sup>214</sup> Therefore, states may want to adopt a policy where (1) the arbitrator makes the contract interpretation and the certification decision at the same time, and (2) the court does not review the decisions until it reviews the final award. This would allow the reviewing court to evaluate all of the arbitrator's decisions at once and maintain some of the procedural flexibility inherent in the arbitration process.<sup>215</sup>

Any of these options could work. The point is that it is not entirely clear which option is the best. Because it is unclear, this is a good area for states to adopt differing policies and act as "testing grounds" to determine which procedure is the most desirable and why. Through experimentation at the early stages of classwide arbitration's development, states can assist in building a more sound class arbitration system by developing the most fair and efficient certification process possible.

### C. *Notice & Settlement*

Regardless of who makes the certification decision, the arbitrator should undertake the responsibility of overseeing the notification process. Rule 6 of the AAA's Supplementary Rules for Class Arbitrations directs arbitrators to ensure that class members receive ade-

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213. AAA CLASS RULES, *supra* note 162, at Rules 3, 5(d).

214. Note, *supra* note 182, at 807-08 (arguing that the arbitrator should make the class certification decision and a court should not review it until the court reviews the final award).

215. *See id.*

quate notice in concise, plain, and “easily understood language.”<sup>216</sup> Rule 6 also provides detailed guidance on what information the notice form should contain.<sup>217</sup> Basically, the AAA’s Supplementary Rules are easy to understand, simple to implement, and well within the arbitrator’s area of professional competence. The same is true for the AAA’s Rule 8 on settlement. The arbitrator simply has to approve any deal reached between the parties, as long as the arbitrator determines the deal is reasonable to all class members.<sup>218</sup> Accordingly, the arbitrator should have control over the notice and settlement procedures.

However, one aspect of the AAA’s rule on settlements may concern some states. Rule 8 gives the arbitrator the power to refuse any settlement that does not give class members a second chance to opt out.<sup>219</sup> This rule “reflects concern that inertia and a lack of understanding may cause many class members to ignore the original exclusion opportunity, while the identification of proposed binding settlement terms may encourage a more thoughtful response.”<sup>220</sup> The objection to such a rule is that a second opt out period will make it more difficult for the parties to reach a settlement agreement.<sup>221</sup> However, Rule 8 avoids this problem by providing the arbitrator with sufficient discretionary authority to make case-by-case determinations on whether a second opt out is necessary based on the circumstances surrounding the arbitration.<sup>222</sup> Therefore, giving the arbitra-

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216. AAA CLASS RULES, *supra* note 162, at Rule 6(b).

217. *Id.* The Notice must concisely state in plain, easily understood language:

- (1) the nature of the action;
- (2) the definition of the class certified;
- (3) the class claims, issues, or defenses;
- (4) that a class member may enter an appearance through counsel if the member so desires, and that any class member may attend the hearings;
- (5) that the arbitrator will exclude from the class any member who requests exclusion, stating when and how members may elect to be excluded;
- (6) the binding effect of a class judgment on class members;
- (7) the identity and biographical information about the arbitrator, the class representative(s) and class counsel that have been approved by the arbitrator to represent the class; and
- (8) how and to whom a class member may communicate about the class arbitration, including information about the AAA Class Arbitration Docket (see Rule 9).

*Id.* In fact, the AAA’s notice provisions mimic the requirements of the Federal Judicial Center’s proposed amendments to Rule 23 of the Federal Rules of Civil Procedure, which took effect in December of 2003. See FED. R. CIV. P. 23(c)(2)(B) (Federal Judicial Center, Proposed Draft) (effective Dec. 2003) [hereinafter PROPOSED AMENDMENTS TO RULE 23].

218. AAA CLASS RULES, *supra* note 162, at Rule 8.

219. *Id.* at Rule 8(c).

220. PROPOSED AMENDMENTS TO RULE 23, *supra* note 217, at 40. The AAA’s Supplementary Rules on Class Arbitration are modeled after the proposed amendments to Rule 23 of the Federal Rules of Civil Procedure, which took effect on December 1, 2003.

221. See *id.* at 41.

222. See *id.*

tor the authority to refuse any settlement that fails to offer a repeat opt out period should help rather than harm the class arbitration proceeding.

#### D. Reasoned Opinions

Possibly the most positive aspect of the AAA's Supplementary Rules for Class Arbitrations is that the rules require the arbitrator to explain—in written opinions—all decisions made during the process. Commercial arbitration awards typically do not set forth the facts of the dispute, do not identify the applicable law and contract language, and do not explain how the arbitrator applied the applicable law and contract language to the facts in order to resolve the parties' disagreement.<sup>223</sup> Rules 3, 5, and 7 of the AAA's Supplemental Rules for Class Arbitrations alter this traditional feature of arbitration by requiring the arbitrator to provide written opinions at three stages in the arbitration hearing. First, the arbitrator has to explain his or her initial contract interpretation in a "Clause Construction Award."<sup>224</sup> Afterwards, in the certification proceeding, the arbitrator has to provide a reasoned opinion for why the class should or should not be certified.<sup>225</sup> Finally, the arbitrator has to issue a written final award on the merits of the arbitration.<sup>226</sup>

Considering the size and complexity of classwide hearings, reasoned opinions seem necessary to ensure that arbitrators accurately understood the nature of the controversy. In fact, requiring reasoned opinions will eliminate some of the uncertainty associated with arbitration hearings and will provide benefits to both plaintiffs and defendants. First, written opinions will reassure parties that the arbitrator committed time and gave thought to their dispute.<sup>227</sup> A reasoned opinion shows respect for parties' views. Furthermore, the opinion requirement will reduce the likelihood of parties feeling that the arbitrator treated them unfairly.<sup>228</sup> More importantly, without a reasoned opinion, parties do not know how to attack the award on appeal.<sup>229</sup> "By forgoing a reasoned award, the arbitrator renders undiscoverable the primary bases upon which an attempt to vacate the award can be founded: inaccurate arbitral findings of fact, incorrect

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223. Stephen L. Hayford, *A New Paradigm for Commercial Arbitration: Rethinking the Relationship Between Reasoned Awards and the Judicial Standards for Vacatur*, 66 GEO. WASH. L. REV. 443, 444 (1998).

224. AAA CLASS RULES, *supra* note 162, at Rule 3.

225. *Id.* at Rule 5.

226. *Id.* at Rule 7.

227. Christopher B. Kaczmarek, *Public Law Deserves Public Justice: Why Public Law Arbitrators Should Be Required to Issue Written, Publishable Opinions*, 4 EMPLOYEE RIGHTS & EMP. POL'Y J. 285, 314-15 (2000).

228. *Id.*

229. *Id.*

interpretations or applications of relevant law or contract language, or both.”<sup>230</sup> Consequently, the absence of a reasoned opinion means that judicial vacatur is virtually precluded.<sup>231</sup> While reasoned opinions will subject arbitration awards to greater judicial scrutiny—and thereby increase the costs of arbitration—the requirement is necessary to protect the parties’ right to appeal under Section 10 of the FAA,<sup>232</sup> especially in the context of classwide arbitration.<sup>233</sup> Therefore, the benefits to reasoned awards far outweigh their potential costs, and instituting a reasoned opinion requirement in the early stages of classwide arbitration’s development is an appropriate and necessary measure to ensure that classwide arbitration is a fair and efficient proceeding for all parties.

## VI. CONCLUSION

Over the last fifty years, the Supreme Court has developed a “national policy favoring arbitration”<sup>234</sup> by expanding the preemptive effect of the Federal Arbitration Act far beyond Congress’ original intent.<sup>235</sup> Many lower courts have relied on this “national policy” to effectively eliminate any review of arbitration agreements under state laws of unconscionability. As a result, the Supreme Court has unwittingly encouraged companies to employ arbitration clauses in consumer contracts as a method of depriving consumers of certain types of relief. Banks, phone companies, and other large consumer businesses now use mandatory arbitration agreements to immunize themselves from class actions and classwide arbitration. As potential defendants, they hope that courts will rely on the Supreme Court’s “national policy” to uphold their arbitration agreements and force individual resolution of all consumer claims against them.

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230. Hayford, *supra* note 223, at 445.

231. *Id.*

232. Federal Arbitration Act, 9 U.S.C. § 10 (2000). Judicial review under § 10 of the FAA is limited to four grounds: fraud, partiality, misconduct in refusing to postpone a hearing, and an arbitrator exceeding his or her powers. *Id.* § 10(a)(1)-(4). Additionally, all of the federal circuits, and several of the states, have adopted manifest disregard as an added ground for vacatur. See 1 DOMKE ON COMMERCIAL ARBITRATION § 33.08 (2003).

233. Organizations other than the AAA are also starting to acknowledge the potential value of having arbitrators provide written opinions. For example, in the Center for Public Resources’ proposed rules and commentary for the arbitration of business disputes, the Center stated that “[a]ll awards shall be in writing and shall state the reasoning on which the award rests unless the parties agree otherwise.” CTR. FOR PUB. RES. INST. FOR DISPUTE RESOLUTION, RULES FOR NON-ADMINISTERED ARBITRATION Rule 14.2 (effective Sept. 15, 2000), available at [www.cpradr.org/arb-rules.htm#14](http://www.cpradr.org/arb-rules.htm#14) (last visited Feb. 29, 2004).

234. *Southland Corp. v. Keating*, 465 U.S. 1, 10 (1984).

235. See *Allied-Bruce Terminix Cos. v. Dobson*, 513 U.S. 265, 284 (1995) (Scalia, J., dissenting); *id.* at 285 (Thomas, J., dissenting); *Southland*, 465 U.S. at 25 (O’Connor, J., dissenting, joined by Rehnquist, C.J.); *Prima Paint Corp. v. Flood & Conklin Mfg.*, 388 U.S. 395, 420 (1967) (Black, J., dissenting); see also Drahozal, *supra* note 37, at 701.

Should the “national policy” work as a shield to protect defendants from having to provide any form of class relief? The Supreme Court will have an opportunity to address this question when it resolves a split between the Seventh and Ninth Circuits on the interplay of the Federal Arbitration Act, the Federal Communications Act, and state laws of unconscionability.<sup>236</sup> Considering the Court’s sensible desire to sustain the legitimacy of its “national policy” in favor of arbitration, one practical compromise would be to uphold the parties’ agreement to arbitrate, but allow state law to determine whether the arbitration may proceed on a classwide basis. This proposal maintains the “national policy favoring arbitration” while returning additional authority over arbitration procedure to the states.

Currently, only a few states have explicitly adopted classwide arbitration as an alternative form of dispute resolution. However, when faced with the possibility of accepting classwide arbitration or allowing companies to continue avoiding class relief, presumably most—if not all—states will adopt a system of classwide arbitration. In fact, if states start accepting such a system now, and adopting rules and procedures to develop it, this will give the Supreme Court greater incentive to return authority over arbitration policies to them when it resolves the split between the Seventh and Ninth Circuits.

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236. Compare *Ting v. AT&T Corp.*, 319 F.3d 1126 (9th Cir. 2003) (holding (1) that the Federal Communications Act does not preempt state laws of unconscionability, and (2) that the FAA does preempt the California Consumer Legal Remedies Act’s ban on waivers of class actions, but that the FAA makes arbitration agreements subject to state laws of unconscionability, which the 9th Circuit used to invalidate the parties’ agreement in this case), *cert. denied*, 124 S. Ct. 53 (2003), with *Boomer v. AT&T Corp.*, 309 F.3d 404 (7th Cir. 2002) (holding that the Federal Communication Act preempts state laws of unconscionability).