The American Bar Association
Section of Litigation and the
Center for Continuing Legal Education
Present

The 11th Annual National Institute on

Class Actions

Defending Liberty
Pursuing Justice

CLASS ACTION ARBITRATION

Stuart M. Widman
Miller Shakman & Beem LLP
Chicago, Illinois

There is a new battleground for class actions—in arbitration. For approximately 40 years, following the 1966 amendments to the Federal Rules of Civil Procedure, parties were fighting class actions in court. Over the decades, the law evolved on issues of jurisdiction and class certification criteria. Now, in the newer arbitration venue, the parties generally select the "judges" for their cases. Also, jurisdiction and class certification tests arise from the parties' arbitration clauses, the rules of any administering organization, and a recent United States Supreme Court case.

This Article discusses how class actions get into and proceed through arbitration. It also examines the rules of the two primary organizations that administer class actions, including how their rules differ from Rule 23 of the Federal Rules of Civil Procedure. Finally, this Article discusses the Supreme Court's watershed decision in *Green Tree Financial Corp. v. Bazzle, et al.*, 539 U.S. 444, 123 S. Ct. 2402 (2003), which vested arbitrators with the authority to decide whether class action arbitration is proper where the parties' arbitration agreement is silent on that question.

THE TWO VENUES FOR CLASS ACTION ARBITRATION

There are two primary administering organizations that provide for class action arbitration—the American Arbitration Association ("AAA") and JAMS.[1] The AAA Supplementary Rules for Class Arbitrations ("Supp. Rule") became effective on October 8, 2003. The current version of the JAMS Class Actions Procedures ("Procedures" or "Rule") were implemented in February, 2005. Both the AAA Supplementary Rules and JAMS Procedures apply when (1) a party submits a dispute to arbitration on behalf of or against a class or purported class, (2) a court refers a matter pleaded as a class action for administration, or (3) a party to a pending arbitration adds new claims on behalf of or against a class or purported class. (AAA Supp. Rule 1(a); JAMS Rule 1(a).)

There are three possible versions of the parties' arbitration agreement that result in different paths to arbitration – where the parties' arbitration agreement: (i) expressly permits class claims, (ii) expressly prohibits class claims, or (iii) is silent about class claims. Each is discussed below.

CLASS ARBITRATION WHERE THE ARBITRATION AGREEMENT EXPRESSLY PERMITS CLASS CLAIMS

Under both the AAA and JAMS rules, upon appointment, the arbitrator[2] "shall determine as a threshold matter . . . whether the applicable arbitration clause permits the arbitration to proceed on

behalf of or against a class." (AAA Supp. Rule 3; JAMS Rule 2.) This clause construction phase technically applies even where the arbitration clause clearly permits class arbitration. (As discussed below, this clause construction phase is primarily intended to apply where the arbitration clause is silent about class arbitration.) In a situation where the clause is clear, this phase would be handled quickly, perhaps based upon a stipulation of the parties.

Once the clause has been construed to permit class arbitration, the parties enter the class certification phase, much like they would in federal court litigation. Here, the arbitrator, like a federal court judge, determines whether the arbitration should proceed as a class action based upon the criteria enumerated in the respective AAA and JAMS rule "and any law or agreement of the parties that the arbitrator determines applies to the arbitration." (AAA Supp. Rule 4(a); JAMS Rule 3(a).)

The criteria in the AAA and JAMS rules closely track the criteria set forth in Fed. R. Civ. P. 23, although there are certain differences, deletions and additions in the AAA and JAMS rules. Below is the comparison of Federal Rule 23 to the AAA and JAMS rules:[3]

FRCP	*AAA SUPP. RULES*	*JAMS RULES*
23(a); Numerosity, etc.	4(a)(1-4); Law Choice	3(a)(1-4)
23(g)(1)(B); Counsel Adequate	4(a)(5)	—
—	4(a)(6) Common Agreement	—
23(b)(1-2); Inconsistent, Injunctive	—	3(b)(1-2)
23(b)(3); Predominance, Superiority	4(b)(1-4)	3(b)(3)
—	5(a) Partial Final Award	3(c)
23(c)(1)(B); Order Specifics	5(b) Attach Notice	—
—	5(c) No Exclusion	—
—	5(d) Stay	—
23(c)(1)(C); Amended Order	5(e)	—

23(c)(2)(B); Notice Given, Contents	6(a), (b)(1-6)	4 (1-6)
—	6(b)(7-8) Information, Communication	4 (7)
—	7 Final Award	5
23(e); Settlement	8	6

As noted above, the respective AAA and JAMS rules vest the arbitrator with discretion to determine what law applies to the class certification analysis. Thus, the parties' negotiated choice of law, particularly of procedural issues such as class determination, can have a major impact in the decision on class certification by the arbitrator. If the parties have not made a law choice, an arbitrator could safely apply the law developed by the Federal courts under Rule 23 because of its similarity to the AAA and JAMS rules.

As could be expected, before the arbitrator determines whether the arbitration can proceed as a class action, the parties would, as in federal court litigation, be given an opportunity to take discovery and have experts analyze the facts and criteria. Neither the AAA nor JAMS rules discuss that, however. Rather, that would be covered by the parties' arbitration agreement and/or the general commercial or employment arbitration rules that govern the proceeding, and which the AAA and JAMS class action rules supplement. (AAA Supp. Rule 1(a); JAMS Rule 1(a).) The usual format of briefing—claimant's motion for class certification accompanied by a memorandum, a response, and a reply in support – all supported by affidavits, deposition testimony, expert reports, and legal authority is the norm. Similarly, although the class action rules do not provide, it would be appropriate for the arbitrator to have a hearing on the class certification issues, even if it were just argument of counsel without live testimony. Post-hearing submissions, accompanied by a transcript of the hearing, could assist the arbitrator where issues remained unclear or unresolved as of the hearing.

Although both the AAA and JAMS rules contemplate a written decision by the arbitrator, there is a striking difference in the formality of the decision and the opportunity for immediate court review. Under the AAA Supplementary Rules, the arbitrator "shall" issue a "reasoned, partial final award" (called the "Class Determination Award") which must address each of the matters set forth in AAA Supplementary Rule 4 (AAA Supp. Rule 5(a).) Also, if the decision certifies a class, the

Class Determination Award must contain a definition of the class, an identification of the class representative(s) and counsel, and a designation of the class claims, issues or defenses. The Class Determination Award must also contain a copy of the proposed Notice of Class Determination (covered by AAA Supplementary Rule 6)[4], and specify the intended mode of delivery of the notice to the class members. (AAA Supp. Rule 5(b).) In addition, the Class Determination Award shall state "when and how members of the class may be excluded from the class arbitration," or, alternatively, reasons why it would be inappropriate to allow class members to request exclusion. (AAA Supp. Rule 5(c).) After the AAA arbitrator issues the Class Determination Award, he or she must stay all proceedings to permit either side to move to confirm or vacate the Class Determination Award in a court of competent jurisdiction. The stay must be for a period of at least 30 days, and the arbitrator has discretion to further extend that stay if judicial review has been sought and a decision is pending.

The JAMS Rule on the class action determination vests the arbitrator with substantially more discretion. (JAMS Rule 3(c).) The JAMS Rule does not require any form of interim award; does not require any expanded reasoning for the decision; does not require the inclusion of a proposed notice to the class; and does not require any stay of the proceedings pending judicial review. Rather, the JAMS Rule states that the determination "may be set forth in a partial final award subject to immediate court review." *Id.*

Thus, an AAA-administered class arbitration is more likely to have court involvement during the class certification process. While that may cause some delay in the arbitration proceeding, it also gives the parties comfort (if needed) that there is judicial oversight before the case gets to the merits. In contrast, under the JAMS Rules, if a partial final award is not issued, and immediate court review does not occur, judicial correction of an allegedly improper certification of a class action may not occur until after the merits are heard and resolved—in other words, after the parties have invested substantially more resources in the proceeding.[5] Both appeal routes arise under Rule 23.

Following a grant of class certification and notice to the class members, the matter would then proceed on the merits. Here also, like federal court class action litigation, any hearing would likely be preceded by extensive discovery and possibly motion practice. Again, those matters would be governed by the parties' arbitration agreement or the general commercial or employment rules governing the underlying case. The mechanics of the hearing on the merits are not covered by the class arbitration rules of either the AAA or JAMS.

However, the final resolution of the class arbitration, via decision on the merits, settlement, or dismissal are addressed in both the AAA and JAMS rules. (AAA Supp. Rules 7-8; JAMS Rules

5-6.) Under both, a decision on the merits shall be a "reasoned" final award. A reasoned award will be much less specific than an award containing findings of fact and conclusions of law. The parties' arbitration agreement may modify the rules to require a more detailed analysis. Otherwise, the extent and breadth of the final decision is left to the discretion of the arbitrator. If the matter is resolved by settlement, the arbitrator must approve the compromise after a hearing, but only where it is found that the resolution is fair, reasonable, and adequate. Class members may object to a proposed settlement. Like any final award in arbitration, either party may seek court review to vacate or confirm the decision on the merits.

CLASS ARBITRATION WHERE THE ARBITRATION AGREEMENT EXPRESSLY PROHIBITS CLASS CLAIMS

The AAA and JAMS take different approaches where the arbitration clause has an express waiver of class actions.

Implicit in the AAA Supplementary Rules is that the parties' arbitration agreement either expressly permits class arbitration or is silent about it. Indeed, the AAA's original Policy on Class Arbitrations, reaffirmed in February 2005, states that the AAA will not administer "demands for class arbitrations where the underlying agreement prohibits class claims, consolidation or joinder, unless an order of a court directs the parties to the underlying dispute to submit their dispute to an arbitrator or to the [AAA]." The AAA concluded that whether an arbitration agreement that prohibits class actions is enforceable is generally an issue for the courts, not an arbitrator, to decide, and the AAA will not intrude upon that territory that the courts may have reserved for themselves.

Under its revised March 2005 policy, JAMS, however, will accept for administration matters that have class action waivers, at least initially not enforcing the waiver clause. Rather, it will let the appointed arbitrator decide whether the prohibition is enforceable or should be stricken under applicable law. Thus, a JAMS arbitrator may proceed with the case, particularly where the bar is clearly unenforceable. If it is unclear whether the clause is unenforceable, JAMS would direct the plaintiff to court to seek a court decision (that either assesses the clause or redirects the matter back to the arbitrator for that ruling).

Thus, where court direction is required, the matter may not be referred to arbitration unless and until a court strikes or severs the class action bar from the arbitration agreement. Most often that requires the plaintiff to seek to void the class action waiver on grounds of unconscionability,

relying on FAA Section 2 or its state counterparts that permit a court to assess the validity of an arbitration agreement under state contract law.

Class action waivers can be valid and enforceable. There is no per se prohibition. Rather, the analysis and outcome depends upon the contents of the arbitration clause, how it arose in the parties' agreement, and the state law that applies to the analysis.

Nothing in the AAA or JAMS class action rules discusses the analysis of unconscionability of a class action waiver. Indeed, the issue of unconscionability often arises before the matter comes to the arbitrator.[6] Generally, a contract provision is unconscionable if the term is procedurally and/or substantively unconscionable. Here again, choice of law is important, as some states (*e.g.*, California) require proof of both procedural and substantive unconscionability, whereas other states (*e.g.*, Illinois) require proof of either but not both. *Discover Bank v. Superior Court of Los Angeles*, 36 Cal. 4th 148, 113 P. 3d 1100 (2005), on remand, 134 Cal. App. 4th 886 (2nd Dist. 2005), review den. 3/29/06; *Kinkel v. Cingular Wireless LLC*, 223 Ill. 2d 1, 857 N.E. 2d 250, 263 (2006).

It is beyond the scope of this article to discuss all aspects of an unconscionability analysis. Nonetheless, factors generally considered are whether the term is hidden or conspicuous; whether the contract was negotiated or an adhesion contract; the size of the claims; the relative costs of litigation and arbitration; whether the defendant would pay the arbitration fees and expenses; whether the claim is governed by a statute that has a fee-shifting provision; whether there are limits on discovery; the size of the class; whether the class procedure is necessary to vindicate substantive rights; and whether there was a widespread scheme to defraud.

If the court determines that the class action bar is unconscionable, the court may sever the clause but leave intact the agreement to arbitrate. The court may then refer the matter to arbitration. Alternatively, the court may strike the entire arbitration clause, forcing the matter to proceed as class action litigation in court. Severability may be the required remedy if the parties' agreement provides for that. Also, strong federal and state policy favoring arbitration could lead to the excising of the offending clause without nullifying the agreement to arbitrate. Notably, the severing of the class action bar then renders the arbitration clause silent on whether class arbitration is permitted. Under the AAA and JAMS rules, it may then be up to the arbitrator to determine whether the silent arbitration agreement permits class arbitration. That is discussed next.

CLASS ARBITRATION WHERE THE ARBITRATION AGREEMENT IS SILENT ABOUT CLASS CLAIMS

When the arbitration clause is silent about class action arbitration, the matter will not proceed before either the AAA or JAMS unless the arbitrator first determines as a threshold matter that the applicable arbitration clause "permits" the arbitration to proceed on behalf of or against the class. (AAA Supp. Rule 3; JAMS Rule 2.) Both AAA and JAMS rules arose in the wake of *Green Tree Financial Corp. v. Bazzle* (2003), where the Supreme Court addressed the issue of who decides "what kind of arbitration proceeding"—class action or not—the parties agreed to where the clause was silent about that. 539 U.S. at 452. Five of the justices accepted that the arbitrator, not the court, should make that decision, particularly where the parties' arbitration clause provided that "any dispute" would go to the arbitrator. 539 U.S. at 451, 453. In the wake of *Bazzle*, the AAA and JAMS decided that they would administer potential class action arbitrations where the arbitration clause was silent, provided that the arbitrator makes the initial determination (the AAA calls it the "Clause Construction Award") whether the arbitration clause permits class action arbitration.

The two rules differ in all other respects, as the AAA Supplementary Rule requires the arbitrator to issue "a reasoned, partial final award on the construction of the arbitration clause," and also requires the arbitrator to stay all proceedings following the issuance of the Clause Construction Award for a period of at least 30 days to permit any party to seek confirmation or vacatur of the award by a court of competent jurisdiction. JAMS Rule 2, like its Rule 3(c), gives the arbitrator discretion to issue a partial final award subject to immediate court review, and the JAMS Rule has no provision for a stay for either side to seek confirmation or vacatur.

What is meant by "permits" under the two rules may even be disputed. Indeed, "permits" has a wide range of meanings, giving both sides ammunition for their respective arguments. For example, in *Newman, et al. v. Checkrite California, Inc.*, 912 F. Supp. 1354, 1368 (E.D. CA. 1995), the court defined "permits" to mean derived from "some state statute which . . . authorizes or allows, in however general a fashion . . . ." See also, *Outdoor Systems, Inc. v. City of Lenexa, Kansas*, 67 F. Supp. 2d 1231, 1236 (D. KS. 1999), holding that "permitted" meant both allowed by a statute or expressly stated. Clearly though, the word "permits" means more than just expressly provided. "Permits" in the AAA and JAMS rules is well-chosen per *Bazzle*. 539 U.S. at 451, 454-455.

Procedurally, the threshold decision by the arbitrator will follow briefing and a hearing (usually just oral argument of counsel). Discovery may be allowed, particularly since issues of the parties' intent under the arbitration clause are at issue. Usually, though, the arbitration clauses arise

in wide-spread consumer or employment agreements, making it unlikely that discovery will reveal much about mutual intent.

The arbitrator's threshold determination should, at its core, apply state law principles to construe the silent clause. *Bazzle* at 450, 457-8. Thus, the arbitrator could consider or apply any of the following concepts that may support or undermine the "permits" argument: that a non-negotiated contract is construed against the drafter; that silence does not equate to consent; that an integration clause bars any interpretation that is not expressed; that a decision-maker cannot add terms to a contract; that arbitration clauses are to be construed liberally in order to promote arbitration; that "any and all claims" may be construed broadly; that the parties' objective intent is to be determined by the words used in the agreement; and whether there is an applicable statute that may amplify the parties' clause. Overall, the burden of proof is on the proponent of class arbitration to show that the clause permits the arbitration to proceed on behalf of or against the class. The outcome likely depends upon how carefully drafted the clause is and what the applicable law says.[7]

CONCLUSION

Class actions in arbitration is the new battlefront between businesses and consumers or employees. Rules have been prescribed to provide parties in arbitration with procedures that give each side an opportunity to protect their interests according to the terms of their contracts. The United States Supreme Court has clearly signaled that arbitrators, not the courts, will determine whether a silent arbitration agreement permits a matter to proceed as a class action in arbitration. Where the clause expressly permits class arbitration, or even where it is expressly barred (but is done so unconscionably), those matters also will or could end up in arbitration. Thus, it is likely that more class actions will be processed through arbitration.

ENDNOTES

1. The National Arbitration Forum has no special rules for class arbitration. Its Rule 19 on joinder and consolidation does not expressly refer to class actions but does permit an individual or entity that has the same arbitration agreement as the claimant and respondent to intervene in an arbitration if a common question of fact or law arises from the same or related transaction or occurrence, and such proceeding promotes fairness, efficiency or economy. On the other hand, Rule 19(a) states that the arbitrator "has no authority to issue an Order or Award binding any individual or Entity not a Party, unless that individual or Entity agrees or as required by applicable law."

   The Rules for Non-Administered Arbitration of the CPR International Institute for Conflict Prevention and Resolution also do not mention class actions and only briefly refer to consolidating arbitrations. Rule 9.3(a). Arbitration under the CPR Rules generally arises in business-to-business agreements, rendering it unlikely that large groups of employees or consumers would even be parties to a matter covered by the CPR Rules.

2. Both the AAA Supplementary Rules and JAMS Rules use the singular "arbitrator." Thus, a three-member panel will generally not exist in class arbitrations, although the parties could in their agreement modify the rules to have a larger panel.

3. "– " means that there is no parallel rule. Thus, the AAA Supplementary Rules have six features that Rule 23 does not, but the AAA has no corollary to Rule 23(b)(1-2). The JAMS Rules have three new features and three deletions compared to Rule 23. Notably, its rules follow Rule 23(b), enabling it to consider a broader range of class action claims than the AAA.

4. The contents of the notice and its communication to class members are virtually identical under both the AAA and JAMS rules. (AAA Supp. Rule 6; JAMS Rule 4.) They both require a plain and easily understood identification of the nature of the action; the definition of the class that is certified; the class claims, issues or defenses; how class members may enter an appearance through counsel and attend the hearings; how class members may request exclusion; the binding effect of a class judgment; and the identity and biographical information of the arbitrator, the class representative(s), and class counsel that have been approved to represent the class. Only the AAA adds an additional feature – the notice must also say how and to whom a class member may communicate about the class arbitration. Neither rule specifically states when the notice must be sent, although the AAA defers notice until after the expiration of any stay of the Class Determination Award.

5. Given the limited grounds for vacatur of an arbitration award under the Federal Arbitration Act ("FAA"), state arbitration acts, and even judicially-created grounds, it is questionable whether a court would vacate a class determination award. Although the breadth of review of an arbitration award by a court is beyond the scope of this article, mere errors of judgment or misapplication of the class certification criteria by the arbitrator would likely not subject the class certification decision to vacatur. Thus, as a practical matter, little may be gained by seeking vacatur of an adverse certification award. Of course, a losing claimant may be forced to seek vacatur if the case is to be preserved as a class action.

6. An unconscionability analysis may, however, be addressed and decided by an arbitrator where, for example, the parties' arbitration agreement contains a clear and unmistakable directive that the issue of enforceability of the arbitration clause is also to be decided by the arbitrator. Bazzle, 539 U.S. at 452. See also, Howsam v. Dean Witter Reynolds, Inc., 537 U.S. 79, 84, 123 S. Ct. 588 (2002), holding that procedural issues, including a waiver defense to arbitrability, are for the arbitrator; AAA Employment Arbitration Rule 6(a) empowering the arbitrator to decide issues of jurisdiction and the validity of the arbitration clause; JAMS Arbitration Rule 11(c) (same).

7. If class action arbitration is to be avoided, the drafting lessons are: it is risky for a business to (1) leave the arbitration clause silent, or (2) include a class action waiver that is hidden or not adopted by the consumer/employee in accordance with normal state contract rules.