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Jean R. Sternlight

University of Nevada, Las Vegas – William S. Boyd School of Law

Elizabeth J. Jensen

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USING ARBITRATION TO ELIMINATE CONSUMER CLASS ACTIONS: EFFICIENT BUSINESS PRACTICE OR UNCONSCIONABLE ABUSE?

JEAN R. STERNLIGHT* AND ELIZABETH J. JENSEN**

I

INTRODUCTION

Companies are increasingly drafting arbitration clauses worded to prevent consumers from bringing class actions against them in either litigation or arbitration.¹ If one looks at the form contracts she receives regarding her credit card, cellular phone, land phone, insurance policies, mortgage, and so forth, most likely, the majority of those contracts include arbitration clauses, and many of those include prohibitions on class actions.² Companies are seeking to

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This Article is also available at <http://www.law.duke.edu/journals/67LCPSternlight>.

* Saltman Professor of Law and Director, Saltman Center for Conflict Resolution, University of Nevada, Las Vegas, Boyd School of Law.

** Professor of Economics, Hamilton College.

1. See *The Supreme Court, 2002 Term: Leading Cases, Federal Statutes and Regulations*, 117 HARV. L. REV. 390, 410-20 (2003) (urging that courts be permitted to declare “no-class action arbitration clause[s]” to be unconscionable and that such analyses not be held preempted by the Federal Arbitration Act). One defender of the practice notes that evading class action liability may be one principal motivation of companies imposing arbitration. See Carroll E. Neesemann, *Should an Arbitration Provision Trump the Class Action? Yes: Permitting Courts to Strike Bar on Class Actions in Otherwise Clean Clause Would Discourage Use of Arbitration*, DISP. RESOL. MAG., Spring 2002, at 13; see also Edward Wood Dunham, *The Arbitration Clause as Class Action Shield*, 16 FRANCHISE L.J. 141 (1997) (urging franchisers to use arbitration to prevent class actions by franchisees); Alan S. Kaplinsky & Mark J. Levin, *Excuse Me, But Who’s the Predator? Banks Can Use Arbitration Clauses as a Defense*, BUS. L. TODAY, May/June 1998, at 24 (urging banks to use arbitration to prevent consumer class actions); Michael R. Pennington, *Every Health Insurer’s Litigation Nightmare: A Case Study of How One Class Action Affected the Business of One Health Insurer*, BRIEF, Summer 1999, at 46, 52 (noting that Alabama insurers are working to sustain the use of arbitration clauses in insurance policies to limit exposure to class actions); J.T. Westermeir, *How Arbitration Clauses Can Help Avoid Class Action Damages: Strategies for Managing Risks of Litigation*, COMPUTER L. STRATEGIST, Sept. 1997, at 1.

2. One study found that thirty percent of the arbitration clauses examined contained explicit class action prohibitions. See Linda J. Demaine & Deborah R. Hensler, “Volunteering” to Arbitrate Through Predispute Arbitration Clauses: The Average Consumer’s Experience, 67 LAW & CONTEMP. PROBS. 55, 65 (Winter/Spring 2004) (stating, in a study of arbitration clauses affecting the hypothetical average citizen in Los Angeles, that sixteen of the fifty-two arbitration clauses examined contained such a prohibition). It is unclear whether clauses in California, a state that allows arbitral class actions, would be more or less likely to contain such prohibitions.

use these clauses to shield themselves from class action liability, either in court or in arbitration.³

Companies' attempts to avoid class action exposure through arbitration give rise to both legal and policy questions. From a legal standpoint, is class action preclusion permitted under existing law, and if so, should it be? While many courts have allowed companies to use arbitration clauses to elude class actions, an increasing number are striking such clauses as unconscionable.⁴ From a policy perspective, what should one make of companies' attempts to use arbitration clauses as a shield against class actions?⁵ Is this an efficient business practice that will benefit consumers in general, or is it an abuse of customers and the public at large? Similarly, how should one view the courts' regulation of class action prohibitions through the unconscionability doctrine? Is case-by-case analysis the best way to examine the legitimacy of this practice?

This Article addresses these questions. Part II examines courts' reliance on the unconscionability doctrine to regulate the use of arbitration clauses to preclude class actions. Part III considers whether, from a policy perspective, companies should be permitted to protect themselves against class actions in this way. Specifically, it examines the economic argument that permitting companies to eliminate class actions benefits consumers at large by lowering prices, suggesting that such an analysis is incomplete and that good reasons support preserving the consumer class action. Part IV discusses whether, assuming class actions should be protected, unconscionability claims are the best mechanism for determining which arbitration clauses are valid. It argues that while the unconscionability doctrine offers some protections, case-by-case adjudication is a costly means of attacking class action prohibitions. Thus, Part IV proposes that the interests of both public policy and efficiency would be better served by federal legislation prohibiting companies from precluding consumer class actions.

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

4. Although this Article focuses on unconscionability, it is also possible to attack a class action prohibition on the ground that it violates the federal statute under which the plaintiff's claim is brought. See Sternlight, *supra* note 3, at 92-105. Depending on the wording of the prohibition, it may also be possible to argue that it precludes class action arbitration, but not litigation, or vice versa. In California, arbitral class actions are well accepted. See *Keating v. Superior Court*, 645 P.2d 1192, 1209 (Cal. 1982) (endorsing, albeit less than enthusiastically, the concept of classwide arbitration). Further, the Supreme Court's decision in *Green Tree Financial Corp. v. Bazzle*, 123 S. Ct. 2402 (2003), implicitly recognized the legitimacy of arbitral class actions. Specifically, the Court remanded to the arbitrator the question whether, given the terms of the particular arbitration clause, an arbitral class action was permitted. *Id.* at 2406-08; cf. *Brennan v. ACE INA Holdings, Inc.*, No. 00-CV-2730, 2002 WL 1804918, at *3 (E.D. Pa. Aug. 1, 2002) (concluding that when an arbitration clause is silent on subject of class actions, it should be up to the arbitrator to determine whether the matter should proceed individually or as a class action).

5. For a short argument that this is bad policy, see Jean R. Sternlight, *Should an Arbitration Provision Trump the Class Action? No: Permitting Companies to Skirt Class Actions Through Mandatory Arbitration Would Be Dangerous and Unwise*, DISP. RESOL. MAG., Spring 2002, at 13.

II

IS IT UNCONSCIONABLE TO USE ARBITRATION
CLAUSES TO ELIMINATE CLASS ACTIONS?

A. The Unconscionability Defense to Mandatory Arbitration

While the Supreme Court views arbitration favorably, it has always made clear that unconscionable arbitration clauses should not be enforced. Section 2 of the Federal Arbitration Act (FAA) provides that arbitration agreements “shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract.”⁶ Throughout the pro-arbitration era that commenced in the 1980s,⁷ the Court has emphasized that unconscionability, along with other generally applicable contract defenses, is an appropriate ground for revoking an arbitration agreement.⁸ Similarly, the Court has frequently stated that it will compel arbitration of federal statutory claims only “so long as the prospective litigant effectively may vindicate his or her statutory cause of action in the arbitral forum, such that the statute will continue to serve both its remedial and deterrent function.”⁹ Thus, in *Green Tree Financial Corp. v. Randolph*,¹⁰ the Court recognized that if it could be proven that a company had designed an arbitration process so costly that the consumer could not vindicate her rights, the arbitration clause imposing that process would not be enforced.¹¹ While all the claims raised in the Supreme Court to

6. 9 U.S.C. § 2 (2000).

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

8. See, e.g., *Doctor's Assocs. v. Casarotto*, 517 U.S. 681, 682 (1996) (“Generally applicable contract defenses, such as . . . unconscionability, may be applied to invalidate arbitration agreements.”); *Allied-Bruce Terminix Cos. v. Dobson*, 513 U.S. 265, 281 (1995) (“States may regulate contracts, including arbitration clauses, under general contract law principles.”); *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*, 473 U.S. 614, 627 (1985) (“[C]ourts should remain attuned to well-supported claims that the agreement to arbitrate resulted from the sort of fraud or overwhelming economic power that would provide grounds ‘for the revocation of any contract.’”) (quoting 9 U.S.C. § 2). Until recently, it was assumed that unconscionability challenges would be made in court. Several courts have recently held, however, that such challenges should be presented to the arbitrator. See, e.g., *Bob Schultz Motors, Inc. v. Kawasaki Motors Corp.*, 334 F.3d 721 (8th Cir. 2003); *Hawkins v. Aid Ass'n for Lutherans*, 338 F.3d 801, 807 (7th Cir. 2003). While exploration of this issue exceeds the scope of this Article, these cases are wrongly decided; courts rather than arbitrators should decide unconscionability challenges. For a consistent analysis, see *Alexander v. Anthony Crane Int'l*, 341 F.3d 256, 264 (3d Cir. 2003).

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

10. 531 U.S. 79 (2000).

11. *Id.* at 92. While the Court in *Randolph* found that the plaintiff had failed to prove that the arbitration process would be excessively costly, subsequent courts have applied the *Randolph* analysis to strike several clauses. See, e.g., *Phillips v. Assocs. Home Equity Servs.*, 179 F. Supp. 2d 840, 846 (N.D. Ill. 2001) (holding an arbitration clause unenforceable as inconsistent with the Truth in Lending

date have involved federal statutory claims, there is no reason to believe that the Court would treat the use of arbitration to eliminate common law or state statutory claims any differently.¹²

B. Class Action Prohibitions as Unconscionable

Building on these principles, numerous courts have held that the inclusion of a class action prohibition in an arbitration clause may render that clause unconscionable.¹³ Of these, the court in *Ting v. AT&T*¹⁴ focused most extensively on

Act, on grounds of prohibitive cost, when the arbitration fees ranged from \$750 to \$5,000 per day and hardship was evinced by the borrower's affidavit and the fact that the borrower was in the lender's target "subprime" market); *Camacho v. Holiday Homes, Inc.*, 167 F. Supp. 2d 892, 897 (W.D. Va. 2001) (refusing to compel arbitration of a Truth in Lending Act claim on the basis of prohibitive cost to the consumer, when the consumer had "limited income" to pay administrative fees of \$2,000, and even if a "rare" waiver of administrative fees were granted, the consumer would still likely be responsible for as much as \$4,100 in arbitrator fees and expenses); *Giordano v. Pep Boys–Manny, Moe & Jack, Inc.*, 2001 WL 484360, at *6-7 (E.D. Pa. Mar. 29, 2001) (striking a provision of an arbitration clause requiring an employer and employee to share the arbitration costs of a Fair Labor Standards Act claim, when the employee earned \$400 per week and would be responsible for \$2,000 in arbitration fees).

12. Cf. *Armendariz v. Found. Health Psychcare Servs.*, 6 P.3d 669 (Cal. 2000) (concluding that a contract requiring employees to waive their rights to pursue sexual harassment or discrimination claims under the California Fair Employment and Housing Act in court is enforceable if the arbitration permits employees to vindicate their statutory rights).

13. At the time one coauthor began writing about class actions and arbitration in 1998, no court had issued such a decision. By the time she finished her first article on the subject, see Sternlight, *supra* note 3, three courts had determined that a class action prohibition contributed to an arbitration clause's unconscionability. Today, at least thirteen decisions from both federal and state courts have held either that a class action prohibition contained in an arbitration clause contributed to a finding that the clause was unconscionable or that the prohibition must be severed from the remainder of the clause due to its unfairness. See *Walker v. Ryan's Family Steak Houses, Inc.*, 289 F. Supp. 2d 916, 934 (M.D. Tenn. 2003); *Luna v. Household Fin. Corp.*, III, 236 F. Supp. 2d 1166 (W.D. Wash. 2002) (concluding that a class action prohibition weighed heavily in favor of finding substantive unconscionability); *Comb v. Paypal, Inc.*, 218 F. Supp. 2d 1165 (N.D. Cal. 2002) (voiding an arbitration clause as unconscionable on grounds that it permitted excessive arbitral fees, prevented plaintiffs from bringing a class action, and imposed a potentially costly venue requirement); *ACORN v. Household Int'l, Inc.*, 211 F. Supp. 2d 1160, 1170 (N.D. Cal. 2002) (voiding an arbitration clause, in part due to the manifest one-sidedness and unfairness of the class action prohibition); *Ting v. AT&T*, 182 F. Supp. 2d 902 (N.D. Cal. 2002) (holding an arbitration clause unconscionable, in part due to a class action prohibition), *aff'd in relevant part*, 319 F.3d 1126 (9th Cir. 2003), *cert. denied*, 124 U.S. 53 (2003); *Lozada v. Dale Baker Oldsmobile, Inc.*, 91 F. Supp. 2d 1087, 1104-05 (W.D. Mich. 2000) (same); *In re Knepp*, 229 B.R. 821, 842 (Bankr. N.D. Ala. 1999) (refusing to enforce an arbitration clause imposed on a debtor, in part because it would prejudice the prosecution of the plaintiff's claim as a class action); *Leonard v. Terminix Int'l Co.*, No. 1010555, 2002 WL 31341084, at *8 (Ala. Oct. 18, 2002) (holding an arbitration clause unconscionable because it both limited the claimants' prospective relief and precluded them from proceeding as a class); *Mandel v. Household Bank Nat'l Ass'n (Nev.)*, 129 Cal. Rptr. 2d 380 (Ct. App. 2003) (severing a class action prohibition); *Szetela v. Discover Bank*, 118 Cal. Rptr. 2d 862 (Ct. App. 2002) (severing a class action prohibition), *cert. denied*, 537 S. Ct. 1226 (2003); *Powertel, Inc. v. Bexley*, 743 So. 2d 570, 576 (Fla. Dist. Ct. App. 1999) (voiding an arbitration clause as unconscionable, in part because it prohibited class actions); *Eagle v. Fred Martin Motor Co.*, No. 21522, 2004 WL 344135 (Ohio Ct. App. Feb. 25, 2004) (holding a clause unconscionable based in part on its class action prohibition); *State ex rel. Dunlap v. Berger*, 567 S.E.2d 265 (W. Va. 2002) (concluding that a class action prohibition contributed to the unconscionability of a clause); see also *Lytte v. CitiFinancial Servs., Inc.*, 810 A.2d 643, 657-58 (Pa. Super. Ct. 2002) (remanding to the trial court the question whether a class action prohibition was unconscionable and recognizing that the determination would turn on the evidence presented by the parties); *Eastman v. Consecro Fin. Servicing Corp.*, No. 01-1743, 2002 WL 1061856 (Wis. Ct. App. May 29, 2002) (certifying the question whether an arbitration clause should be held unconscionable due to its class action prohibition).

the question. In *Ting*, AT&T customers claimed AT&T violated California consumer protection laws by imposing new legal remedies provisions upon them through a revised consumer services agreement. These provisions contained an arbitration clause precluding customers' use of class actions.¹⁵ The consumers argued that the new provisions were unconscionable.¹⁶

The district court held the new provisions unconscionable, in part because of their class action prohibition.¹⁷ Having reviewed evidence regarding the kinds of lawsuits filed against AT&T and its competitors in recent years, the court found that "[i]t would not have been economically feasible to pursue the claims in these cases on an individual basis, whether . . . in court or in arbitration."¹⁸ Nor would "the lawyers who represented the plaintiffs in these cases . . . have taken them if the only claim they could have pursued was the claim of the individual plaintiff."¹⁹ The court found this worrisome not only because consumers would be left without the opportunity to obtain relief, but also because the company would be able to escape liability and, thus, would not be deterred from acting illegally.²⁰

The court rejected AT&T's argument that enforcement by the Federal Communications Commission (FCC) would be sufficient to protect consumers' rights, finding as a matter of fact that such enforcement is unlikely.²¹ It also rejected "the only justification advanced for [the class action prohibition], that it will limit AT&T's cost of litigation,"²² as insufficient to defeat numerous courts' and legislatures' findings as to the benefits of class actions.²³ Labeling as "somewhat disingenuous" AT&T's claim that it devised the new legal remedies provisions to give consumers a "broad range of options" and to avoid meritless suits,²⁴ the court concluded that "AT&T's principal purpose was [instead] to put

14. 182 F. Supp. 2d 902 (N.D. Cal. 2002).

15. *Id.* at 921.

16. *Id.*

17. *Id.* at 931.

18. *Id.* at 918.

19. *Id.* The court explained,

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

Id.

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

21. *Id.* at 919. The court based its conclusion on an examination of FCC reports for the previous ten years and on the FCC's own statement that it "does not consider the award of damages to a class of individuals to be consistent with its consumer complaint procedures." *Id.*

22. *Id.* at 931.

23. *Id.*

24. *Id.*

sufficient obstacles in the path of litigants to effectively deter many claims from being pursued.”²⁵ Thus, the court held the class action ban substantively unconscionable.²⁶

The *Ting* court explained that AT&T’s legal remedies clause was void, not because it required arbitration, but because it contained substantially unfair features:

Aware that the vast majority of service related disputes would be resolved informally, AT&T sought to shield itself from liability in the remaining disputes by imposing Legal Remedies Provisions that eliminate class actions, sharply curtail damages in cases of misrepresentation, fraud, and other intentional torts, cloak the arbitration process with secrecy and place significant financial hurdles in the path of a potential litigant. It is not just that AT&T wants to litigate in the forum of its choice—arbitration; it is that AT&T wants to make it very difficult for anyone to effectively vindicate her rights, even in that forum. That is illegal and unconscionable and must be enjoined.²⁷

In *Szetela v. Discover Bank*,²⁸ a second important case in this area, a cardholder attempted to bring a class action against his credit card company alleging various unfair practices that caused cardholders to be charged fees for exceeding their credit limits.²⁹ When the trial court granted Discover’s motion to compel, the plaintiff was required to go to arbitration, individually, where he won an award of \$29, the over-limit fee.³⁰ He then appealed, seeking the opportunity to bring a class action, and claiming that the class action prohibition was unconscionable.³¹

The court held that the class action prohibition was not only procedurally unconscionable, but substantively unconscionable as well. The court emphasized that “[t]he manifest one-sidedness” of the provision was “blindingly obvious” because it could negatively affect only cardholders.³² The court then explained that the clause was intended to preclude customers with small claims from obtaining relief,³³ thereby providing Discover with “virtual immunity” from class actions.³⁴ The court found this immunity troubling, not only because it was “harsh and unfair to Discover customers who might be owed a relatively small sum of money, but . . . also [because it] serves as a disincentive for

25. *Id.* at 920-21.

26. *Id.* at 931.

27. *Id.* at 938-39.

28. 118 Cal. Rptr. 2d 862 (Ct. App. 2002), *cert. denied*, 537 U.S. 1226 (2003).

29. *Id.* at 865.

30. *Id.*

31. *Id.* at 866.

32. *Id.* at 867. The court explained that “[a]lthough styled as a mutual prohibition on representative or class actions, it is difficult to envision the circumstances under which the provision might negatively impact Discover [since] credit card companies typically do not sue their customers in class action lawsuits.” *Id.*

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

34. *Id.* at 867.

Discover to avoid the type of conduct that might lead to class action litigation in the first place.”³⁵

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.³⁶

The court also considered the class action prohibition problematic from a public policy perspective because it allowed litigants to contract away a procedural device—the class action—that serves the courts’ interest in efficiency.³⁷ Having held the class action prohibition unconscionable, the *Szetela* court directed the trial court to strike the prohibition from the arbitration clause,³⁸ apparently intending that cardholders be required to arbitrate their claims but be allowed to bring arbitral class actions, which are permitted in California.³⁹

In two subsequent federal cases, *ACORN v. Household International, Inc.*⁴⁰ and *Comb v. Paypal, Inc.*,⁴¹ the Northern District of California followed the basic rationale of *Szetela* and concluded that a class action prohibition contained in an arbitration clause was unconscionable.⁴² In *ACORN*, the court rejected the defendants’ argument that *Szetela* only applies in those jurisdictions that accept arbitral class actions.⁴³ In *Comb*, the court similarly rejected the defendant’s argument that the FAA preempted the conclusion that

35. *Id.* at 868.

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

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

38. *Id.*

39. See *Keating v. Superior Court*, 645 P.2d 1192, 1209 (Cal. 1982) (endorsing, albeit less than enthusiastically, the concept of classwide arbitration). For a discussion of the advantages and disadvantages of classwide arbitration, see Sternlight, *supra* note 3, at 37-52.

40. 211 F. Supp. 2d 1160 (N.D. Cal. 2002).

41. 218 F. Supp. 2d 1165 (N.D. Cal. 2002).

42. *Id.* at 1176; *ACORN*, 211 F. Supp. 2d at 1173-74.

43. The defendants in *ACORN* asserted that, whereas California state courts may order arbitral class actions, federal courts may not, except when expressly permitted by the terms of the arbitration agreement. In light of this purported distinction, they argued it would be inappropriate to find the class action prohibition unconscionable. 211 F. Supp. 2d at 1170-71. The court found that the defendants had failed to establish that federal courts cannot order class-wide arbitration, *id.* at 1171 n.2, and that, even accepting that proposition, the defendants’ “subtle argument is ultimately unpersuasive” because it merges substantive unconscionability analysis with the analysis of proper remedy. *Id.* at 1171. “If federal courts are not permitted to order class-wide arbitration, then an alternative remedy must be devised to prevent enforcement of an unconscionable contract.” *Id.*

The defendants’ argument that federal courts cannot order classwide arbitration absent specific language in the arbitration clause is based on *McCarthy v. Providential Corp.*, No. C 94-0627 FMS, 1994 WL 387852 (N.D. Cal. July 18, 1994). See *ACORN*, 211 F. Supp. 2d at 1171 n.2. For a critique of this position, see Sternlight, *supra* note 3, at 84-90.

the class action prohibition was unconscionable.⁴⁴ Rather than merely severing the class action prohibition, both federal courts found it necessary to hold the entire arbitration clause unenforceable given its multiple unconscionable provisions.⁴⁵

West Virginia's Supreme Court, too, has held unconscionable an arbitration clause prohibiting class actions. *State ex rel. Dunlap v. Berger*⁴⁶ involved a class claim brought against Friedman's Jewelry by an individual who alleged that he and others had been deceived into purchasing unrequested insurance when buying jewelry at the store. Mr. Dunlap paid \$1.48 for credit life insurance and \$6.96 for property insurance.⁴⁷ On behalf of the class, he sought declaratory and injunctive relief, as well as various types of damages and attorneys' fees.⁴⁸ When Friedman's sought to compel arbitration based on a contract Mr. Dunlap had signed, he argued that the arbitration provision was unconscionable,⁴⁹ in part because it prohibited class actions.⁵⁰

The court accepted Dunlap's argument that the class action prohibition was unconscionable. Emphasizing that "[c]lass action relief—including the remedies of damages, rescission, restitution, penalties, and injunction—is often at the core of the effective prosecution of consumer . . . cases,"⁵¹ the court recognized that the \$8.46 Friedman's added to Dunlap's purchase price was "precisely the sort of small-dollar/high volume (alleged) illegality that class action claims and remedies are effective at addressing. . . . In many cases, the availability of class action relief is a *sine qua non* to permit the adequate vindication of consumer

44. 218 F. Supp. 2d at 1175-76 (holding that while preemption would prevent California from adopting a statute that would prevent enforcement of arbitration covered by the FAA, ordinary state law doctrines such as unconscionability are not preempted); *accord* Mandel v. Household Bank, 129 Cal. Rptr. 2d 380, 386 (Ct. App. 2003). *Contra* Discover Bank v. Superior Court, 129 Cal. Rptr. 2d 393, 396 (Ct. App. 2003) (concluding that "where a valid arbitration agreement governed by the FAA prohibits classwide arbitration, section 2 of the FAA preempts a state court from applying state substantive law to strike the class action waiver from the agreement."), *review granted*, 65 P.3d 1285 (Cal. 2003). In *Discover Bank v. Superior Court*, the court held: "If a state statute requiring a nonwaivable judicial forum for resolution of consumer disputes must give way to section 2 of the FAA, it necessarily must follow that a state judicial policy precluding class-wide arbitration waivers must also give way . . ." *Id.* at 343. Further, "[w]hile a state may prohibit the contractual waiver of statutory consumer remedies, including the right to seek relief in a class action, such protections fall by the wayside when the waiver is contained in a validly formed arbitration agreement governed by the FAA." *Id.* at 346.

45. *ACORN*, 211 F. Supp. 2d at 1174; *Comb*, 218 F. Supp. 2d at 1176. In *ACORN*, the court wrote: "The interlocking nature of these hindrances indicates that the purpose of the arbitration agreement is not to transfer claims to a more expeditious forum but to deter Defendants' customers from bringing claims. As such, the agreement's purpose is 'tainted with illegality' and severance is not appropriate." 211 F. Supp. 2d at 1174 (quoting *Armendariz v. Found. Health Psychcare Servs., Inc.*, 6 P.3d 669, 696 (Cal. 2000)).

46. 567 S.E.2d 265 (W. Va. 2002).

47. *Id.* at 270.

48. *Id.* at 269.

49. *Id.* at 271.

50. *Id.* at 278-79.

51. *Id.* at 278.

rights.”⁵² The court considered class action preclusion problematic because it could enable companies to get away with illegal acts:

Thus, in the contracts of adhesion that are so commonly involved in consumer and employment transactions, permitting the proponent of such a contract to include a provision that prevents an aggrieved party from pursuing class action relief would go a long way toward allowing those who commit illegal activity to go unpunished, undeterred, and unaccountable.⁵³

Not surprisingly, given this language, the court held the class action prohibition unconscionable.⁵⁴ Rather than rewrite the arbitration clause to eliminate the class action exclusion and other problematic terms, the court felt bound to void the arbitration agreement altogether:

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

Under such circumstances, we think a court doing equity should not undertake to sanitize any aspect of the unconscionable contractual attempt.⁵⁵

Other courts have employed similar reasoning in voiding class action prohibitions as unconscionable. For example, in *Powertel, Inc. v. Bexley*,⁵⁶ a Florida appellate court stated:

The arbitration clause also effectively removes Powertel’s exposure to any remedy that could be pursued on behalf of a class of consumers. . . . Class litigation provides the most economically feasible remedy for the kind of claim that has been asserted here. . . . By requiring arbitration of all claims, Powertel has precluded the possibility that a group of its customers might join together to seek relief that would be impractical for any of them to obtain alone.⁵⁷

Similarly, in *In re Knepp*,⁵⁸ a federal bankruptcy court explained:

If this approach [allowing the preclusion of class actions] prevails, the pervasive use of arbitration agreements in consumer contracts could have the effect of eliminating class actions as an option available to aggrieved consumers. If class actions are no longer an option, the vast majority of consumer claims involving relatively small sums of money on an individual basis will be left without a remedy.⁵⁹

While the discussion above may make it sound as though class action exclusions are clearly unconscionable, numerous courts have enforced arbitration clauses containing class action prohibitions.⁶⁰ In some of these cases, the plain-

52. *Id.*

53. *Id.* at 278-79.

54. *Id.* at 280.

55. *Id.* at 284.

56. 743 So. 2d 570 (Bankr. Fla. App. 1999).

57. *Id.* at 576.

58. 229 B.R. 821 (Bankr. N.D. Ala. 1999).

59. *Id.* at 842.

60. See, e.g., *Lomax v. Woodmen of the World Life Ins. Soc’y*, 228 F. Supp. 2d 1360 (N.D. Ga. 2002) (stating that the prohibition of class actions, without more, does not render an arbitration clause unconscionable); *Lozano v. AT&T Wireless*, 216 F. Supp. 2d 1071 (C.D. Cal. 2002) (refusing to find class action exclusion unconscionable and explaining that plaintiffs relinquish such “procedural niceties” as class actions when they agree to arbitrate their claims). Other cases enforcing arbitration

tiffs apparently failed to raise an unconscionability argument. For example, in *Johnson v. West Suburban Bank*,⁶¹ the Third Circuit rejected the plaintiff's argument that class action prohibitions are impermissible under certain federal statutes,⁶² but noted that it might have reached a different result if the plaintiff had been able to show that the arbitral forum selected was inadequate to vindicate his statutory rights.⁶³ Similarly, in *Randolph v. Green Tree Financial Corp.*,⁶⁴ on remand from the Supreme Court,⁶⁵ the Eleventh Circuit held that "a contractual provision to arbitrate [Truth in Lending Act (TILA)] claims is enforceable even if it precludes a plaintiff from utilizing class action procedures in vindicating statutory rights under TILA."⁶⁶ In neither case, however, did the plaintiffs claim that the prohibition was unconscionable.⁶⁷

In other cases, the plaintiffs have presented at least the outlines of an unconscionability argument, and that argument has been rejected. For example, in *Pick v. Discover Financial Services, Inc.*,⁶⁸ the court refused to void an arbitration provision on the ground of class action preclusion, stating that "it is generally accepted that arbitration clauses are not unconscionable because they preclude class actions."⁶⁹

Courts such as that in *Pick* often cite the Supreme Court's decision in *Gilmer v. Interstate/Johnson Lane Corp.*⁷⁰ to support the proposition that companies are free to use arbitration to preclude class actions. The *Gilmer* Court opined in dictum that

even if the arbitration could not go forward as a class action or class relief could not be granted by the arbitrator, the fact that the [Age Discrimination in Employment Act] provides for the possibility of bringing a collective action does not mean that individual attempts at conciliation were intended to be barred."⁷¹

clauses prohibiting class actions are summarized in Alan S. Kaplinsky & Mark J. Levin, 2001: *An Arbitration Odyssey*, 57 BUS. LAW. 1287 (2002).

61. 225 F.3d 366 (3d Cir. 2000), *cert. denied*, 531 U.S. 1145 (2001).

62. *Id.* at 369. The statutes at issue were the Truth in Lending Act, 15 U.S.C. § 1601 (2000), and the Electronic Fund Transfer Act, 15 U.S.C. § 1693 (2000).

63. 225 F.3d at 373.

64. 244 F.3d 814 (11th Cir. 2001).

65. 531 U.S. 79 (2000).

66. 244 F.3d at 819.

67. For similar cases, see *Arellano v. Household Fin. Corp.* III, No. 01 C 2433, 2002 WL 221604 (N.D. Ill. Feb. 13, 2002); *Rains v. Found. Health Sys. Life & Health*, 23 P.3d 1249, 1253 (Colo. Ct. App. 2001); *Pyburn v. Bill Heard Chevrolet*, 63 S.W.3d 351, 364 (Tenn. Ct. App. 2001).

68. No. Civ.A 00-935-SLR, 2001 WL 1180278 (D. Del. Sept. 28, 2001).

69. *Id.* at *5 (citing *Gilmer v. Interstate/Johnson Lane Corp.*, 500 U.S. 20, 33 (1991), and *Johnson v. W. Suburban Bank*, 223 F.3d 366, 377 (3d Cir. 2000)); *see also* *Vigil v. Sears Nat'l Bank*, 205 F. Supp. 2d 566, 573 (E.D. La. 2002) ("[T]he fact that the clause implicitly waives . . . the 'right' to proceed by class action does not, in itself, render the clause unconscionable."); *AutoNation USA Corp. v. Leroy*, 105 S.W.3d 190, 200 (Tex. Ct. App. 2003) ("While there may be circumstances in which a prohibition on class treatment may rise to the level of fundamental unfairness, [the plaintiffs'] generalizations do not satisfy her burden to demonstrate that the arbitration provision is invalid here."); *cf.* *Forrest v. Verizon Communications, Inc.*, 802 A.2d 1007 (D.C. Ct. App. 2002) (holding that a forum-selection clause resulting in the denial of class action—because state law did not permit class actions—was not unconscionable or unreasonable given that the company's principal place of business was in the forum state).

70. 500 U.S. 20 (1991).

71. *Id.* at 32.

However, it is critical to recognize several limitations to this statement. First, the Court found that the plaintiff had failed to show that class relief was unavailable, since the Court concluded that relevant New York Stock Exchange rules allowed for collective proceedings and that the EEOC could seek class-wide relief.⁷² Second, Mr. Gilmer brought his suit individually, not as a class action. Third, Mr. Gilmer did not try to argue that the class action prohibition was unconscionable. Finally, it is simply not clear what the Court meant in stating that individual attempts at conciliation should not be barred.

What, then, makes the difference as to whether a court will find a class action prohibition unconscionable?

C. Good Arguments and Good Facts

Claims that class action prohibitions are unconscionable depend on the same building blocks as most other legal claims: good arguments and good facts. When plaintiffs make only general assertions that a class action prohibition is unconscionable, their attack is likely to fail.⁷³ But, if they can assemble the facts necessary to support some or all of the arguments set out, they have a good chance of success.⁷⁴

1. Individual Claims Would Not Be Financially Feasible

The court decisions striking class action prohibitions have all emphasized that many small-dollar claims are simply not feasible if brought individually.⁷⁵

72. *Id.*

73. See F. Paul Bland, Jr., *Is That Arbitration Clause Unconscionable? PROVE IT!*, CONSUMER ADVOC. (Nat'l Ass'n of Consumer Advocates, Washington, D.C.), July-Aug. 2002, at 1, 5 (observing that the one common thread in cases in which plaintiffs failed to show that class action prohibitions were unconscionable was "that the plaintiffs treated the cases principally as posing legal rather than factual issues"); James C. Sturdevant, *The Critical Importance of Creating an Evidentiary Record to Prove that a Mandatory, Pre-Dispute Arbitration Clause is Unconscionable*, FORUM, Oct. 2002, at 18 (urging that attorneys seeking to defeat motions to compel arbitration engage in substantial discovery and seek to amass actual cases showing that the clause is illegal and unconscionable, rather than relying on purely legal arguments).

74. See Bland, *supra* note 73, at 1 ("Fighting a mandatory arbitration clause is not for the lazy, the meek, or those exclusively inclined to broad abstractions. The key to success for a consumer advocate who wishes to avoid having her client forced into a particularly unfair arbitration system is both simple and difficult: one should put a powerful factual record before the court."); see also Lytle v. CitiFinancial Servs. Inc., 810 A.2d 643, 664-665 (Pa. Super. Ct. 2002) (recognizing that class action preclusion could be unconscionable, but ordering remand to permit the parties to present evidence as to whether class action was needed to permit the plaintiffs to present their claims).

To prevail on an unconscionability claim plaintiffs generally must demonstrate both procedural and substantive unconscionability. See, e.g., *Armendariz v. Found. Health Psychcare Servs., Inc.*, 6 P.3d 669, 690 (Cal. 2000) ("The prevailing view is that [procedural and substantive unconscionability] must both be present in order for a court to exercise its discretion to refuse to enforce a contract or clause under the doctrine of unconscionability."). While both requirements are significant, this Article focuses on substantive unconscionability because the proof necessary to establish procedural unconscionability is no different for class action prohibitions than for other alleged flaws in arbitration clauses. Paul Bland has discussed some of the proof plaintiffs' counsel need to produce to establish procedural unconscionability. See Bland, *supra* note 73, at 1-2; see also *Blair v. Scott Specialty Gases*, 283 F.3d 595, 604-10 (3d Cir. 2002) (same).

75. See *Ting v. AT&T*, 182 F. Supp. 2d 902, 918 (N.D. Cal. 2002) ("It would not have been economically feasible to pursue the [small-dollar] claims . . . on an individual basis, whether the case was

In essence, these cases recognize the point made by Professor Marc Galanter and others that by increasing plaintiffs' transaction costs, defendants can induce them to accept lower settlements or even drop their claims altogether.⁷⁶ Citing the Supreme Court's oft-stated justification for supporting class actions,⁷⁷ courts invalidating class action prohibitions explain that it is often not rational for individual consumers or attorneys to bring small claims,⁷⁸ whether through litigation or arbitration.⁷⁹ At the same time, these courts have emphasized that a company that has perpetrated small-dollar illegal acts against numerous consumers should not be permitted to escape liability simply because it would be irrational or impossible for any single individual to bring the claim. Such an

brought in court or in arbitration."); *In re Knepp*, 229 B.R. 821, 842 (Bankr. N.D. Ala. 1999) ("If class actions are no longer an option, the vast majority of consumer claims involving relatively small sums of money on an individual basis will be left without a remedy."); *Leonard v. Terminix Int'l Co.*, 854 So. 2d 529, 538 (Ala. 2002) ("The limitation upon recovery of 'indirect, special, and consequential damages or loss of anticipated profits' in the arbitration clause and elsewhere in the agreement and the preclusion of eligibility for class-action treatment by inserting a provision requiring arbitration deprive the Leonards of a meaningful remedy and lead us to conclude that Terminix has extracted unreasonably favorable and patently unfair terms in its contract of adhesion."); *Szetela v. Discover Bank*, 118 Cal. Rptr. 2d 862, 868 (Ct. App. 2002) ("[The class action exclusion] is . . . harsh and unfair to Discover customers who might be owed a relatively small sum of money . . ."); *Powertel, Inc. v. Bexley*, 743 So. 2d 570, 576 (Fla. Dist. Ct. App. 1999) ("Class litigation provides the most economically feasible remedy for the kind of claim that has been asserted here. The potential claims are too small to litigate individually, but collectively they might amount to a large sum of money."); *State ex rel. Dunlap v. Berger*, 567 S.E.2d 265, 278 (W. Va. 2002) (stating that the plaintiff's claim of \$8.46 in added insurance charges "is precisely the sort of small-dollar/high volume (alleged) illegality that class action claims and remedies are effective at addressing").

76. See Marc S. Galanter, *The Quality of Settlements*, 1988 J. DISP. RESOL. 55, 70-72 (arguing that one party can encourage a settlement that would not otherwise have been desirable by imposing high transaction costs on the other); Lisa B. Bingham, *Control Over Dispute System-Design and Mandatory Commercial Arbitration*, 67 LAW & CONTEMP. PROBS. 221, 232-39 (Winter/Spring 2004) (explaining that by controlling dispute-system design, one party can impose transaction costs on the other, thereby dramatically altering the available settlement range or making it no longer cost effective for the opposing party to bring a claim). Eliminating the possibility of class actions is but one of many ways of increasing plaintiffs' transaction costs. See, e.g., Sternlight, *supra* note 7, at 682-83 (discussing additional mechanisms, such as imposing high arbitral fees and selecting a distant forum).

77. See, e.g., *Deposit Guar. Nat'l Bank v. Roper*, 445 U.S. 326, 338-39 (1980) (noting that class actions make it possible to bring claims that would otherwise be infeasible); *Eisen v. Carlisle & Jacquelin*, 417 U.S. 156, 161 (1974) (stating that absent a class action, "[n]o competent attorney would undertake [the petitioner's] action to recover so inconsequential an amount").

78. See, e.g., *Leonard*, 2002 WL 31341084, at *5, *8 (showing that the plaintiffs, who claimed less than \$500, would face fees and costs in arbitration substantially higher than the amount claimed); *Powertel*, 743 So. 2d at 576 ("The potential claims are too small to litigate individually, but collectively they might amount to a large sum of money."); *Dunlap*, 567 S.E.2d at 278.

79. See, e.g., *Ting*, 182 F. Supp. 2d at 918. The *Ting* court observed that most claims against AT&T for less than \$1,000 are likely to be handled by customer service representatives, rather than through either litigation or arbitration. *Id.* at 917.

enforcement gap would lead to unjust enrichment⁸⁰ and the failure to deter illegal conduct.⁸¹

Plaintiffs are most successful when they can support their assertions factually, rather than ask courts to assume that all small claims are infeasible if brought individually. Testimony from parties, local attorneys, or experts can establish which claims plaintiffs and their attorneys deem worth bringing. Such testimony needs to be specific as to what kinds of damages and attorneys' fees would be available for individual claims, why these are insufficient, whether joinder of claims is permitted under the arbitration clause, and, if so, why joinder would not cure the problem. If, as is sometimes true, the arbitration clause would permit plaintiffs to litigate claims that are small enough to qualify for small claims court, plaintiffs will need to show as well why that remedy is insufficient.⁸²

The *Ting*⁸³ litigation illustrates some of the kinds of evidence plaintiffs can use to support their claims that a class action prohibition is unconscionable because individual claims are infeasible. The plaintiffs used discovery to determine the nature of suits that had been brought against AT&T and its competitors in the past,⁸⁴ "contact[ing] more than a dozen attorneys who had previously brought class actions against AT&T to learn about their cases."⁸⁵ When virtually all those attorneys stated they would be willing to testify "that they would not have been able to pursue the claims at issue in those cases—even if the claims were valid—if they were unable to proceed on a class basis,"⁸⁶ AT&T "stipulated to what they would have said rather than face this litany of damaging testimony."⁸⁷ The plaintiffs' counsel also "introduced testimony from three experts on the subject of whether counsel could be found to bring such

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

81. See, e.g., *Comb v. Paypal, Inc.*, 218 F. Supp. 2d 1165, 1176 (N.D. Cal. 2002) ("PayPal appears to be attempting to insulate itself contractually from any meaningful challenge to its alleged practices."); *Szetela v. Discover Bank*, 118 Cal. Rptr. 2d 862, 868 (Ct. App. 2002) (explaining that the clause "serves as a disincentive for Discover to avoid the type of conduct that might lead to class action litigation," essentially granting Discover "a license to push the boundaries of good business practices to their furthest limits"); *Powertel*, 743 So. 2d at 576 ("The prospect of class litigation ordinarily has some deterrent effect on a manufacturer or service provider, but that is absent here.").

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

83. 182 F. Supp. 2d 902 (N.D. Cal. 2002).

84. See Bland, *supra* note 73, at 5; see also *Ting*, 182 F. Supp. 2d at 915, 917 (summarizing the evidence); Sturdevant, *supra* note 73, at 19 (observing that *Ting* plaintiffs took "[d]ocumentary and deposition discovery as to class action litigation . . . that [had] been filed against AT&T").

85. E-mail from Paul Bland, Esq., Staff Attorney, Trial Lawyers for Public Justice, to Jean R. Sternlight (July 29, 2002, 07:05 CST) (on file with author) [hereinafter Bland E-mail].

86. Bland, *supra* note 73, at 5.

87. *Id.* at 5.

cases on an individual basis.”⁸⁸ Each testified that most if not all consumers with such claims would have been unable to “find competent counsel to handle their claims . . . , in or out of arbitration, even if their claims were entirely valid.”⁸⁹ On the basis of this evidence, the court found that the lawyers who represented plaintiffs in class actions against AT&T and its competitors would not have handled those cases as individual matters.⁹⁰ The plaintiffs also presented evidence that legal aid programs would not likely have the resources to take such cases.⁹¹ The court observed that the defendant, in contrast, “did not produce any testimony from any practicing lawyer, or any other evidence, that any of the cases [previously filed] . . . would be economically feasible to litigate” under AT&T’s consumer services agreement.⁹²

Depending on the stage at which they are presenting proof, plaintiffs may also be able to rely on expert affidavits. For example, Edward Sherman, an eminent professor of complex litigation, opined in an affidavit that a suit, which alleged that the defendants’ “payday loan” interest rates violated the Indiana loansharking statute, was

a “negative value suit,” that is, a suit in which the potential recovery to any individual would be too small and the costs of litigation too large to have an adequate incentive to litigate individually. Consumer class actions are often negative value suits and have a much stronger claim for class action treatment than would [a dispute arising under] a contract between two corporations or well-heeled parties in which there is an arbitration clause. . . . Some consumers may do the same kind of calculus as do attorneys in judging that the recovery in a case may not justify the time and expense of pursuing a remedy through litigation or arbitration.⁹³

2. Individual Claims Would Not Be Feasible Due to a Lack of Information as to the Merits of the Claim or the Nature of Arbitration

As Professor Sherman has noted, often consumers do not know that a potential defendant’s conduct is illegal.⁹⁴ When they are being charged an excessive interest rate or a penalty for check bouncing, for example, few know or even sense that their rights are being violated. Nor, given the relatively small amounts at stake, would most consumers find it worthwhile to seek legal advice to determine whether this is the case. As a Wisconsin appellate court

88. Bland E-mail, *supra* note 85.

89. Bland, *supra* note 73, at 5; *accord* Sturdevant, *supra* note 73, at 20 (noting that three experienced consumer attorneys “testified as experts that virtually all consumers with statutory claims would not have been able to locate competent counsel to represent their interests in the absence of a certified class action, even if their claims had a high likelihood of success”)

90. *Ting v. AT&T*, 182 F. Supp. 2d 902, 918 (N.D. Cal. 2002) (stating that this evidence was “undisputed”).

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

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

93. Aff. of Professor Edward F. Sherman ¶ 8, *Sullivan v. QC Fin. Servs. Inc.* (No. 82D03-0003-CP-738) (Vanderburgh Super. Ct., Ind.) (on file with author).

94. *Id.* ¶ 9(a).

explained, “[u]nless class action is authorized, many plaintiffs will be unaware of the allegedly illegal activities and will not commence any proceedings.”⁹⁵

One of the virtues of the class action is that it requires that putative class members be notified of the potential violation of their rights.⁹⁶ Once notified, class members can typically opt in or out of the class, depending on how the suit has been structured.⁹⁷ Thus, whereas lack of information as to the existence of a possible claim will prevent most consumers from filing individual claims in arbitration or litigation, a single informed consumer can help initiate a class action that might help many others.

Lack of information as to *how* to file a claim may also be important. Consumers may well be unsure how to file an individual claim in either litigation or arbitration. And those with claims too small to attract an attorney to represent them on a contingent fee basis face a formidable barrier to bringing a claim. Moreover, to the extent that a consumer realizes that she is required to bring her claim in arbitration, lack of understanding or even misunderstandings of that process may deter her from filing a claim.⁹⁸

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

96. *See, e.g.*, FED. R. CIV. P. 23(c)(2), (d)(2). Although notice is only required for those class actions certified under Rule 23(b)(3), courts are free to give notice in other cases and often do. *See* MANUAL FOR COMPLEX LITIGATION (THIRD) § 30.21 (1995) (observing that notice, while required for (b)(3) class actions, may be advisable at times for (b)(1) and (b)(2) class actions as well); HERBERT NEWBERG & ALBA CONTE, NEWBERG ON CLASS ACTIONS, §§ 8.01-8.45 (1992) (detailing the notice requirements for class action suits).

97. With respect to those claims brought under Rule 23(b)(3), class members must be afforded the right to opt out. *See* FED. R. CIV. P. 23(c)(2); MANUAL FOR COMPLEX LITIGATION, *supra* note 96, at § 30.231. This right need not be afforded for claims brought under Rules 23(b)(1) or 23(b)(2). *See* MANUAL FOR COMPLEX LITIGATION, *supra* note 96, at §30.14.

98. Professor Sherman has made precisely these points:

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

b. Consumers may also fail to invoke arbitration because of lack of knowledge or distrust of the process. This is especially true of “payday loan” borrowers who are often unsophisticated concerning legal matters and may be hesitant to devote the time and expense to arbitration. Most citizens are aware that the courts provide an impartial tribunal for resolution of legal matters and a jury of one’s peers. To the extent that they have heard anything about arbitration, it may be negative, casting doubts upon it as the best vehicle for an individual to vindicate rights against large corporations or institutions. Of course, there are also serious doubts in our society about the efficacy of the court system, especially if one must hire his own attorney to pursue litigation, but the class action provides a feasible alternative for the impecunious consumer. Individual arbitration is less attractive than class action treatment regarding attorneys fees and costs. In an arbitration, the consumer would have to pay his own attorneys and investigation/preparation costs, while attorneys fees in a class action are generally

Thus, the class action not only provides financial feasibility through combining small claims but also surmounts deterrents to the filing of claims caused by the average consumer's lack of information. When companies prohibit class actions, they greatly decrease the likelihood that any claims will be filed against them.

3. Even If Individual Suits Were Feasible, They Would Not Result In Full Enforcement of the Law

The federal court in *Ting* pointed out another critical aspect of class actions: Many types of relief can be afforded only on a group basis. The *Ting* court examined the kinds of claims that had been filed against AT&T:

In 2000, AT&T was named as a defendant in 59 consumer long distance suits filed in other courts (not small claims courts) nationwide. It appears that the principal types of claims which members of the class can expect to litigate outside small claims court are not individual billing disputes or disputes about poor service, but claims of intentional misconduct, such as discrimination or harassment in the course of providing service, credit reporting problems and problems relating to identity theft and claims that involve practices or problems that pertain to all or a group of consumers. Examples of group claims include complaints about the way AT&T is measuring the length of a call or complaints that AT&T has misrepresented the terms of a calling plan in its advertising. If a consumer complains about such a practice, AT&T can try to satisfy the consumer by making a billing adjustment, but it cannot change its practice as to only that consumer without being considered discriminatory under the FCC's standards. In other words, if AT&T decided on an informal basis to measure the length of one class member's phone calls a certain way, it would be discriminating in violation of the [Federal Communications Act] if it measured the calls of other similarly situated class members differently.⁹⁹

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

Some might argue that several successful suits for individual relief might lead a company to change its overall policy; in fact, it is not at all obvious that this is true. A company may find it worthwhile to pay off a few individual claims but keep its overall policy. This is, in effect, a form of price discrimination that offers a lower price to those very few customers who are enterprising enough to complain about an illegal policy.¹⁰⁰ When the individual claims are arbitrated rather than litigated, it is even less likely that they will lead to company-wide reform. Unlike public litigation, which can lead to widespread pub-

not payable unless the class prevails and then are generally authorized by the court out of the recovery to the class at large.

Aff. of Professor Edward F. Sherman ¶ 9, *Sullivan v. QC Fin. Servs. Inc.* (No. 82D03-0003-CP-738) (Vanderburgh Super. Ct., Ind.).

99. *Ting v. AT&T*, 182 F. Supp. 2d 902, 915 (N.D. Cal. 2002).

100. DENNIS W. CARLTON & JEFFREY M. PERLOFF, *MODERN INDUSTRIAL ORGANIZATION* 290-312 (4th ed. 2005). Carlton and Perloff's discussion of the use of coupons and rebates highlights this point. They note that using cents-off coupons or offering rebates allows companies to price discriminate. Only some consumers—those who put a relatively low value on their time, for example—will take the time to collect, sort, and use coupons or send in the wrappers required for a rebate. *Id.* at 292. Similarly, only some consumers will have the expertise and time to pursue individual claims.

licity based on even a small individual claim, the arbitration process is typically private. Journalists cannot usually read and report on arbitration claims as they do complaints filed in court.

Thus, to the extent that class actions are eliminated, many types of relief simply will not be available. Whereas an individual consumer might be able to recover the excessive twenty-dollar check-bouncing charge that was levied against her, she could not, through either litigation or arbitration, obtain an order requiring the company to change its policy.

Once again, plaintiffs who seek to void a class action prohibition should not present this argument in the abstract, but should gather specific evidence, as did the *Ting* plaintiffs, regarding the types of claims that can and cannot effectively be prosecuted individually.¹⁰¹

4. Administrative Enforcement Actions Would Not Be an Adequate Substitute for the Class Action

In multiple cases, companies have attempted to fight the claim that class action preclusion is unconscionable by arguing that various government agencies are available to defend the group rights of consumers and others. For example, in *Green Tree Financial Corp. v. Randolph*,¹⁰² the U.S. Chamber of Commerce urged as amicus curiae, “[E]nforcement of arbitration agreements for TILA claims will have no effect on the powerful deterrent force of agency and criminal enforcement mechanisms provided by TILA. These enforcement mechanisms make class actions unnecessary to ensure a high level of TILA compliance.”¹⁰³ Similarly, in *Ting*, AT&T argued that a class action was not needed because the FCC could adequately protect consumers’ rights.¹⁰⁴ At a minimum, one cannot help but see such arguments as ironic, given that the attorneys and firms charged with defending their corporate clients are often critics of the government agencies that they are now praising.¹⁰⁵

101. See Plaintiffs’ Statement Re: Discovery, *Ting v. AT&T*, Case No. C 0129696 BZ ADR (Aug 29, 2001) (on file with author) (describing document and deposition discovery sought from AT&T); Bland, *supra* note 73, at 5 (discussing interviews with attorneys who had sued AT&T); Bland E-mail, *supra* note 85 (same).

102. 531 U.S. 79 (2000).

103. Brief of the Chamber of Commerce of the United States of America as Amicus Curiae in Support of Petitioners at *18, *Randolph* (No. 99-1235), available at 2000 WL 744157.

104. 182 F. Supp. 2d at 919 (discussing AT&T’s position that consumer claims should be presented to the FCC).

105. For example, in *EEOC v. Waffle House*, 534 U.S. 279 (2002), various business organizations argued that an employee’s agreement to arbitrate should prevent the EEOC from seeking monetary damages on that individual’s behalf. See Brief of Amici Curiae Associated Industries of Massachusetts, Connecticut Business and Industry Association, and New England Legal Foundation in Support of Respondent at *4, *Waffle House* (No. 99-1823), available at 2001 WL 799187. If this position had prevailed, the EEOC’s ability to protect the rights of those employees required to arbitrate claims individually would have been tightly constrained. Fortunately, however, a six-to-three majority of the Court refused to allow companies to use arbitration to escape this government regulation. See 534 U.S. at 312.

The *Ting* plaintiffs presented facts related to actual FCC activity that convinced the court that governmental enforcement actions could not take the place of class actions. The court found that, "in a variety of contexts,"

the FCC is not a forum before which a class member can effectively vindicate her right to recover damages from AT&T. . . . Nor is the FCC an effective forum for a class of similarly situated consumers seeking to recover damages from AT&T for a classwide practice without each consumer having to file an individual complaint¹⁰⁶

This conclusion—that the FCC could not be relied on to enforce consumers' rights—was critical to the court's holding that AT&T's class action prohibition was unconscionable.

III

BUT, ARE CLASS ACTION PROHIBITIONS EFFICIENT?

It can be argued that, for the reasons outlined above, class actions are beneficial to consumers, and class action exclusions must therefore be detrimental. Professor Stephen Ware, however, legitimately points out that a fair analysis of class exclusions would be more complex.¹⁰⁷ In particular, he suggests that the gains companies make by prohibiting class actions may be passed on to con-

106. 182 F. Supp. 2d at 920. The *Ting* court explained its findings as follows:

A review of FCC reports for the past ten years discloses that until recent years there are very few reports of FCC decisions involving a complaint by an individual consumer against a long distance carrier. Most of the complaints in recent years have concerned "slamming," the unauthorized substitution of a consumer's preferred long distance carrier for another without proper consent. It was largely undisputed at trial that it took the FCC approximately seventeen years before it effectively responded to "slamming" complaints.

In recent years, in response to consumers' complaints, the FCC has initiated investigations which ultimately resulted in changes in telephone company practices and in the imposition of forfeitures, or the payment of "voluntary contributions" to the United States Treasury. At defendant's request, I took judicial notice of 14 orders of the FCC adopting consent decrees or imposing forfeitures or notices of apparent liability, all of which issued during the year 2000. With the exception of *In the Matter of MCI WorldCom Communications, Inc.*, 15 F.C.C.R. 12, 181 (2000), in which the FCC approved a mechanism for providing some credit to certain consumers adversely impacted by the company's practices, *see id.* at 12, 182, the FCC does not appear to have concerned itself with obtaining individual relief for the complainants, even in situations where the FCC has concluded the carrier committed an "egregious" practice.

. . . .

This is not surprising, since the FCC has stated that it does not consider the award of damages to a class of individuals to be consistent with its consumer complaint procedures. . . . Nor have I seen a single report of the FCC addressing a consumer complaint for an intentional tort allegedly committed by a carrier

Id. at 919-20.

107. *See* Stephen J. Ware, *Paying the Price of Process: Judicial Regulation of Consumer Arbitration Agreements*, 2001 J. DISP. RESOL. 89 [hereinafter Ware, *Paying the Price*]; *see also* Christopher R. Drahozal, "Unfair" Arbitration Clauses, 2001 U. ILL. L. REV. 695, 771-72 (suggesting that there may be reasons, such as lower prices or higher payments, that rational persons or businesses would agree to seemingly unfair arbitration); STEPHEN J. WARE, ARBITRATION UNDER ASSAULT: TRIAL LAWYERS LEAD THE CHARGE (Cato Inst., Policy Analysis No. 433, 2002), at 6, 9 [hereinafter WARE, ARBITRATION UNDER ASSAULT], available at <http://www.cato.org/pubs/pas/pa-433es.html> (urging that bills prohibiting mandatory arbitration would likely harm consumers, in that mandatory arbitration makes dispute resolution more accessible to most consumers and "almost certainly lowers prices").

sumers¹⁰⁸ and that as a society we might be better off allowing companies to engage in this strategy.¹⁰⁹ “Attempts to make arbitration more favorable (or ‘fair’) to consumers have a downside for consumers if the effect of those attempts is to raise businesses’ arbitration costs.”¹¹⁰ As to class actions in particular, Ware argues that cases “requiring that arbitration preserve the class action[] raise the cost of arbitration to businesses and, therefore, raise prices to consumers.”¹¹¹ While Ware does not insist that companies must be allowed to eliminate class actions, he does urge that policymakers consider the effect on prices in determining how much leeway to afford companies.¹¹²

Professor Ware’s argument, however, is incomplete. While it is certainly true as a matter of economic theory that all of a company’s savings may be passed on to consumers in the form of lower prices, it is also true that they may not. The former, Panglossian event occurs only to the extent that the requirements of perfect competition are met.¹¹³

Four market characteristics are critical to define perfect competition:

- (1) There should be a sufficient number of small buyers and sellers such that no single buyer nor seller can influence the market price. No seller should produce a large percentage of the total market output.
- (2) The good or service produced should be homogeneous, so that no firm produces a unique product.
- (3) Entry and exit into the market should be very easy. No significant barriers to entry should exist such as licenses, economies of scale, high capital setup costs, or brand loyalty.

108. It is interesting to consider why companies apparently prefer to be sued individually rather than in class actions—that is, why eliminating class actions is a “gain” for a company. If a company engaged in no illegal conduct, would it not often be quicker and cheaper for the company to establish the validity of its conduct, once and for all, in a class action? On the other hand, if the company in fact engaged in illegal conduct, it is easier to see why a class action would be more costly than arbitration. The class device allows multiple claimants who might well have been deterred by the arbitral requirement to bring successful claims. Perhaps the most efficient and cost-effective solution is for companies to obey the law.

109. To support this argument, Professor Ware cites economic theory. He explains that “[i]n a market economy, characterized by freedom of entry and exit,” if any company is earning an excessive profit, other companies will enter that market and begin competing by selling the goods or services at a lower price. This, argues Ware, will cause prices to fall and benefit consumers. Ware, *Paying the Price*, *supra* note 107, at 91-92 (citing JAMES D. GWARTNEY & RICHARD L. STROUP, *ECONOMICS: PRIVATE AND PUBLIC CHOICE* 532-39, 563-65, 595-98 (7th ed. 1995)).

110. *Id.* at 93; *see also* WARE, *ARBITRATION UNDER ASSAULT*, *supra* note 107, at 9-10 (arguing, more generally, that mandatory arbitration is beneficial for most consumers, for businesses, and for society as a whole, and that it is only plaintiffs’ lawyers and consumers who hope to bring large cases who will be harmed); *cf.* Stephen J. Ware, *The Effects of Gilmer: Empirical and Other Approaches to the Study of Employment Arbitration*, 16 OHIO ST. J. ON DISP. RESOL. 735, 741 (2001) (recognizing that the extent to which costs imposed on employers by statute will be borne by employers, employees, and consumers “is determined by the elasticity of supply and demand in the ultimate product markets, and in the markets for the factors of production, labor and capital”).

111. Ware, *Paying the Price*, *supra* note 107, at 94.

112. *Id.* at 99.

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

- (4) All buyers and sellers should have very good access to relevant information such as prices, quality and characteristics of goods, and costs of production.¹¹⁴

Are these conditions likely to be met in the real world, where companies are mandating arbitration and eliminating class actions? First, think again about phone companies, credit card companies, banks, and insurance companies. While there are many small purchasers of these services, the number of producers is definitely limited. For example, of the over 6,000 banks and nonbank holding companies that issue credit cards, only around fifty do so nationally. In the period from 1989 to 1994, only ten companies held approximately sixty percent of total outstanding credit card balances.¹¹⁵ And in banking, the ten largest banks held almost thirty-seven percent of total deposits nationally in 1998, an increase of roughly seventeen percentage points since 1990.¹¹⁶ In such markets, it is far from clear that no single seller can influence market prices.¹¹⁷

Second, these companies' products are not entirely homogeneous. Rather, these companies attempt to distinguish themselves based on interest rates, types of service, and similar characteristics. Consumers will not necessarily drop one credit card, bank, insurer, or phone company at will to pick up another. There are differences among these products, and costs to making the switch. Switching banks, for example, results in significant costs, such as those associated with opening and closing accounts and making arrangements for direct deposits. Switching phones may result in the consumer being charged substantial fees.¹¹⁸

Third, as Professor Ware notes, his argument is entirely dependent on free entry and exit from the market.¹¹⁹ When access to the market is impeded, as by a monopoly or cartel, companies are able to keep their profits.¹²⁰ High capital investment requirements, lack of information, and other barriers to entry may

114. See WALTER NICHOLSON, *MICROECONOMIC THEORY: BASIC PRINCIPLES AND EXTENSIONS* 401-02 (7th ed. 1998); ROBERT S. PINDYCK & DANIEL L. RUBINFELD, *MICROECONOMICS* 252-53 (5th ed. 2001).

115. Victor Stango, *Competition and Pricing in the Credit Card Market*, 82 *REV. ECON. & STAT.* 499, 500 (2000).

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

117. For evidence that the largest health insurance firms control a significant share of the market, see, for example, Roger Feldman et al., *HMO Consolidations: How National Mergers Affect Local Markets*, *HEALTH AFF.*, July-Aug. 1999, at 96-104; see also Stephen E. Foreman et al., *Monopoly, Monopsony and Contestability in Health Insurance: A Study of Blue Cross Plans*, 34 *ECON. INQUIRY* 662 (1996).

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

119. Ware, *Paying the Price*, *supra* note 107, at 91 (assuming "a market economy, characterized by freedom of entry and exit").

120. LIPSEY ET AL., *supra* note 118, at 236-37.

make it difficult or impossible for new companies to enter particular markets.¹²¹ With local phone service, for example, both government regulations and capital outlay requirements substantially limit access to the field. In fact, entry barriers in local telephone service have been characterized as “formidable.”¹²² In banking, lack of information about local businesses and residents can constitute a serious barrier to entry since unfamiliarity with local conditions makes risk evaluation difficult.¹²³

In sum, economic theory alone raises significant doubts that companies pass on to consumers the entire cost-savings from using arbitration clauses to eliminate class actions.¹²⁴ It is not surprising that, to date, no published studies show that the imposition of mandatory arbitration leads to lower prices.

Also, as Professor Ware recognizes, low prices neither are, nor necessarily should be, policymakers’ primary concern.¹²⁵ Many government regulations clearly increase companies’ costs, and these regulations may even increase prices, but policymakers have determined that these regulations make sense nonetheless.¹²⁶ For example, we require manufacturers of tires, drugs, and cars to meet minimum standards to protect public health and safety. Congress has now passed legislation geared to ensuring that businesses are honest in their accounting practices.¹²⁷ Will such rules lead to higher prices? Perhaps. But Congress has determined that any such costs are well worthwhile to protect investors and the public from fraudulent activity.

Further, Professor Ware does not sufficiently acknowledge the distributive aspects of his argument. Even assuming that permitting companies to eliminate

121. LIPSEY ET AL., *supra* note 118, at 236-37, 266-69; STIGLITZ & WALSH, *supra* note 118, at 258.

122. Manley R. Irwin & James McConnaughey, *Telecommunications*, in THE STRUCTURE OF AMERICAN INDUSTRY, *supra* note 116, at 308. One objective of the Telecommunications Act of 1996, 47 U.S.C. §§ 251-61 (2000), was to increase competition at the local level by introducing competitive local exchange carriers (CLECs). But these alternative local service providers have had only a minimal effect on the market share of local monopolies, primarily the regional Bell operating companies. See Irwin & McConnaughey, *supra*, at 309-11.

123. Pilloff, *supra* note 116, at 234. For a summary of evidence that markups on credit cards remained high even as credit card interest rates fell, suggesting that the market was not perfectly competitive, see Stango, *supra* note 115, at 500-01.

124. Suppose the market is imperfectly competitive, even monopolistic. What guidance does economic theory offer as to whether cost-savings will be passed on to consumers in the form of lower prices? Not surprisingly, the answer is less clear than it is in a competitive market. The extent to which cost-savings by a monopoly will be transferred to consumers depends heavily on the elasticity of the market demand curve and on the shape of the firm’s marginal cost curve. See HAL R. VARIAN, INTERMEDIATE MICROECONOMICS: A MODERN APPROACH 420-25 (6th ed. 2003).

125. See Ware, *Paying the Price*, *supra* note 107, at 90, 99 (recognizing that regulation may yield benefits that outweigh any costs); see also Christopher R. Drahozal, *Privatizing Civil Justice: Commercial Arbitration and the Civil Justice System*, 9 KAN. J.L. & PUB. POL’Y 578, 587-88 (2000) (noting a tradeoff between the costs and benefits of regulating arbitration).

126. As noted earlier, see *supra* note 108, it is interesting to consider when and why it would be less expensive for companies to be sued in numerous individual suits rather than in a single class action. Whereas a company that has broken the law may find it preferable to avoid class liability, a company that has committed no illegal acts may be better off establishing its lack of liability, once and for all, in a class action. That is, the elimination of class actions may be particularly important to those companies that act illegally.

127. See Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, 116 Stat. 745 (2002).

class actions would cause prices of phone service or credit or insurance to drop slightly, how should this be weighed against the cost to the individual consumers who find themselves unable to vindicate their rights? Those consumers may well feel that any small gains for the group as a whole do not warrant their individual losses. Moreover, given the informed choice, many consumers might be willing to pay a slightly higher price to preserve their right to litigate a class action.¹²⁸ In economic terms, the lower price situation may not be Pareto-optimal.¹²⁹

Moreover, even if, in return for a lower price, informed consumers might gamble that they would not need to litigate, policymakers might still be justified in prohibiting the elimination of class actions. Regulation is sometimes appropriate to protect individuals from their own irrational actions if such actions might fail to serve their best interests.¹³⁰ In particular, psychologists have shown

128. Professor Ware has recognized and attempted to counter this argument. See Stephen J. Ware, *Consumer Arbitration as Exceptional Consumer Law (With a Contractualist Reply to Carrington & Haagen)*, 29 MCGEORGE L. REV. 195, 212-13 n.95 (1998). However, his arguments are not compelling. First, he asserts that it is improper to consider what consumers "would have" agreed to, since contract law ought to focus on what they did actually agree to. Second, he urges that courts cannot easily determine what consumers "would have" agreed to. Third, he urges it is no more appropriate to equalize information than to equalize any other property. *Id.* In essence, the difference between Ware's position and our own is that we believe in the propriety of government regulation, and he does not. The question is precisely whether contracts *ought* to be enforced if they would not have been entered into by persons possessing full information. While Ware is correct that courts cannot easily determine on a case-by-case basis what individual consumers would have agreed to, courts can and frequently do determine what a reasonable person would have done. Moreover, this Article urges legislative action rather than such individualized determinations. It is perfectly appropriate for legislatures to take steps to correct informational inequities and to redistribute wealth and income in appropriate circumstances.

As a thought experiment, one might put consumers behind a Rawlsian "veil of ignorance." See JOHN RAWLS, *A THEORY OF JUSTICE* 136-42 (1971). Would such consumers, unsure whether they might have the desire to sue a company in a class action to eliminate illegal practices, be willing to trade that opportunity for a slightly reduced price? Clearly, companies have not been willing to give consumers the choice because, in the vast majority of situations, companies do not permit consumers to choose whether they would prefer arbitration to litigation. Advocates of mandatory arbitration have consistently argued that it is not practical to afford consumers such a genuine choice on either a predispute or post-dispute basis. See, e.g., Samuel Estreicher, *Saturns for Rickshaws: The Stakes in the Debate over Predispute Employment Arbitration Agreements*, 16 OHIO ST. J. ON DISP. RESOL. 559 (2001) (arguing that it is not practical to permit employees to choose between arbitration and litigation on a post-dispute basis).

129. Although Professor Ware is correct in his insistence that perfect information on the part of consumers is not necessary to ensure that price reductions are passed along to consumers, *Paying the Price*, *supra* note 107, at 92, an efficient solution cannot be achieved without such perfect information, see STIGLITZ & WALSH, *supra* note 118, at 232-35, 287-301.

130. The recently emerged field referred to as "behavioral law and economics" or "law and behavioral science" attempts to modify standard economic assumptions with psychological insights. See generally BEHAVIORAL LAW AND ECONOMICS (Cass R. Sunstein ed., 2000); Christine Jolls et al., *A Behavioral Approach to Law and Economics*, 50 STAN. L. REV. 1471 (1998); Symposium, *The Legal Implications of Psychology: Human Behavior, Behavioral Economics, and the Law*, 51 VAND. L. REV. 1497 (1998); Jon D. Hanson & Douglas A. Kysar, *Taking Behavioralism Seriously: The Problem of Market Manipulation*, 74 N.Y.U. L. REV. 630 (1999); Russell B. Korobkin & Thomas S. Ulen, *Law and Behavioral Science: Removing the Rationality Assumption from Law and Economics*, 88 CAL. L. REV. 1051 (2000). For a critique of this new discipline, see Gregory Mitchell, *Taking Behavioralism Too Seriously? The Unwarranted Pessimism of the New Behavioral Analysis of Law*, 43 WM. & MARY L. REV. 1907 (2002).

that individuals often behave in an irrational but predictable fashion.¹³¹ They tend to be overoptimistic, so they might undervalue the cost of giving up their right to sue.¹³² Similarly, individuals are not necessarily risk-neutral, but rather may take irrational gambles on prospective losses,¹³³ they are often risk-seeking with respect to moderate-to-high probability losses and risk-averse with respect to low probability losses.¹³⁴ Thus, even assuming an informed consumer would accept a binding arbitration provision excluding class actions in return for a slightly lower price, policymakers might well determine that it would be inappropriate to allow companies to impose such a restriction on consumers.¹³⁵ This is particularly true if one accepts the argument of Professors Hanson and Kysar that companies will inevitably seek to take advantage of consumers' irrational behavior by manipulating the market.¹³⁶ Similarly, Professor Korobkin has

131. The word "irrational," as used here, denotes that individuals' expressed preferences may not make sense from a mathematical-probabilistic standpoint. See Korobkin & Ulen, *supra* note 130, at 1144 (explaining that their identifying behavior that deviates from what rational choice theory would predict does not equate to a claim that people are generally irrational). For a summary of some common irrational behaviors, see Jean R. Sternlight, *Lawyers' Representation of Clients in Mediation: Using Economics and Psychology to Structure Advocacy in a Nonadversarial Setting*, 14 OHIO ST. J. ON DISP. RESOL. 269, 306-13 (1999).

132. See, e.g., Jolls et al., *supra* note 130, at 1541-43 (explaining that individuals' inability to accurately assess risks may undermine the "consumer sovereignty" arguments against paternalism and government regulation). Of course, it is also true that government bureaucrats and politicians may themselves be affected by irrational biases. *Id.* at 1543-45; see also Roger G. Noll & James E. Krier, *Some Implications of Cognitive Psychology for Risk Regulation*, in BEHAVIORAL LAW AND ECONOMICS, *supra* note 130, at 325-54 (recognizing that politicians may be influenced by voters' expressed preferences, even if they recognize those preferences as irrational).

133. Cognitive psychologists Daniel Kahneman and Amos Tversky developed this widely accepted account of decisionmaking, which is known as "prospect theory." See Daniel Kahneman & Amos Tversky, *Prospect Theory: An Analysis of Decision Under Risk*, 47 ECONOMETRICA 263 (1979); see also Amos Tversky & Daniel Kahneman, *Rational Choice and the Framing of Decision*, 59 J. BUS. 251 (1986); Daniel Kahneman & Amos Tversky, *Judgment Under Uncertainty: Heuristics and Biases*, in JUDGMENT UNDER UNCERTAINTY: HEURISTICS AND BIASES 3 (Daniel Kahneman et al. eds., 1982).

134. Chris Guthrie, *Framing Frivolous Litigation: A Psychological Theory*, 67 U. CHI. L. REV. 163, 165-67 (2000). It is unclear whether a well-informed consumer would view the risk of being required to take a dispute to arbitration as low, moderate, or high. It is also unclear how the informed consumer would calculate the expected value of such a risk—that is, how harmful they would think it would be to forego the opportunity to litigate. But, one can say with some confidence that individuals would not typically be able to evaluate these probabilities in a rational, risk-neutral fashion, and this can provide a justification for regulation.

135. Of course, the mere possibility of these irrationality phenomena should not be used to justify regulation any more than the assumptions of perfect competition should be used to oppose regulation. Ideally, policymakers would empirically investigate the need for regulation in this area. Where the necessarily empirical work has not been done, however, policymakers have no choice but to rely on their intuition and instincts. Unfortunately, as noted earlier, policymakers may themselves be affected by these same biases, and may also be influenced by voters' irrational preferences. See Noll & Krier, *supra* note 132, at 325-54. Nevertheless, regulation does afford at least an opportunity to protect consumers and others from their own irrationality.

136. Jon D. Hanson & Douglas A. Kysar, *Taking Behavioralism Seriously: Some Evidence of Market Manipulation*, 112 HARV. L. REV. 1420, 1425 (1999) (drawing on a case study of the tobacco industry to argue that "because a multitude of nonrational factors influence individual decisionmaking, consumers cannot be expected to engage in efficient product purchasing analyses—regardless of whether manufacturers are required to supply product warnings"); Hanson & Kysar, *supra* note 130, at 747 ("Manufacturers, to survive, *must* behave 'as if' they are attempting to manipulate consumer risk perceptions. And in light of the immense power of the market forces driving these attempts, it seems highly doubtful that manufacturer strategies (be they deliberate or accidental) will fail.") (emphasis

recently argued that because consumers typically behave with only bounded rationality, companies that draft form contracts have an incentive to slant contractual terms in their direction, whether or not those terms would be efficient.¹³⁷

At least one corporate defendant has tried a version of Professor Ware's argument that lower prices would be passed on to consumers, but the court did not find it persuasive. In *Ting v. AT&T*, the district court stated:

AT&T has suggested that if its costs are lower, it can charge less. It presented no evidence that the Legal Remedies Provisions would produce lower charges Nor am I prepared to make that assumption, since while lower costs can produce lower charges, they can also produce higher profits. In any event, the notion that it is to the public's advantage that companies be relieved of legal liability for their wrongdoing so that they can lower their cost of doing business is contrary to a century of consumer protection laws.¹³⁸

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

In considering whether it is appropriate to permit companies to use arbitration clauses to eliminate class actions, policymakers should also be cognizant of the important role that private litigation plays in the U.S. legal system. Whereas some countries choose to enforce their laws by establishing large and powerful government bureaucracies, the United States has generally taken a different approach. Although the United States does have government agencies devoted to protecting the rights of consumers and others, these tend to be on a small scale compared to those of other nations, such as many European countries.¹³⁹ Instead, the United States relies on affected individuals bringing their own lawsuits and calls them private attorneys general. In such a system, the elimination of class actions is far more worrisome than it would be in a

added). While Hanson and Kysar focus on manufacturers' potential use of packaging, manufacture, and marketing to take advantage of consumers' irrationalities, the same analysis could be applied to the manner of providing an arbitration provision. Indeed, discovery conducted in the *Ting* litigation showed that AT&T spent substantial resources determining how best to implement their binding arbitration policy so that it would not be opposed by consumers. See *Ting v. AT&T*, 182 F. Supp. 2d 902, 911-13 (N.D. Cal. 2002). In short, merely requiring companies to provide accurate and visible descriptions of their arbitration requirements will not be sufficient to protect consumers from unfair arbitration provisions.

137. See Russell Korobkin, *Bounded Rationality, Standard Form Contracts, and Unconscionability*, 70 U. CHI. L. REV. 1203 (2003).

138. *Ting*, 182 F. Supp. 2d at 931 n.16.

139. See Richard M. Alderman, *Pre-Dispute Mandatory Arbitration in Consumer Contracts: A Call for Reform*, 38 HOUS. L. REV. 1237, 1263 (2001) ("The American justice system substantially relies upon private enforcement to help define and explain regulatory legislation and to insure that it is enforced."); Christopher R. Drahozal & Raymond J. Friel, *Consumer Arbitration in the European Union and the United States*, 28 N.C. J. INT'L L. & COM. REG. 357 (2002) (noting that European countries take a more regulatory approach to consumer law than does the United States). For a general discussion of some of the institutional differences between U.S. and European approaches to consumer law, see A. Brooke Overby, *An Institutional Analysis of Consumer Law*, 34 VAND. J. TRANSNAT'L L. 1219 (2001).

system in which well-financed government bureaucracies also protect consumers' rights.¹⁴⁰

Considering these policy arguments, absent any empirical proof that allowing companies to eliminate class actions would serve the best interests of consumers, the only reasonable conclusion is that the practice of allowing U.S. companies to use arbitration clauses to insulate themselves from class action liability is problematic. At minimum, this practice should be subject to regulation.

IV

THE NEED FOR CONGRESSIONAL ACTION

Assuming that policymakers determine that companies should not have an unrestricted license to eliminate class actions, the question becomes how best to regulate this practice. As Professor Ware notes,¹⁴¹ the current approach requires prospective class plaintiffs to argue, on a case-by-case basis, that the prohibition in a particular contract is unconscionable or otherwise illegal.¹⁴² Faced with these arguments, courts are reaching disparate conclusions. Some are refusing to address the unconscionability question at all, instead referring the issue to the arbitrators.¹⁴³ Some are voiding arbitration clauses that prohibit class actions,¹⁴⁴ some are severing that portion of the clause,¹⁴⁵ and many others are upholding such clauses.¹⁴⁶ As noted earlier, plaintiffs' challenges are most likely to succeed when they are based upon a substantial factual record.¹⁴⁷

Are individual court challenges a satisfactory way to regulate class action preclusion? Some might say "yes," arguing that mandatory arbitration should

140. European Union countries, in addition to using various government agencies to protect consumers' rights, have also prohibited companies from imposing mandatory arbitration on consumers. See Council Directive 93/13/EEC, Annex 1(q), 1993 O.J. (L 95) 29; see also Council Directive 93/13/EEC, art. 1(1), 1993 O.J. (L 95) 29; Commission Recommendation 98/257/EC, art. 1-7, 1998 O.J. (L 115) 31. For a discussion of how mandatory arbitration is treated outside the United States, see Jean R. Sternlight, *Is the U.S. Out on a Limb?*, 56 U. MIAMI L. REV. 831 (2002).

141. Ware, *Paying the Price*, *supra* note 107, at 89 ("Courts regulate consumer arbitration by enforcing arbitration clauses that have certain features, while refusing to enforce arbitration clauses that lack those features.").

142. The primary argument plaintiffs have made, in addition to unconscionability, is that the use of an arbitration clause to eliminate class actions violates the federal statute under which their claim is brought. For a discussion of this argument, see Sternlight, *supra* note 3, at 93-105. The argument remains available and has prevailed in at least one case. See *Lozada v. Dale Baker Oldsmobile, Inc.*, 91 F. Supp. 2d 1087 (W.D. Mich. 2000) (finding an arbitration clause unenforceable because it violates the Truth in Lending Act). Most courts, however, have rejected the argument that the Truth in Lending Act guarantees a right to proceed by class action. See, e.g., *Johnson v. W. Suburban Bank*, 225 F.3d 366 (3d Cir. 2000); *Hale v. First U.S.A. Bank, N.A.*, No. 00 Civ. 5406, 2001 U.S. Dist. LEXIS 8045 (S.D.N.Y. Jun. 19, 2001); *Lloyd v. MBNA Am. Bank, N.A.*, No. 00-109-SLR, 2001 U.S. Dist. LEXIS 8279 (D. Del. Feb. 22, 2001).

143. See *supra* note 8.

144. See *supra* note 13.

145. See *Szetela v. Discover Bank*, 118 Cal. Rptr. 2d 862, 867-68 (Ct. App. 2002).

146. See *supra* note 60.

147. See *supra* notes 73-74.

be permitted unless it has been proven unfair.¹⁴⁸ The Supreme Court has interpreted existing law to require this result, holding in such cases as *Gilmer v. Interstate/Johnson Lane Corp.*¹⁴⁹ and *Green Tree Financial Corp. v. Randolph*¹⁵⁰ that the employee or consumer bears the burden of showing that an arbitration clause should be voided on statutory or common law grounds.¹⁵¹

While placing the burden of proof on the challenger may sound reasonable at first blush, it fails to take into consideration the costs and logistical realities of challenging an arbitration clause. For instance, in *Ting*, the plaintiffs were able to convince the court to throw out the arbitration clause only because they conducted extensive discovery and presented large quantities of factual information at trial. The plaintiffs' attorneys spent more than 2,000 hours on the pretrial, trial, and immediate post-trial portions of the case,¹⁵² an investment worth over \$400,000 using an hourly rate of just \$200 per hour. The defendants, in responding to these challenges, similarly expended large sums amassing their facts for trial. One of the plaintiffs' attorneys, Paul Bland, notes that "[a]t one point we counted that AT&T and [the American Arbitration Association (AAA)] between them had at least 17 lawyers enter appearances or engage in discovery battles in the case."¹⁵³ Because the costs of challenging a class action prohibition are very high, many plaintiffs and plaintiffs' attorneys likely opt not

148. See Estreicher, *supra* note 128; see also Neesemann, *supra* note 1 (arguing that arbitration clauses that are otherwise fair should not be voided merely for containing class action prohibitions).

149. 500 U.S. 20 (1991).

150. 531 U.S. 79 (2000).

151. See, e.g., *Randolph*, 531 U.S. at 92 ("[W]here . . . a party seeks to invalidate an arbitration agreement on the ground that arbitration would be prohibitively expensive, that party bears the burden of showing the likelihood of incurring such costs."); *Gilmer*, 500 U.S. at 26 (stating that the party seeking to avoid arbitration of statutory claims bears the burden of establishing that Congress intended to preclude arbitration of the claims at issue); *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*, 473 U.S. 614, 627 (1985) ("Of course, courts should remain attuned to well-supported claims that the agreement to arbitrate resulted from the sort of fraud or overwhelming economic power that would provide grounds for the revocation of any contract.") (quotations omitted). For examples of how this presumption affects class action unconscionability challenges, see *Adkins v. Labor Ready Inc.*, 303 F.3d 496 (4th Cir. 2002) (holding that the plaintiff had failed to meet his burden of proof of showing that a class actions prohibition would render litigation under the Fair Labor Standards Act prohibitively expensive); *Lytle v. CitiFinancial Servs., Inc.*, 810 A.2d 643, 666 (Pa. Super. Ct. 2002) (stating that the plaintiffs cannot go forward without presenting evidence showing that they cannot feasibly present their claims individually).

In *Randolph*, four dissenting justices recognized the significance of the majority's holding and suggested that it is not necessarily appropriate to place the burden of proving the inaccessibility of the arbitral forum on the challenger merely because the challenger has traditionally been required to bear the burden of showing that arbitral remedies are inadequate. 531 U.S. at 93-96 (Ginsburg, J., dissenting). The dissenting justices further observed that a repeat-player defendant may be in a better position to make a showing regarding the costs of arbitration.

152. See Time Reports from Sturdevant Law Firm and Trial Lawyers for Public Justice, Chart 2 (reflecting hours expended on the *Ting* litigation from May 2001 to February 25, 2002) (on file with authors); Bland E-mail, *supra* note 85 (stating that the plaintiffs' attorneys "put in well over 2,000 hours of lawyer time during the trial phase" of the suit); cf. Sturdevant, *supra* note 73 (describing substantial discovery undertaken by the plaintiffs' attorneys). The time records from *Ting* reflect hundreds of additional hours expended by paralegals and law clerks.

153. Bland E-mail, *supra* note 85. The AAA became involved in the suit because it was the designated service provider.

to even mount such attacks¹⁵⁴—not because they lack merit, but simply because they are not economically feasible, given the cost, the likelihood of success, and the likely payoff.¹⁵⁵

Policymakers should take into account the difficulty of court challenges as they decide how to handle companies' attempts to use arbitration clauses to eliminate consumer class actions. On the one hand, it might appear that courts can adequately protect the class action using existing law, such as the unconscionability doctrine.¹⁵⁶ The case-by-case approach allows courts to distinguish between those class action prohibitions that substantially limit plaintiffs' ability to bring claims and those that do not.¹⁵⁷ This may seem fair and appropriate. On the other hand, putting the unconscionability doctrine to use comes at a high cost. To enable courts to distinguish between those class action prohibitions that are and are not unconscionable, both plaintiffs and defendants must expend significant time and money. Plaintiffs win class action exclusion challenges only when they can present substantial evidence that the arguments made in Part II of this Article—for example, that individual suits are not feasible or that government enforcement is not effective—apply to the facts of their particular case.¹⁵⁸ Plaintiffs' costs deter many challenges, and defendants' costs may well cause the price of their products or services to rise for all consumers.¹⁵⁹

An alternative to using a case-by-case approach would be for Congress to prohibit companies from using arbitration clauses to preclude class actions. If Congress thought such a general prohibition too broad, it could at least prohibit the practice with respect to arbitration agreements imposed on consumers or employees.¹⁶⁰ Such a legislative approach would have both costs and benefits. Its primary advantage would be substantially reducing the cost of challenging class action prohibitions, but it would also serve other interests that are furthered by class actions, including the courts' interest in the efficient resolution

154. *Ting* was brought as a collaborative effort by San Francisco attorney Jim Sturdevant and the public interest firm Trial Lawyers for Public Justice. The latter has devoted substantial resources to fighting mandatory arbitration throughout the country, and likely did not take on this suit as a profit-making venture. See Trial Lawyers for Public Justice, at <http://www.tlpj.org> (last visited Mar. 5, 2004).

155. Economists refer to the costs associated with negotiating, reaching, and enforcing contracts as transaction costs. See generally OLIVER E. WILLIAMSON, *THE ECONOMIC INSTITUTIONS OF CAPITALISM* (1985) (giving an overview of transaction-cost economics and its behavioral assumptions and discussing the implications of transaction costs for topics as diverse as the structure of firms, contract relations, and antitrust law); Oliver E. Williamson, *Transaction Cost Economics*, in *HANDBOOK OF INDUSTRIAL ORGANIZATION* 135-82 (Richard Schmalensee & Robert D. Willig eds., 1989); Oliver Hart, *An Economist's Perspective on the Theory of the Firm*, 89 COLUM. L. REV. 1757 (1989).

156. Sternlight, *supra* note 3, at 121 (“[C]ourts can adequately protect the policies underlying both class actions and arbitration using existing case law.”).

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

158. See *supra* Part II.C.

159. See Ware, *Paying the Price*, *supra* note 107, at 94.

160. The securities industry typically requires individual claims to be arbitrated but allows class actions to be litigated. See Sternlight, *supra* note 3, at 45-49.

of disputes and the public's interest in ensuring that the law is enforced.¹⁶¹ Under the current system, in which class action prohibitions can be defeated only if challenged in court, these broader interests are often ignored.

Admittedly, it can also be argued that class actions are detrimental, not only to defendants but to the court system and to the public at large. Academics as well as corporate interests have pointed to ethical and efficiency issues and have urged that class actions be limited or reformed, if not eliminated.¹⁶² To date, however, having weighed these arguments, Congress has determined that the benefits of class actions outweigh any costs. Class actions remain a crucial element of federal and state rules of civil procedure and of the U.S. legal system. While legislation is being considered that would further regulate class actions, no one has seriously proposed wholesale elimination of this important procedural device.¹⁶³ Many, including those representing consumers, have recognized that class actions can be abused.¹⁶⁴ Trial Lawyers for Public Justice, for example, runs a "class action abuse prevention project—just as it runs a project to oppose mandatory arbitration."¹⁶⁵ However, to recognize that the use of class actions must be reasonably constrained is not to say that companies should be able to "self-deregulate" by giving themselves complete immunity from class actions.

Although the focus here has been on legislation that might be enacted by the U.S. Congress, state legislatures might separately prohibit companies from proscribing the use of class actions. While it is clear that state legislation unfavorably targeting arbitration will be preempted by the Federal Arbitration Act,¹⁶⁶ it is not evident that state efforts to protect class actions would be void. First, such legislation would not need to focus on arbitration alone; states might well choose to prohibit companies from precluding class actions in either litigation or arbitration. Second, state legislation that prohibited companies from using arbitration clauses to preclude class action would not eliminate but rather regulate arbitration.¹⁶⁷ As the Supreme Court has now implicitly recognized, arbitral class actions are viable procedural devices.¹⁶⁸ Thus, state legislation that

161. See *Szetela v. Discover Bank*, 118 Cal. Rptr. 2d 862, 867-868 (Cal. Ct. App. 2002).

162. For a summary of some of the criticisms of class actions, see Sternlight, *supra* note 3, at 34-37.

163. See, e.g., Class Action Fairness Act of 2003, H.R. 1115, 108th Cong. (2003) (amending the procedures that apply to the certification of interstate class actions).

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

165. Trial Lawyers for Public Justice, at <http://www.tlpj.org> (last visited Mar. 5, 2004).

166. See *Doctor's Assocs. v. Casarotto*, 517 U.S. 681, 688 (1996).

167. For a fuller discussion of the preemption issue, see Jean R. Sternlight, *The Rise and Spread of Mandatory Arbitration as a Substitute for the Jury Trial*, 38 U.S.F. L. REV. 17, 35-38 (2003) (arguing that state constitutional jury-trial requirements are not preempted); see also David S. Schwartz, *Correcting Federalism Mistakes in Statutory Interpretation: The Supreme Court and the Federal Arbitration Act*, 67 LAW & CONTEMP. PROBS. 5 (Winter/Spring 2004).

168. See *Green Tree Fin. Corp. v. Bazzle*, 123 S. Ct. 2404 (2003) (holding that the arbitrator should determine whether an ambiguous clause allows arbitral class action); see also *Brennan v. ACE INA Holdings, Inc.*, No. 00-CV-2730, 2002 WL 1804918, at *3 (E.D. Pa. Aug. 1, 2002) (stating that an arbitrator should be free to certify a class action); *Keating v. Superior Court*, 645 P.2d 1192, 1208 (Cal.

protects the right to proceed by class action should not be held preempted by the Federal Arbitration Act.

V

CONCLUSION

Companies are increasingly using arbitral class action prohibitions to insulate themselves from class action liability. These prohibitions are detrimental not only to potential class members but to the public at large in that they are preventing the law from being adequately enforced. In essence, by precluding class actions, companies are engaging in “do-it-yourself tort reform,” freeing themselves from liability without having to convince legislatures to change the substantive law.¹⁶⁹ The unconscionability defense, while sometimes successful, is itself too expensive and unwieldy to adequately regulate companies’ attempts to elude class action liability. Thus, as a matter of fairness, efficiency, and justice, Congress should prevent companies from exempting themselves from class action liability.

1982) (recognizing the possibility of classwide arbitration); *Dickler v. Shearson Lehman Hutton Inc.*, 596 A.2d 860 (Pa. Super. Ct. 1991) (recognizing the possibility of arbitral class action).

169. This phrase was coined in an attack on the practice of using arbitration to eliminate class actions. See Sternlight, *supra* note 3, at 11. Paul D. Carrington has employed a similar phrase: “self-deregulation.” See Paul D. Carrington, *Unconscionable Lawyers*, 19 GA. ST. U. L. REV. 361 (2002). While one commentator has suggested that do-it-yourself tort reform is commendable, see Roger S. Haydock, *The Supreme Court Creates Real Civil Justice Reform*, 9 Metropolitan Corporate Counsel # 11 (Metropolitan Corporate Counsel, Mountainside, NJ), Nov. 2001, at 45, the legislature, not individual companies, should determine whether those companies should be allowed to avoid the strictures of substantive law.
