

The Necessity of an “Opt-In” Approach to Class Arbitration

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In recent decades, as the federal policy favoring arbitration has fully emerged,¹ an increasing number of parties have been turning to arbitration as an expeditious and cost-effective alternative to court. Today, arbitration provisions can be found in a spectrum of contracts, everywhere from motion picture distribution agreements² to cell phone calling plans.³ The prevalence of arbitration agreements has spawned extensive commentary and a substantial body of case law on the feasibility and propriety of class arbitration.

Some commentators have argued that the complexity and formality of class-wide proceedings is antithetical to the premise of arbitration as a simplified and streamlined

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¹ See, e.g., *Buckeye Check Cashing, Inc. v. Cardegna*, 546 U.S. 440, 443 (2006) (“Section 2 [of the Federal Arbitration Act] embodies the national policy favoring arbitration and places arbitration agreements on equal footing with all other contracts.”); *Green Tree Fin. Corp.-Al. v. Randolph*, 531 U.S. 79, 91 (2000) (invalidating an arbitration agreement based on speculation “would undermine the ‘liberal federal policy favoring arbitration agreements. . .’”); *Gilmer v. Interstate/Johnson Lane Corp.*, 500 U.S. 20, 26 (1991) (applying the rule that “questions of arbitrability must be addressed with a healthy regard for the federal policy favoring arbitration”) (quoting *Moses H. Cone Memorial Hosp. v. Mercury Const. Corp.*, 460 U.S. 1, 24 (1983)); *Shearson/Am. Express, Inc. v. McMahon*, 482 U.S. 220, 226 (1987) (holding that the Federal Arbitration Act (“FAA”) “establishes a ‘federal policy favoring arbitration’” and a concomitant duty to enforce arbitration agreements, which “is not diminished when a party bound by an agreement raises a claim founded on statutory rights”) (quoting *Moses H. Cone Memorial Hosp.*, 460 U.S. at 24); *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*, 473 U.S. 614, 631 (1985) (citing “the emphatic federal policy in favor of arbitral dispute resolution”); *Southland Corp. v. Keating*, 465 U.S. 1, 10 (1984) (“In enacting § 2 of the [FAA], Congress declared a national policy favoring arbitration and withdrew the power of the states to require a judicial forum for the resolution of claims which the contracting parties agreed to resolve by arbitration.”); *Moses H. Cone Memorial Hosp.*, 460 U.S. at 24 (“Section 2 [of the FAA] is a congressional declaration of a liberal federal policy favoring arbitration agreements, notwithstanding any state substantive or procedural policies to the contrary.”).

² See, e.g., *Mediafiction S.p.A. v. Miramax Film Corp.*, No. B185953, 2006 WL 3307068 (Cal. Ct. App. Nov. 15, 2006).

³ See, e.g., *Scott v. Cingular Wireless*, 161 P.3d 1000 (Wash. 2007).

method of dispute resolution.⁴ In an evocative take on this inherent friction, one commentator has described class arbitration as “half fish and half fowl, and about as pretty as that image suggests.”⁵ The New Jersey Supreme Court, meanwhile, has suggested that arbitration may be fertile ground for developing an approach to class-wide proceedings that improves upon the class action lawsuit in its current form.⁶

The debate over the propriety and feasibility of class arbitration is not the subject of this article. It is merely a backdrop. This article sets aside the questions of propriety and feasibility in order to focus on the best approach to class arbitration. Specifically, this article explains why an “opt-in” approach to class arbitration is necessary both to ensure a capable resolution and to preserve the rights of prospective class members.

The article begins by discussing the background of class arbitration and recent developments in that area of the law.⁷ Next, the article briefly examines the “opt-out” approach to class action lawsuits as embodied by Rule 23 of the Federal Rules of Civil Procedure.⁸ Finally, the article concludes that an opt-out approach to class arbitration

⁴ See, e.g., Kirk D. Jensen, *Can Financial Institutions Be Required to Arbitrate on a Class-Wide Basis Notwithstanding Provisions That Prohibit Class Arbitration*, 122 BANKING L.J. 328, 329-30 (2005) (“Class arbitration is an attempt to combine the streamlined procedures of an informal dispute resolution mechanism with the complexity of resolving the individual claims of large numbers of individuals, in some cases tens of thousands or more.”).

⁵ Jensen, *supra* note 4, at 330 (quoting Eric Mogilnicki, *Courts Undermine Arbitration When They Grant Class Status*, AM. BANKER., Feb. 14, 2003, at 9).

⁶ See *Muhammad v. County Bank of Rehoboth Beach, Del.*, 912 A.2d 88, 102 (N.J. 2006) (“The drafters of arbitration agreements and forum rules, as well as the arbitrators themselves, may allow for the development of innovative class-arbitration procedures that address some of the perceived inadequacies with the current system.”); *but see*, *In re Rhone-Poulenc Rorer, Inc.*, 51 F.3d 1293, 1299-1300 (7th Cir. 1995), *cert. denied*, 516 U.S. 867 (1995).

⁷ See *infra* Section I.

⁸ See *infra* Section II.

creates significant difficulties that are fully remedied by an opt-in approach.⁹

I. The Historical Approach to Class Arbitration

Historically, most courts ascribed to the view that class arbitration is impermissible unless the arbitration agreement expressly provides for it.¹⁰ Only two jurisdictions deviated from this majority rule.¹¹ First, in a lawsuit brought by 7-Eleven franchisees against the owner of the franchise, the California Supreme Court relied on Rule 81(a)(6)(B) of the Federal Rules of Civil Procedure¹² in holding that a court may

⁹ See *infra* Sections III-IV.

¹⁰ See *Champ v. Siegel Trading Co.*, 55 F.3d 269, 277 (7th Cir. 1995) (“Since the parties’ arbitration agreement does not expressly provide for class arbitration, the district court correctly concluded that it was prohibited from reading such a procedure into these arbitration agreements.”); see also, *Dominium Austin Partners, L.L.C. v. Emerson*, 248 F.3d 720, 728-29 (8th Cir. 2001) (“[B]ecause the partnership agreements make no provision for arbitration as a class, the district court did not err by compelling appellants to submit their claims to arbitration as individuals.”); *Johnson v. West Suburban Bank*, 225 F.3d 366, 377 n. 4 (3rd Cir. 2000) (“This court has never addressed the question whether class actions can be pursued in arbitral forums, though it appears impossible to do so unless the arbitration agreement contemplates such a procedure.”); *Bischoff v. DirecTV, Inc.*, 180 F.Supp.2d 1097, 1108-09 (C.D. Cal. 2002) (“Consistent with the Seventh Circuit, the Central District of California has held that a district court cannot order arbitration to proceed on a class-wide basis unless the arbitration clause contains a provision for class-wide resolution of claims.”); *Gammara v. Thorp Consumer Discount Co.*, 828 F.Supp. 673, 674 (D. Minn. 1993) (“The Court must give effect to the agreement of the parties, and this arbitration agreement makes no provision for class treatment of disputes. Accordingly, the Court finds that it is without power to order this matter to proceed to arbitration as a class action.”).

¹¹ See *Keating v. Superior Court*, 645 P.2d 1192 (Cal. 1982), *cert. granted, rev’d in part*, *Southland Corp. v. Keating*, 465 U.S. 1 (1984); *Bazzle v. Green Tree Fin. Corp.*, 569 S.E.2d 349 (S.C. 2002), *cert. granted, vacated*, *Bazzle v. Green Tree Fin. Corp.*, 539 U.S. 444 (2003).

¹² This rule provides that the Federal Rules of Civil Procedure govern proceedings under the FAA unless the FAA provides otherwise. See Fed. R. Civ. P. 81(a)(6)(B). Since *Keating* was decided, several federal courts have clarified that Rule 81 applies only to judicial proceedings under the FAA and not to the arbitration proceeding itself. See, e.g., *Application of Deiuemar Compagnia Di Navigazione S.p.A. v. M/V Allegra*, 198 F.3d 473, 483 (4th Cir. 1999) (“Rule 81 simply does not apply with respect to the arbitration proceeding itself.”); *Champ*, 55 F.3d at 276 (“Rule 81(a)(3) only applies to *judicial* proceedings under the FAA.”); *Gov’t of U.K. v. Boeing Co.*, 998 F.2d 68, 73 (2nd Cir. 1993) (“Rule 81(a)(3) clearly does not import the Federal Rules of Civil Procedure to the private arbitration proceedings that underlie the Title 9 proceedings pending before a court.”).

order class arbitration even though the arbitration agreement is silent on the issue.¹³ In remanding the case to the trial court with instructions to decide the question of class certification, the Court acknowledged that “judicially ordered class-wide arbitration would entail a greater degree of judicial involvement than is normally associated with arbitration, ideally ‘a complete proceeding, without resort to court facilities.’”¹⁴

The other jurisdiction which deviated from the majority rule is South Carolina.¹⁵ In a case that would eventually reach the United States Supreme Court and ultimately change the landscape of class arbitration, the South Carolina Supreme Court held that “class-wide arbitration may be ordered when the arbitration agreement is silent if it would serve efficiency and equity, and would not result in prejudice.”¹⁶ In reaching its holding, the court relied largely on reasoning that would later guide a small minority of jurisdictions to conclude that express prohibitions on class arbitration are sometimes unenforceable.¹⁷

¹³ See *Keating*, 645 P.2d 1192. The Supreme Court granted certiorari in this case and reversed the court’s refusal to order arbitration of a claim brought under the California Franchise Investment Law. See *Southland Corp.*, 465 U.S. at 16-17. In reaching its decision, the Court expressly avoided the question of class arbitration. *Id.* at 17 (stating it would be inappropriate to decide “whether the [FAA] precludes a class action arbitration”).

¹⁴ *Keating*, 645 P.2d at 613 (quoting *East San Bernardino County Water Dist. v. City of San Bernardino*, 109 Cal. Rptr. 510, 515 (Cal. Ct. App. 1973)).

¹⁵ See *Bazzle*, 569 S.E.2d 349.

¹⁶ *Bazzle*, 569 S.E.2d at 360.

¹⁷ See *id.* at 360-61 (“If we enforced a mandatory, adhesive arbitration clause, but prohibited class actions in arbitration where the agreement is silent, the drafting party could effectively prevent class actions against it without having to say it was doing so in the agreement.... Under those circumstances, parties with nominal individual claims, but significant collective claims, would be left with no avenue for relief and the drafting party with no check on its abuses of the law.”).

A. The Bazzle Decision

In *Bazzle v. Green Tree Financial Corp.*,¹⁸ the case in which the South Carolina Supreme Court upheld a court order for class arbitration, the United States Supreme Court granted certiorari to consider whether court-ordered class arbitration is permissible under the Federal Arbitration Act (“FAA”).¹⁹ The Court’s decision in *Bazzle* would change the landscape of class arbitration by (1) casting doubt on the prevailing view that class arbitration is impermissible in the absence of express provision for such procedures, (2) leading some arbitration administrators to adopt rules for class arbitration, and (3) prompting parties to draft arbitration agreements that precisely address the permissibility of class arbitration.²⁰

In *Bazzle*, a group of homeowners sued Green Tree Financial Corp. (“Green Tree”), a commercial lender, alleging that Green Tree loaned them money without providing a legally required form that would have notified the homeowners of a right to choose their own attorney or insurance agent.²¹ Green Tree sought arbitration in accordance with the loan agreement, and based on a trial court order both compelling

¹⁸ 569 S.E.2d 349 (S.C. 2002).

¹⁹ See *Green Tree Financial Corp.*, 537 U.S. 1098.

²⁰ See *Bazzle*, 539 U.S. 444. Some commentators have argued that *Bazzle* has been misconstrued as an endorsement of class arbitration. See David S. Clancy & Matthew K. Stein, *An Uninvited Guest: Class Arbitration and the Federal Arbitration Act’s Legislative History*, 63 BUS. LAW. 55, 68 (2007) (“In [*Bazzle*], the U.S. Supreme Court did not explicitly validate class arbitration: the Court simply did not address the legal validity of class arbitration. Nor did the Supreme Court implicitly validate class arbitration.”); Imre S. Szalai, *The New ADR: Aggregate Dispute Resolution and Green Tree Financial Corp. V. Bazzle*, 41 CAL. W. L. REV. 1, 2 (2004) (“The Supreme Court’s *Bazzle* decision did not set forth binding precedent, contrary to the interpretations of various courts, the [American Arbitration Association], and arbitrators.”).

²¹ *Bazzle*, 539 U.S. at 448.

arbitration and certifying a class, arbitration proceeded on a class-wide basis.²² In total, the arbitrator awarded the homeowners \$26,883,660 in damages, costs, and attorney fees.²³

The trial court confirmed the award, and on appeal to the South Carolina Supreme Court, Green Tree argued that the trial court violated the FAA in ordering class arbitration because the arbitration agreement contained no provision for class arbitration and the FAA requires courts to enforce arbitration agreements in accordance with their terms.²⁴ The South Carolina Supreme Court rejected this argument based on its holding that the arbitration agreement was silent on and thus permitted class arbitration.²⁵

The United States Supreme Court granted certiorari.²⁶ A plurality of the Court held that the permissibility of class arbitration was a matter of contract interpretation and thus a question for the arbitrator rather than the court.²⁷ Accordingly, with Justice Stevens joining the plurality solely to effectuate a judgment, the Court reversed the judgment of the South Carolina Supreme Court and remanded the matter to the arbitrator with instructions to decide whether the arbitration agreement permitted class arbitration.²⁸

²² *Id.* For sake of precision, it should be pointed out that the case originally consisted of two separate lawsuits.

²³ *Id.* at 354.

²⁴ *See Bazzle*, 569 S.E.2d at 356; *see also* 9 U.S.C.A. § 4 (providing that “the court shall make an order directing the parties to proceed to arbitration in accordance with the terms of the agreement”).

²⁵ *Bazzle*, 569 S.E.2d at 360.

²⁶ *See Bazzle*, 537 U.S. 1098.

²⁷ *Bazzle*, 539 U.S. at 451-53.

²⁸ *Id.* at 454.

B. Class Waivers

In wake of the *Bazzle* decision, it is increasingly common for arbitration agreements to include an express prohibition on class-wide proceedings.²⁹ These prohibitions are commonly referred to as “class action waivers” or simply “class waivers.” The increased incidence of class waivers has given rise to extensive litigation over enforceability of both the waiver and the underlying arbitration agreement.

Class waivers have been upheld in the vast majority of cases and jurisdictions.³⁰ Nevertheless, a small number of jurisdictions have ruled that class waivers are sometimes unenforceable. These rulings have been based on three distinct but related theories. Most frequently, courts have cited the doctrine of unconscionability – a state law doctrine – as a basis for invalidating class waivers under circumstances where the waiver allegedly functions as an exculpatory clause.³¹

²⁹ During oral arguments in *Bazzle*, Justice Stevens anticipated this response. Specifically, he inquired of counsel: “Does this case have any future significance, because isn’t it fairly clear that all the arbitration agreements in the future will prohibit class actions?” Transcript of Oral Argument at 55, *Green Tree Financial Corp. v. Bazzle*, 539 U.S. 444 (No. 02-634), available at 2003 WL 1989562.

³⁰ See, e.g., *Doyle v. Finance America, LLC*, 918 A.2d 1266, 1271 n. 6 (Md. Ct. Spec. App. 2007) (“Although a minority of jurisdictions take the position that “no-class-action” provisions are unenforceable, Maryland stands firm in the majority.”); *Tillman v. Commercial Credit Loans, Inc.*, 629 S.E.2d 865, 873 (N.C. Ct. App. 2006) (pointing out that the trial court’s refusal to enforce a class waiver “is contrary to the great majority of federal and state courts that have examined and ruled upon this issue”).

³¹ See, e.g., *Discover Bank v. Superior Court*, 113 P.3d 1100, 1108 (Cal. 2005) (“[C]lass action waivers found in such contracts may also be substantively unconscionable inasmuch as they may operate effectively as exculpatory contract clauses that are contrary to public policy.”); *Kinkel v. Cingular Wireless LLC*, 857 N.E.2d 250, 274 (Ill. 2006) (“Cingular similarly seeks to insulate itself from liability to a potential class of customers by enforcing a class action waiver in its standard service agreement. We find that under the circumstances of this case, the class action waiver is unconscionable and unenforceable.”); *Muhammad*, 912 A.2d 88, 100 (N.J. 2006) (“[C]lass-action waivers can functionally exculpate wrongful conduct by reducing the possibility of attracting competent counsel to advance the cause of action.”); *Scott v. Cingular Wireless*, 161 P.3d 1000, 1008 (Wash. 2007) (“[T]his class action waiver effectively prevents one party to the contract, the consumer, from pursuing valid claims, effectively exculpating the drafter from potential liability for small claims, no matter how widespread.”); but see *Iberia Credit Bureau, Inc. v. Cingular Wireless LLC*, 379 F.3d 159, 174 (5th Cir. 2004) (“As the Supreme Court has explained, the fact that certain litigation devices may not be available in an arbitration [e.g., class-wide proceedings] is part and

More recently, two appellate courts have cited public policy as a basis for refusing to enforce class waivers in some circumstances.³² Lastly, at least two federal courts have refused to enforce class waivers by invoking a principle derived from the federal law of arbitrability³³ – namely, the principle that federal statutory claims are arbitrable, but only if the claimant may effectively vindicate their statutory rights in the arbitral forum.³⁴

II. Paths to Class Arbitration

There are now essentially three paths to class arbitration. First, class arbitration may occur if the parties' arbitration agreement expressly provides for class arbitration. Second, under *Bazze*, class arbitration may occur if (1) the parties' arbitration agreement is silent on the permissibility of class arbitration, (2) the applicable arbitration rules authorize the arbitrator to decide whether the arbitration agreement permits class arbitration,³⁵ and (3) the arbitrator construes the agreement to permit class arbitration.³⁶ Third, even if the arbitration agreement contains a class waiver, class arbitration may

parcel of arbitration's ability to offer 'simplicity, informality, and expedition,' characteristics that generally make arbitration an attractive vehicle for the resolution of low-value claims.')

³² See *Gentry v. Superior Court*, 64 Cal. Rptr. 3d 773, 790, 165 P.3d 556 (Cal. 2007) (holding that class waiver would be unenforceable on public policy grounds if "class arbitration would be a significantly more effective means than individual arbitration actions of vindicating the right to overtime pay of the group of employees whose rights to such pay have been allegedly violated"); *S.D.S. Autos, Inc. v. Chrzanowski*, No. 1D06-4293, 2007 WL 4145222 (Fla. Dist. Ct. App. Nov. 26, 2007).

³³ See *Kristian v. Comcast Corp.*, 446 F.3d 25, 63-64 (1st Cir. 2006) (distinguishing "a vindication of statutory rights analysis" from the doctrine of unconscionability); *Wong v. T-Mobile USA, Inc.*, No. 05-73922, 2006 WL 2042512 (E.D. Mich. July 20, 2006).

³⁴ See *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*, 473 U.S. 614, 637 (1985).

³⁵ See, e.g., AAA Supplementary Rules for Class Arbitrations R. 3 ("Upon appointment, the arbitrator shall determine as a threshold matter, in a reasoned, partial final award on the construction of the arbitration clause, whether the applicable arbitration clause permits the arbitration to proceed on behalf of or against a class (the 'Clause Construction Award')."), available at <http://www.adr.org/sp.asp?id=21936>; JAMS Class Action Procedures Rule 2 ("Once appointed, the Arbitrator shall determine as a threshold matter whether the applicable arbitration clause permits the arbitration to proceed on behalf of or against a class."), available at http://www.jamsadr.com/rules/class_action.asp.

³⁶ 539 U.S. 444 (2003).

occur if a court rules that the class waiver is unenforceable and severs it from the arbitration agreement.³⁷

The prospect of class arbitration calls for inquiry into the proper approach. Arbitration fundamentally differs from litigation, so the Rule 23 approach to class action lawsuits can not be imported wholesale into the arbitral forum. Instead, there must be a model of class arbitration which accounts for the unique aspects of arbitration and the body of law which governs it. This article now turns to one facet of that model and explains why class arbitration must follow an “opt-in” approach rather than an “opt-out” approach.

Rule 23 and the “Opt-Out” Approach

Rule 23 of the Federal Rules of Civil Procedure prescribes an “opt-out” approach for class action lawsuits premised on the existence of class-wide questions of law or fact (i.e., for Rule 23(b)(3) class actions).³⁸ Under an opt-out approach to class-wide proceedings, prospective class members must affirmatively “opt out” of the class, or they are bound by the ultimate judgment – whether adverse or favorable – even if they had no actual notice of the proceeding.

More specifically, when a Rule 23(b)(3) class is certified, the court issues an order describing the class, and every person who falls within that description is bound by the ultimate judgment or settlement unless they have exercised their right to opt out of the

³⁷ See, e.g., *Skirchak v. Dynamics Research Corp.*, 508 F.3d 49, 63 (1st Cir. 2007).

³⁸ See Fed. R. Civ. P. 23(c)(3)(B).

class.³⁹ This result holds true regardless of whether the affected class member received notice of the proceeding or their opt-out right because Rule 23(c)(2)(B) only requires “the best notice that is practicable under the circumstances.”⁴⁰

The opt-out approach raises due process concerns insofar as a person’s right to recovery may be decided by a legal proceeding in which they did not participate, of which they had no knowledge, and to which they did not consent. The Supreme Court addressed these concerns in *Phillips Petroleum Co. v. Shutts*.⁴¹ In that case, a class action defendant argued that a Kansas court could not exercise personal jurisdiction over out-of-state class members who did not affirmatively elect to participate.⁴² The Court rejected this argument on the ground that absent class members are not subject to the same burdens as out-of-state defendants because absent class members are “not haled anywhere to defend themselves upon pain of default judgment.”⁴³

Moreover, the Court stated that the named plaintiffs and presiding court protect the interests of absent class members.⁴⁴ In making this assertion, the Court pointed out that class action procedures generally require court approval of any compromise or dismissal.⁴⁵ Based on that reasoning, the Court held that due process requirements are satisfied so long as absent class members receive “a fully descriptive notice” advising

³⁹ *Id.*

⁴⁰ *Id.*

⁴¹ 472 U.S. 797 (1985).

⁴² *Id.* at 806.

⁴³ *Id.* at 809.

⁴⁴ *Id.* (“The court and named plaintiffs protect his interests.”)

⁴⁵ *Id.* at 810.

them of their right to opt out of the class.⁴⁶

III. Problems with “Opt-Out” Approach to Class Arbitration

An “opt-out” approach is incongruous with class arbitration for several reasons. First, an opt-out approach does not satisfy fundamental fairness requirements as embodied by the Due Process Clause or set forth in state laws governing arbitration. Second, an opt-out approach deprives absent class members of contractual rights arising under their respective arbitration agreements. Third, an opt-out approach creates a substantial risk that the arbitration will not produce a capable resolution because of noncompliance with statutory notice requirements and individualized questions of award validity. Fourth, an opt-out approach could deprive the arbitrator’s award of *res judicata* effect. Fifth, an opt-out approach subjects the arbitrator to reprisals by dissatisfied class members because it affords them an avenue for arguing that arbitral immunity does not apply.

A. Fundamental Fairness

Ordinarily, due process requirements do not apply to contractual arbitration because there is no state action.⁴⁷ However, it remains an open question whether due process requirements apply to class arbitration, either because of the widespread impact

⁴⁶ *Id.* at 812.

⁴⁷ See Sarah Rudolph Cole & E. Gary Spitko, *Arbitration and the Batson Principle*, 38 GA. L. REV. 1145, 1161 (2004), and cases cited therein.

of the proceedings or by virtue of the judiciary playing an increased role.⁴⁸ In fact, both of the pre-*Bazzle* decisions authorizing class arbitration operated on the assumption that due process protections would apply.⁴⁹

Even if due process requirements do not apply to class arbitration, the parties are still entitled to a “fundamentally fair” hearing. This fundamental fairness requirement may arise from federal or state law. Federal law requires fundamental fairness insofar as several federal courts have recognized “fundamental unfairness” as either a statutory or common law basis for vacating an arbitration award.⁵⁰ Similarly, most states have enacted arbitration statutes that embody the requirement of fundamental fairness.⁵¹

Regardless of whether the fundamental fairness requirement arises from statute, common law, or the Due Process Clause, the requirement does not allow for an opt-out

⁴⁸ One commentator has argued that due process requirements should apply to at least some forms of class arbitration because of the judiciary’s increased involvement. See Carole J. Buckner, *Due Process in Class Arbitration*, 58 FLA. L. REV. 185 (2006). This argument has added force where the court invalidates a class action waiver and thereby dictates the nature of the proceeding.

⁴⁹ See *Keating*, 645 P.2d at 1209 (“The court would have to make initial determinations regarding certification and notice to the class, and if classwide arbitration proceeds it may be called upon to exercise a measure of external supervision in order to safeguard the rights of absent class members to adequate representation and in the event of dismissal or settlement.”); *Bazzle*, 569 S.E.2d at 362 (stating that “protection of the due process rights of absent class members is an essential component in all class actions, and one which may necessitate particular attention in class-wide arbitrations”).

⁵⁰ See *P & P Indus., Inc. v. Sutter Corp.*, 179 F.3d 861, 870 (10th Cir. 1999) (“In addition to the[] statutory grounds for vacation, courts have on occasion vacated arbitration awards which violate public policy, were based on a manifest disregard of the law, or were arrived at without a fundamentally fair hearing.”) (citing *Denver & Rio Grande Western R.R. Co. v. Union Pac. R.R. Co.*, 119 F.3d 847, 849 (10th Cir. 1997)); *Tempo Shain Corp. v. Bertek, Inc.*, 120 F.3d 16, 20 (2nd Cir. 1997) (“Courts have interpreted section 10(a)(3) to mean that except where fundamental fairness is violated, arbitration determinations will not be opened up to evidentiary review.”); *In re Trans Chemical Ltd.*, 978 F.Supp. 266 (S.D. Tex. 1997), *aff’d*, 161 F.3d 314 (5th Cir. 1998) (“In reviewing an arbitration award the court asks whether the arbitration proceedings were ‘fundamentally unfair.’”) (citing *Gulf Coast Indus. Workers Union v. Exxon Co.*, 70 F.3d 847, 850 (5th Cir. 1995)); see also *Bowles Fin. Group, Inc. v. Stifel, Nicolaus & Co.*, 22 F.3d 1010, 1012-13 (10th Cir. 1994) (“Courts have created a basic requirement that an arbitrator must grant the parties a fundamentally fair hearing, expressing the requirement in various forms.”).

⁵¹ See, e.g., CAL. CIV. PROC. CODE § 1282.2 (West 2007); FLA. STAT. ANN. § 682.06 (West 2003); MINN. STAT. § 572.12 (2000); N.Y. C.P.L.R. 7506 (McKinney 1998); see also *In re Arbitration of Cincinnati Ins. Co. v. Tyco Fire Prods.*, No. A06-1264, 2007 WL 1248173, at *5 (Minn. App. May 1, 2007) (referring to “the due process requirements in Minn. Stat. § 572.12”).

approach to class arbitration because the *sine qua non* of fundamental fairness is notice, and in the absence of an affirmative election to participate, there is no means of assuring that absent class members received notice of the proceeding.

The Supreme Court’s endorsement of the opt-out approach to class action lawsuits does not mitigate this concern. First and foremost, in endorsing the opt-out approach, the Court relied on the presiding court serving as guardian of the rights and interests of absent class members.⁵² In class arbitration, the court is not present to play the role of guardian, and judicial review of arbitration awards is far too narrow for a court to play this role on the back end.⁵³

Moreover, as the body charged with interpreting the Constitution, the Court may construe the Due Process Clause in a manner that accommodates the policy considerations underlying an opt-out approach to class action lawsuits. By contrast, fundamental fairness requirements set forth in the FAA and state arbitration acts are a legislative pronouncement. Neither court nor arbitrator has authority to dispense with these express statutory requirements in favor of judicially crafted policy considerations.

Finally, the policy considerations which guided the Court’s endorsement of the opt-out approach do not apply to class arbitration. Specifically, the Court explained: “[W]e do not think that the Constitution requires the State to sacrifice the obvious advantage in *judicial efficiency* resulting from the ‘opt out’ approach for the protection of

⁵² See *Phillips Petroleum*, 472 U.S. at 809-10.

⁵³ The standard of review has been described as “among the narrowest known to the law.” *ARW Exploration Corp. v. Aguirre*, 45 F.3d 1455, 1462 (10th Cir. 1995) (quoting *Litvak Packing Co. v. United Food & Commercial Workers, Local Union No. 7*, 886 F.2d 275, 276 (10th Cir. 1989)).

the *rara avis* portrayed by petitioner.”⁵⁴ Thus, the governmental interest in judicial efficiency does not apply to class arbitration because arbitration is privately administered, and fundamental fairness requirements (especially those arising from the Constitution) should not yield to the private interests of the respondent, class counsel, or the arbitrator.

B. Contractual Rights

The contractual rights of absent class members also render the opt-out approach unsuitable for class arbitration. In addition to their right to fundamental fairness, parties to an arbitration agreement typically enjoy important contractual rights that attend the arbitral process. Most notably, parties to an arbitration agreement generally have a right to participate in arbitrator selection. In his dissenting opinion in *Bazzle*, Chief Justice Rehnquist highlighted the importance of this right in stating that “[j]ust as fundamental to the agreement of the parties as *what* is submitted to the arbitrator is to *whom* it is submitted.”⁵⁵

An opt-out approach to class arbitration would deprive absent class members of this important contractual right by excluding them from the process of arbitrator selection but including them within the class without any indication that they have elected to waive this right. This interference with the contractual rights of absent class members has the potential to spawn satellite litigation in the form of breach of contract claims by absent class members who are dissatisfied with the outcome of the arbitration.

⁵⁴ *Phillips Petroleum*, 472 U.S. at 814 (emphasis added).

⁵⁵ *Bazzle*, 539 U.S. at 456 (Rehnquist, C.J., dissenting).

C. Award Confirmation

An opt-out approach to class arbitration creates a risk that there will be no capable resolution of the dispute because noncompliance with statutory notice requirements lays the groundwork for challenging a class arbitration award. As previously discussed, most states have enacted arbitration statutes that expressly require a specified form of individual notice of an arbitration proceeding.⁵⁶ Noncompliance with these notice requirements can be deemed a denial of fundamental fairness and thus provide a basis for vacating the award.⁵⁷

Moreover, there are statutory notice requirements that apply to the confirmation proceeding itself. For instance, when a party applies for confirmation of an arbitration award pursuant to the FAA, the party must serve notice of the application on the adverse party.⁵⁸ State arbitration statutes generally have similar notice requirements for confirmation proceedings.⁵⁹ Courts do not have authority to dispense with these notice requirements unless the parties have agreed upon an alternate form of notice.

Not only are the statutory notice requirements an obstacle to confirmation, an absent class member dissatisfied with the outcome could argue that the arbitrator exceeded their powers by issuing an award that determined the rights of the absent class

⁵⁶ See statutes cited *supra* note 51.

⁵⁷ See cases cited *supra* note 50; see also *Konkar Maritime Enters., S.A. v. Compagnie Belge D’Affretement*, 668 F.Supp. 267, 271 (S.D.N.Y. 1987) (“In the cited cases, vacatur of the award was justified because the lack of notice or denial of an opportunity to be heard involved the merits of the controversy.”); *Tyco Fire Prods.*, 2007 WL 1248173, at *5; *PPX Enters., Inc. v. Musicali*, 366 N.E.2d 1341, 1342 (N.Y. 1977) (holding proper notice not given and therefore vacating the award).

⁵⁸ 9 U.S.C. § 9 (2000) (“Notice of the application shall be served upon the adverse party, and thereupon the court shall have jurisdiction of such party as though he had appeared generally in the proceeding.”).

⁵⁹ See, e.g., CAL. CIV. PROC. CODE. § 120.4 (West 2007); FLA. STAT. ANN. § 682.17 (WEST 2003); MINN. STAT. § 572.23 (2000).

members who never consented to participate in the proceeding. This argument would have added merit if the arbitration agreement required a form of notice that was never provided or gave both parties a right to participate in arbitrator selection.

If a party succeeded in challenging an award on this basis, the consequences would be far-reaching because an arbitrator exceeding their powers is ground for vacating an award, not modifying it.⁶⁰ Accordingly, if the arbitrator in a class arbitration issued a single, comprehensive award, the entire process would be undone by a successful argument that the arbitrator exceeded their powers in authorizing a lesser form of notice or in depriving absent class members of a contractual right to participate in arbitrator selection.

Moreover, even if the award were confirmed, the resultant judgment would not necessarily preclude duplicative claims by absent class members because the validity of the underlying award is wholly contingent on the existence of a valid arbitration agreement, and this predicate question is predominantly an individual matter. For example, arbitration agreements are frequently challenged on the basis of unconscionability, which is a case-by-case inquiry with variant requirements depending on the jurisdiction.⁶¹

⁶⁰ See 9 U.S.C. §§ 10-11 (2000); *see also* Carroll v. Ferro, 633 S.E.2d 708, 710 (N.C. Ct. App. 2006) (“[T]he trial court based its ruling on its determination that the arbitrator ‘exceeded or imperfectly executed his powers and authority’ in making his award. This is a ground for vacating an award under 9 U.S.C. § 10 or N.C. Gen.Stat. § 1-567.13 (2002), this is not a ground for modifying or correcting an award.”).

⁶¹ The Ninth Circuit Court of Appeals recently affirmed an order denying certification of a nationwide class action because the enforceability of the arbitration agreement varied by jurisdiction. *See* Lozano v. AT & T Wireless Services, Inc., 504 F.3d 718, 728 (9th Cir. 2000).

The following hypothetical illustrates the predicament. Assume that assistant managers at Kwik-E-Mart are required to enter into an arbitration agreement that only requires the employee to submit their claims to arbitration. The arbitration agreement is silent on the permissibility of class-wide proceedings, and an assistant manager in Texas files a demand for class arbitration, seeking overtime pay under the Fair Labor Standards Act.

The arbitrator certifies a nationwide class using an opt-out approach, and in the end, the arbitrator enters an award in favor of Kwik-E-Mart, which is confirmed by a federal court in Texas. Is an assistant manager at Kwik-E-Mart in California bound by the award even though the lack of mutuality renders the arbitration agreement unconscionable and therefore unenforceable under California law?⁶² Or could the assistant manager seek relief from the court order confirming the award pursuant to Rule 60(b)(6) of the Federal Rules of Civil Procedure? These are among the thorny questions that attend an opt-out approach to class arbitration.

D. Res Judicata Effect

In light of the issues previously discussed, an opt-out approach could deprive the award of its res judicata effect on absent class members, especially if the award is based on a class-wide settlement. Even class action settlements approved by a court in

⁶² See *Armendariz v. Found. Health Psychcare Servs., Inc.*, 6 P.3d 669, 692 (Cal. 2000) (“[I]t is unfairly one-sided for an employer with superior bargaining power to impose arbitration on the employee as plaintiff but not to accept such limitations when it seeks to prosecute a claim against the employee, without at least some reasonable justification for such one-sidedness based on ‘business realities.’”).

accordance with Rule 23 have come under collateral attack by absent class members.⁶³

Those cases have established a rule that a court-approved class action settlement is entitled to full faith and credit only if the presiding court adopted procedures to safeguard the rights of absent class members, including sufficient notice and the right to adequate representation.⁶⁴

In light of this rule, the res judicata effect of a class arbitration award is contingent on the implementation of procedures that safeguard the rights of absent class members. Since there is no right of appeal in arbitration, those procedures must go beyond Rule 23 in safeguarding the rights of absent class members in order to ensure res judicata effect. An opt-out approach, by simply mirroring Rule 23, does not afford the protection necessary to offset the absence of any appeal and thereby fails to ensure that the award will have res judicata effect.

E. Arbitral Immunity

An opt-out approach to class arbitration is also problematic for the arbitrator because it exposes the arbitrator to reprisals by absent class members who are dissatisfied with the outcome. Ordinarily, the doctrine of arbitral immunity guards against such

⁶³ See, e.g., *Epstein v. MCA, Inc.*, 179 F.3d 641 (9th Cir. 1999); *Nottingham Partners v. Trans-Lux Corp.*, 925 F.2d 29 (1st Cir. 1991).

⁶⁴ See *Nottingham Partners*, 925 F.2d at 33 (“[A] court-approved settlement containing a release may be applied against a class member who is not a representative member, even if that member objects to the settlement, so long as acceptable procedural safeguards have been employed.”); see also *Epstein*, 179 F.3d at 648 (“[T]he absent class members’ due process right to adequate representation is protected not by collateral review, but by the certifying court initially, and thereafter by appeal within the state system and by direct review in the United States Supreme Court.”); *Hospitality Mgmt. Assocs., Inc. v. Shell Oil Co.*, 591 S.E.2d 611, 619 (S.C. 2004) (concurring with the Ninth Circuit’s view that “due process requires that an absent class member’s rights are protected by the adoption and utilization of appropriate procedures by the certifying court...”).

reprisals by immunizing the arbitrator from liability for acts performed within the scope of the arbitration.⁶⁵ However, the doctrine of arbitral immunity does not protect an arbitrator who has acted in “clear absence” of jurisdiction.⁶⁶

In the case of an opt-out approach to class arbitration, absent class members would have a basis for arguing that the arbitrator acted in “clear absence” of jurisdiction. For example, if the arbitration agreement gave both parties a right to participate in arbitrator selection, absent class members could claim that the arbitrator is liable for tortious interference with contract while arguing that the “clear absence” of jurisdiction takes the dispute outside the doctrine of arbitral immunity.

F. Cumulative Effect

Each of these factors, standing alone, is a compelling reason to reject an opt-in approach to class arbitration, but it is the cumulative effect of these factors which renders the opt-out approach completely unworkable. Moreover, in light of these various factors, an opt-in approach best protects everyone’s interests. First, for unnamed class members, an opt-in approach preserves their right to fundamental fairness. Second, for class counsel and the respondent, an opt-in approach ensures the validity of the award. And third, for arbitrators, an opt-in approach guarantees arbitral immunity.

⁶⁵ See *Austern v. Chicago Bd. Options Exch., Inc.*, 898 F.2d 882, 886 (2nd Cir. 1990).

⁶⁶ See *New England Cleaning Servs., Inc. v. American Arbitration Ass’n*, 199 F.3d 542, 545 (1st Cir. 1999); see also *In’l Medical Group, Inc. v. American Arbitration Ass’n*, 312 F.3d 833, 844 (7th Cir. 2002) (leaving open the question of whether there is a cause of action for wrongful exercise of jurisdiction).

IV. Conclusion

An “opt-in” approach to class arbitration is necessary both to ensure a capable resolution and to preserve the rights of prospective class members. An “opt-out” approach to class arbitration raises several difficulties concerning the rights of absent class members, the enforceability of the award, and the availability of arbitral immunity. An opt-in approach to class arbitration resolves those difficulties by ensuring that everyone bound by the award and any resultant judgment has affirmatively chosen to participate.

First, absent class members cannot claim they were deprived of fundamental fairness because the act of opting in definitively proves actual notice. Second, absent class members cannot claim they were deprived of any contractual rights under the arbitration agreement because they effectively waived those rights by opting in. Third, absent class members dissatisfied with the outcome cannot challenge the validity of their arbitration agreement because they consented to the arbitration post-dispute. Fourth, by requiring their consent to participate, an opt-in approach affords heightened protection to absent class members and thereby guards against collateral attack. Lastly, the availability of arbitral immunity is no longer in doubt because the absent class members clearly consented to the arbitrator’s exercise of jurisdiction. For those reasons, class arbitration must follow an opt-in approach.