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# Ethical Problems in Class Arbitration

Andrew Powell\* and Richard A. Bales\*\*

## I. INTRODUCTION

Many types of agreements contain arbitration clauses.<sup>1</sup> With the growing trend favoring arbitration in disputes,<sup>2</sup> a newer fashion of arbitration formed — class arbitration.<sup>3</sup> While class arbitration is widely popular and has been exercised in multiple disputes over the last eight years, the Supreme Court of the United States recently restricted the availability of class arbitration claims in *AT&T Mobility v. Concepcion*.<sup>4</sup> In light of the Supreme Court's ruling in *Concepcion*, there is a strong possibility that Congress will amend the Federal Arbitration Act to nullify the holding.<sup>5</sup> Regardless of whether the Supreme Court came to the correct conclusion in *Concepcion*, the holding presents the perfect opportunity for Congress to also address the ethical issues in class arbitration.<sup>6</sup>

This article examines two significant conflicts of interest that arise in class arbitration<sup>7</sup> in six parts. Part II provides background on the recent evolution of class arbitration, explaining how the Supreme Court had decided several cases involving class arbitration but has not explicitly ruled that class actions are either permitted or forbidden.<sup>8</sup> Meanwhile, class-action cases continued to be arbitrated — at least until *Concepcion* — without consideration of the ethical issues discussed in this article. Parts III and IV describe the conflicts of interest in detail, provide illustrative examples, and contrasts the lack of protection for absent members in class arbitration with the protection for absent class members in class-action litigation provided by Rule 23 of the Federal Rules of Civil Procedure (Rule 23).<sup>9</sup>

Part III discusses the conflicts of interest that could arise at the beginning of class arbitration. In class arbitration, the arbitrator selects lead counsel to represent

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1. See, e.g., *Hill v. Gateway 2000, Inc.*, 105 F.3d 1147 (7th Cir. 1997) (holding a shrink wrap arbitration clause found inside the box of a new computer valid); see also National Basketball Players Association Collective Bargaining Agreement, art. XXXI, <http://www.nbpa.org/sites/default/files/ARTICLE%20XXXI.pdf> (last visited Sept. 16, 2011) (17 page section in the CBA establishing arbitration procedures for disputes arising from the CBA).

2. See *id.*

3. Class arbitration was first recognized by the United States Supreme Court beginning in 2003. See *Green Tree Fin. Corp. v. Bazzle*, 539 U.S. 444, 455 (2003).

4. 131 S. Ct. 1740 (2011).

5. Over 25 briefs were filed in *Concepcion*. Seven states and the District of Columbia all filed amicus briefs in support of the consumers.

6. See Thomas A. Doyle, *Protecting Nonparty Class Members in Class Arbitrations*, 25 A.B.A. J. LAB. & EMP. L. 25 (2009).

7. *Id.*

8. See discussion *infra* Part II.

9. See discussion *infra* Parts III-IV.

the class as a whole,<sup>10</sup> just as a judge would in traditional class-action litigation.<sup>11</sup> Whereas Rule 23 sets criteria for judges to selecting class counsel in litigation, arbitrators are not bound by the Rule 23 criteria for selecting class counsel. Therefore, there is no standard to keep arbitrators neutral and their counsel selection decisions unbiased from financial and social influence. An attorney's selection and payment of fees to an arbitrator, followed almost immediately by the arbitrator's selection of that attorney as lead counsel, creates a strong appearance of partiality.

Part IV discusses conflicts of interest that arise at the end of class arbitration. In class arbitration, the arbitrator must make an award or approve a settlement between the parties and ensure that the counsel adequately represents the class as a whole<sup>12</sup>—again, just as a judge would in class-action litigation.<sup>13</sup> In class arbitration, however, the arbitrator is initially selected by class counsel, and likely has been receiving payment for his or her services since the onset of the proceedings. This creates a strong financial incentive for the arbitrator to be more concerned with the interests of class counsel than with the interests of absent class members. The problem is exacerbated by the fact that arbitrators, unlike judges, are not bound by Rule 23's criteria for scrutinizing settlements to ensure that absent class members receive a fair deal. Additionally, there is little chance that misconduct on the part of the arbitrator will ever be discovered in light of the fact that judicial review of arbitration awards is extremely limited.

Part V of this article argues that if and when Congress amends the Federal Arbitration Act to statutorily permit class arbitration in light of *Concepcion*, a fully developed statute should be enacted to permit limited judicial supervision of the process of selecting class arbitrators and the process of issuing a class award or approving a class settlement.<sup>14</sup> Doing so will allow Congress to eliminate the conflicts of interest while retaining the benefits of class arbitration. Part VI concludes.

## II. BACKGROUND

Class arbitration is a relatively new field in the world of alternative dispute resolution.<sup>15</sup> It is a mix of two efficiency mechanisms in dispute resolution—class actions that allow the joining of multiple parties who have suffered similar injuries (usually by the same defendant) in a financially feasible fashion;<sup>16</sup> and arbitration, which offers binding results and a plethora of advantages over litigation.<sup>17</sup>

Some advantages of arbitration over conventional litigation include the accelerated nature of arbitration proceedings, lowered expenses, the relaxation

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10. See discussion *infra* Part III.B.2.

11. See FED. R. CIV. P. 23(g)(2).

12. See discussion *infra* Part IV.B.2.

13. See FED. R. CIV. P. 23(e).

14. See discussion *infra* Part V.

15. The American Arbitration Association did not formally recognize class arbitration until 2003. See Am. Arbitration Ass'n, Supplementary Rules for Class Arbitrations (Oct. 8, 2003), <http://www.adr.org/sp.asp?id=21936>.

16. See FED. R. CIV. P. 23.

17. See generally KATHERINE V.W. STONE & RICHARD A. BALES, *ARBITRATION LAW* 1-2 (2d ed. 2010).

of the evidentiary rules and discovery, the confidentiality of the proceeding over a public hearing, the opportunity to have arbitrators who have subject matter expertise over the issue, the less adversarial nature, and fewer formalities.<sup>18</sup> While complex class arbitration proceedings can lead to greater fees required by both parties to pay to the arbitrator(s), these fees are offset by the numerosity of the class yielding much greater benefit than an arbitration proceeding brought by a single claimant over the same issue.<sup>19</sup> The following examines the origination of class arbitration to give an essential background into its unique qualities that have been controversial from the beginning.

No provisions in either the Federal Arbitration Act or the Federal Rules of Civil Procedure specifically refer to class arbitration. Over the last decade, as arbitral class actions have become increasingly common, the Supreme Court had decided several cases involving class arbitration. In any of those cases, the Court could have ruled that this absence of a legal foundation makes class arbitration impermissible. The Court has not done so; nor has it ruled explicitly that class arbitration is permissible. Instead, the Court has decided these cases on other grounds. Meanwhile, class-action cases continued to be arbitrated – at least until the Court held earlier this year in *Concepcion* that class-action waivers in arbitration agreements are enforceable – without consideration of the ethical issues discussed in this article.

### A. Federal Arbitration Act

Congress passed the Federal Arbitration Act (“FAA”) in 1925.<sup>20</sup> The purpose of the FAA is to ensure the enforcement of arbitration agreements in “contract[s] evidencing a transaction involving commerce.”<sup>21</sup> After a few revisions and updates, the FAA became the federal backbone for enforcing commercial arbitration proceedings in the United States.<sup>22</sup> Congress desired to put arbitration agreements “upon the same footing as other contracts, where [they] belong.”<sup>23</sup> The FAA provides a framework for when arbitrations should occur and how arbitrations should be conducted.<sup>24</sup> Nevertheless, the FAA is silent on whether class arbitrations are allowed or disallowed in disputes.<sup>25</sup> Also, the FAA neither speaks about the viability of class arbitrations nor provides guidelines for class arbitration.<sup>26</sup>

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18. *Id.* See also AM. ARBITRATION ASS’N, A GUIDE TO MEDIATION AND ARBITRATION FOR BUSINESS PEOPLE 4 (2003), available at <http://www.adr.org/si.asp?id=4121>; see also David S. Clancy & Matthew M. K. Stein, *An Uninvited Guest: Class Arbitration and the Federal Arbitration Act’s Legislative History*, 63 BUS. LAW. 55, 73-74 (2007).

19. STONE & BALES, *supra* note 17, at 488.

20. See 9 U.S.C. § 1 (2011).

21. Jon O. Shimabukuro, THE FEDERAL ARBITRATION ACT: BACKGROUND AND RECENT DEVELOPMENTS, CRS REPORT FOR CONGRESS (Aug. 15, 2003), available at [http://digital.library.unt.edu/ark:/67531/metacrs3879/m1/1/high\\_res\\_d/RL30934\\_2003Aug15.pdf](http://digital.library.unt.edu/ark:/67531/metacrs3879/m1/1/high_res_d/RL30934_2003Aug15.pdf) (quoting 9 U.S.C. § 2 (2011)).

22. See 9 U.S.C. § 13 (2011).

23. H.R. REP. NO. 68-96 (1924).

24. See 9 U.S.C. § 2-13 (2011).

25. See 9 U.S.C. § 1 (2011).

26. See *id.*

*B. Green Tree Finance Corp. v. Bazzle*

Prior to 2003, there were no statutory provisions for or against class arbitration. That year, however, the United States Supreme Court implicitly recognized class arbitration in *Green Tree Finance Corp. v. Bazzle*, implicitly recognized class arbitration in 2003.<sup>27</sup> Lynn and Burt Bazzle, along with over 3,700 individuals, took out loans for various purposes from the Green Tree Finance Corporation in South Carolina.<sup>28</sup> Green Tree failed to provide proper documentation regarding borrowers' rights according to South Carolina law.<sup>29</sup> The Bazzles sued filed a claim and subsequently asked the trial court to certify their claims as a class action moved for class certification.<sup>30</sup> Green Tree, in response, moved for the court to compel arbitration.<sup>31</sup> The trial court did both: the court consolidated the claims as a class action and entered an order compelling arbitration.<sup>32</sup> The parties then selected an arbitrator and the arbitration proceeding ended with the awarding of nearly eleven million dollars in statutory damages to the class.<sup>33</sup> The trial court affirmed the award and Green Tree appealed to the South Carolina Court of Appeals.<sup>34</sup> The Supreme Court of South Carolina withdrew the case from the Court of Appeals and assumed jurisdiction.<sup>35</sup> The Supreme Court of South Carolina found that the contracts were silent in respect to class arbitration and consequently authorized, although by omission, class arbitration, and that the arbitration properly proceeded in class form.<sup>36</sup>

The United States Supreme Court granted certiorari to consider whether the holding of the Supreme Court of South Carolina was consistent with the Federal Arbitration Act.<sup>37</sup> The issue of the case was the interpretation of the arbitration clauses found in Green Tree's lending agreements, and whether the contracts allowed class arbitration claims against the lender.<sup>38</sup> The opinion found that the appropriateness of class arbitration is an issue for the arbitrator to decide, and should be determined according to the terms of the arbitration agreement found in the lending contract, the appropriateness of class arbitration was an issue for the arbitrator to decide.<sup>39</sup> Therefore, the court reversed the ruling of the Supreme Court of South Carolina, and remanded the case to arbitration for an arbitrator to

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27. *Green Tree*, 539 U.S. at 453-54.

28. *Id.* at 448; *see also* *Bazzle v. Green Tree Fin. Corp.*, 569 S.E.2d 349 (S.C. 2002); Brief of Petitioner-Appellant at \*3, *Green Tree Fin. Corp. v. Bazzle*, 539 U.S. 444 (2003) (No. 02-634).

29. *Green Tree*, 539 U.S. at 448.

30. *Id.* at 449.

31. *Id.*

32. *Id.*

33. *Id.*

34. *Id.*

35. *Green Tree*, 539 U.S. at 450. The Supreme Court at that time consolidated a factually similar case against Green Tree to review both concurrently. *See also* *Lackey v. Green Tree Fin. Corp.*, 498 S.E.2d 898 (S.C. 1998).

36. *Id.*

37. *Id.*; *See also* 9 U.S.C. § 1 (2011).

38. *Green Tree*, 539 U.S. at 450 (Stevens, J., concurring in part and dissenting in part). Justice Breyer delivered the controlling opinion of the Court, but the Justices were unable to provide a majority opinion.

39. *Id.* at 454.

interpret the arbitration clause in the lending agreement and the appropriateness of class arbitration.<sup>40</sup>

The Court's narrow decision giving an arbitrator the power to decide whether an arbitration clause in a contract forbids class arbitration, was weakened in that only a controlling opinion and not a majority opinion of authoritative precedent was delivered.<sup>41</sup> The impact of *Bazze* left the future of class action arbitration unclear. By not holding outright that class arbitration is incompatible with the FAA, the plurality opinion it seems implicitly the assumption that the FAA disfavors class arbitration, which has led to numerous class arbitration filings.<sup>42</sup>

### *C. Stolt-Nielsen v. Animalfeeds Int'l Corp.*

In *Stolt-Nielsen v. Animalfeeds Int'l Corp.*, the Supreme Court of the United States held that neither arbitrators nor courts could compel arbitration on a class basis if the arbitration clause is silent in regards to the authorization of class arbitration.<sup>43</sup> *Stolt-Nielsen* involved several companies accusing their marine shipping partners of fixing the prices for shipping their liquid goods.<sup>44</sup> The parties submitted the case to arbitration and left to the arbitrators the decision whether to certify class proceedings.<sup>45</sup> Upon submitting the case to the arbitrators, the parties stipulated that the agreement was silent on the issue of class certification, and the parties had not reached an agreement on the matter.<sup>46</sup> The arbitration panel certified the class, but stayed the proceeding to allow the parties to issue a stay of the proceedings so that the parties could seek judicial review of the certification.<sup>47</sup> The District Court reversed the finding of the arbitration panel, and the Second Circuit Court of Appeals reversed the District Court and reinstated the arbitrators' class certification.<sup>48</sup>

In the majority opinion, Justice Alito declined to discuss the rationale of the lower courts and instead focused on what he felt was a correct class certification based upon a justified and sound public policy in light of *Bazze*. Rather than discussing the rationale of the lower courts, Justice Alito, in the majority opinion, noted the arbitrators' class certification was based upon and justified as being sound public policy following *Green Tree*.<sup>49</sup> The majority opinion, however, questioned whether the arbitration panel's public policy justification was appropriate as a default rule under the FAA, and whether the panel's decision conflicted with the long-standing view that arbitration is a matter of consent.<sup>50</sup> Justice Alito

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40. *Id.*

41. *Id.*

42. STONE & BALES, *supra* note 19 at 488; See also *Kristian v. Comcast Corp.*, 446 F.3d 25 (1st Cir. 2006).

43. 130 S. Ct. 1758 (2010). For further discussion, see Diana Link & Richard A. Bales, *Waiving Rights Goodbye: Class Action Waivers in Arbitration Agreements after Stolt-Nielsen v. Animalfeeds International*, PEPP. DISP. RESOL. L.J. 275 (2011).

44. *Stolt-Nielsen*, 130 S. Ct. at 1764-65.

45. *Id.* at 1766.

46. *Id.*

47. *Id.*

48. *Id.* at 1768-69.

49. *Id.*

50. *Stolt-Nielsen*, 130 S. Ct. at 1769.

stated, “While the interpretation of an arbitration agreement is generally a matter of state law . . . , the FAA imposes certain rules of fundamental importance, including the basic precept that arbitration ‘is a matter of consent, not coercion.’”<sup>51</sup> The Court found the primary purpose of the FAA is to ensure the enforcement of private agreements according to their terms.<sup>52</sup> The Court concluded, “a party may not be compelled under the FAA to submit to class arbitration unless there is a contractual basis for concluding that the party *agreed* to do so.”<sup>53</sup> Given that the parties had stipulated that there was no such agreement as to class arbitration, a party could not coerce the other party into class arbitration.<sup>54</sup>

Justice Ginsburg, dissenting, argued that overview by the Court at that time would be improper as the case was not yet ripe.<sup>55</sup> The parties had submitted to the selected arbitrators, the decision as to whether the agreement allowed for arbitration.<sup>56</sup> Just as the Second Circuit had stated, the parties also submitted the decisions as to the whether their arbitration clause allowed for class arbitration, and the arbitrators did not overstep their authority in deciding, regardless as to which way they went.<sup>57</sup> Justice Ginsburg emphasized that the majority opinion acknowledged that the parties were sophisticated business entities<sup>58</sup> which created major issue Justice Ginsburg’s dissent emphasized that this new rule left unanswered questions as to whether this type of “affirmative-authorization” requirement applies to contracts of adhesion, such as a form contract, which are offered on a “take-it-or-leave-it” basis.<sup>59</sup> With the recognition of class arbitration by the Supreme Court,<sup>60</sup> new conflicts and ethical issues arise for the arbitrators who take on class arbitration hearings.<sup>61</sup>

In light of *Stolt-Nielsen*, has the Supreme Court effectively crushed class arbitration if the arbitration clause is silent as to its authorization? Justice Ginsburg’s closing remarks indicate that *Stolt-Nielsen* is a very particular case and narrow decision which likely does not effectively ban class arbitration in its entirety, and most likely not even in all clauses that are silent in regards to class arbitration.<sup>62</sup> *Stolt-Nielsen* is a case between two sophisticated companies dealing in a very particular maritime industry.<sup>63</sup> The Court’s rationale considered the parties mutual business aptitude, and most likely would not reach the same conclusion in cases dealing with contracts of adhesion between sophisticated companies and individual consumers.<sup>64</sup> In addition, the Court does not ban class arbitration in contracts;

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51. *Id.* at 1773 (quoting *Volt Info. Sci., Inc. v. Bd. of Tr. of Leland Stanford Junior Univ.*, 489 U.S. 468, 479 (1989) (internal citations omitted)).

52. *Id.*; see also 9 U.S.C. § 4 (2011).

53. *Stolt-Nielsen*, 130 S. Ct. at 1774.

54. *Id.* at 1776.

55. *Id.* at 1777 (Ginsburg, J., dissenting).

56. *Id.* at 1778 (Ginsburg, J., dissenting).

57. *Id.* (Ginsburg, J., dissenting).

58. *Id.* at 1783 (Ginsburg, J., dissenting).

59. *Stolt-Nielsen*, 130 S. Ct. at 1783 (Ginsburg, J., dissenting).

60. See *Green Tree Fin. Corp.* 539 U.S. at 454; see also *Stolt-Nielsen*, 130 S. Ct. at 1758 (2010).

61. See Doyle, *supra* note 6, at 30.

62. See *Stolt-Nielsen*, 130 S. Ct. at 1783.

63. See *id.* at 1758.

64. For an example of a court striking a class action ban in a consumer cases in part because of the disparity in sophistication between the parties, see *Schnuerle v. Insight Comm. Co.*, 2010 LEXIS 288 (Ky. 2010).

parties are still able to negotiate class arbitration contract clauses if they choose. Many may see *Stolt-Nielsen* as a significant blow to class arbitration,<sup>65</sup> but *Stolt-Nielsen* merely served to better define when class arbitration is appropriate.

#### *D. AT&T Mobility, LLC v. Concepcion*

The United States Supreme Court released *AT&T Mobility, LLC v. Concepcion* in April 2011.<sup>66</sup> The majority opinion, authored by Justice Scalia, ignored the ethical issues discussed further in this essay and instead focused almost entirely on the preemption issue between California state law and the FAA.<sup>67</sup> Preemption issues such as the one in question in *Concepcion* have occurred numerous times in the life span of the FAA.<sup>68</sup> However, *Concepcion* appears to have, at least temporarily, significantly restricted class arbitration proceedings.<sup>69</sup>

The Concepcions purchased a cell-phone contract from AT&T.<sup>70</sup> The contract contained an arbitration provision requiring that claims be brought in the party's "individual capacity, and not as a plaintiff or class member in any purported class or representative proceeding."<sup>71</sup> The cell-phone contract came with a "free" phone, but AT&T nonetheless billed the Concepcions for \$30.22 in tax for the retail value of the phone.<sup>72</sup> The Concepcions then brought a class action on behalf of other similarly situated customers of AT&T.<sup>73</sup>

The trial court denied AT&T's motion to compel individual arbitration because it found that AT&T's arbitration agreement was unconscionable under California law and such law was not preempted by the FAA.<sup>74</sup> Following the denied motion, AT&T filed an interlocutory appeal to the Ninth Circuit Court of Appeals from the denial of the motion to compel arbitration.<sup>75</sup>

#### *1. Ninth Circuit Opinion*<sup>76</sup>

The Ninth Circuit agreed with the federal district court in that under California law, the arbitration clause contained in the written agreements was uncon-

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65. See Link & Bales, *Comment, Waiving Rights Goodbye: Class Action Waivers in Arbitration Agreements after Stolt-Nielsen v. Animalfeeds International*, PEPP. DISP. RESOL. L.J. 275 (2011).

66. 131 S. Ct. 1740 (2011).

67. *Id.*

68. Under the Eric doctrine, federal courts must decide cases according to state substantive law and federal procedural law. Because the FAA was "outcome determinative," the Supreme Court ruled that the FAA was substantive rather than procedural. See *Bernhardt v. Polygraphic Co. of America*, 350 U.S. 198 (1956). This was at odds with the understanding of Congress, which had intended the FAA to be procedural in nature. As a result the Supreme Court eventually ruled that the FAA applied as substantive law in state as well as federal courts. See *Moses H. Cone Mem'l Hospital v. Mercury Constr. Corp.*, 460 U.S. 1, 20 (1983) (thereby greatly increasing the significance of the FAA's contractual approach).

69. *AT&T Mobility, LLC*, 131 S. Ct. at 1752.

70. *Laster v. AT&T Mobility, LLC*, 584 F.3d 849, 852 (9th Cir. 2009).

71. *Id.* at 852-53.

72. *Id.* at 852.

73. *Id.* at 853.

74. *Id.*

75. *Id.*

76. The case name was changed upon appeal to the United States Supreme Court. In the Ninth Circuit, the case name was under *Laster v. AT&T Mobility, LLC*, 584 F.3d 849 (9th Cir. 2009).



scionable and unenforceable.<sup>77</sup> Both courts did so on the basis of the California Supreme Court's ruling in *Discover Bank v. Superior Court*<sup>78</sup> that class-action waivers are unconscionable under California contract law if, among other things, bilateral dispute resolution would not substitute for the deterrent effect of a class action. Following *Discover Bank*, the Ninth Circuit in *Concepcion* applied a three-part test to determine whether a class action waiver in a consumer contract is unconscionable under California law.<sup>79</sup> For such a waiver to be unconscionable, the test is: (1) whether the contract was a contract of adhesion; (2) whether the disputes between the contracting parties were likely to involve small amounts of damages; and (3) whether it was alleged that the party with superior bargaining power had "carried out a scheme deliberately to cheat large numbers of consumers out of individually small sums of money."<sup>80</sup>

First, the appellate court found that AT&T's agreement was a contract of adhesion fulfilling the first part of the test because the agreement was a standardized contract imposed on the subscribing party without an opportunity to negotiate the terms.<sup>81</sup> Second, the appellate court then found that the second part of the test was fulfilled because the damages for each consumer affected by the tax on the "free" cell phones would be \$30.22, and were thus sufficiently and predictably small amounts of damages for each consumer which was for the sales tax charged on cell phones AT&T advertised were "free" constituting predictably small amounts of damages.<sup>82</sup> Third, the *Concepcion* plaintiffs alleged in their complaint that "AT&T was fraudulently advertising the phones were free while knowing AT&T would charge consumers sales tax on such phones."<sup>83</sup> The court found this sufficient to satisfy the third-prong of the test, rendering the contract unconscionable and unenforceable, and affirming the district court's initial holding.<sup>84</sup> Because AT&T's contract fulfilled all the prong of the test, the court found the contract to be unconscionable.<sup>85</sup>

The Court further affirmed the district court's holding that the FAA does not expressly preempt California law.<sup>86</sup> The FAA provides that arbitration clauses "shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract."<sup>87</sup> The court found because unconscionability is a generally applicable contract defense based on California law, courts may apply unconscionability to invalidate an arbitration agreement without contravening the FAA.<sup>88</sup>

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77. *Id.* at 853.

78. 36 Cal. 4th 148 (2005).

79. *Laster*, 584 F.3d at 854.

80. *Id.* at 854-55 (citing *Shroyer v. New Cingular Wireless Servs., Inc.*, 498 F.3d 976, 983 (9th Cir. 2007)).

81. *Id.* at 855.

82. *Id.*

83. *Id.*

84. *Id.*

85. *Laster*, 584 F.3d at 855-57.

86. *Id.* at 856-57.

87. *Id.* at 857; *see also* 9 U.S.C. § 2 (2011).

88. *Laster*, 584 F.3d at 857 (citing *Shroyer v. New Cingular Wireless Servs., Inc.*, 498 F.3d 976, 988 (9th Cir. 2007)).

The Ninth Circuit Court of Appeals affirmed the district court and held AT&T's class waiver unenforceable.<sup>89</sup> The court of appeals found the waiver unconscionable under California law and was therefore unenforceable, and the FAA neither expressly nor impliedly preempts California law determining unconscionability and enforceability.<sup>90</sup>

## 2. *Supreme Court Opinion*

The Supreme Court ruled 5-4 in favor of AT&T,<sup>91</sup> finding the application of unconscionability to this case preempted by the FAA. As discussed above, Section 2 of the FAA provides that arbitration agreements are enforceable "save upon such grounds as exist at law or in equity for the revocation of any contract." Prior to *Concepcion*, the Court consistently had interpreted this to mean that arbitration agreements must be treated the same as other contracts; if state law imposes a restriction on arbitration agreements but not on other contracts, that restriction is preempted by the FAA.<sup>92</sup>

The *Discover Bank* rule would have been valid under that test, because the *Discover Bank* rule forbade unconscionable consumer class-action waivers not only in arbitration agreements, but in any agreements, whether the agreements contained an arbitration clause or not regardless of the presence of an arbitration clause. The majority, however, found that the *Discover Bank* rule has the effect of discouraging arbitration by increasing the complexity of the dispute resolution process and thereby making arbitration less attractive to the AT&Ts of the world. The problem with this argument, as the dissent points out, is that it is inconsistent with the text of the statute.<sup>93</sup>

The majority also found that the requirement of allowing class wide arbitration "interferes with the fundamental attributes of arbitration and creates a scheme inconsistent with the FAA."<sup>94</sup> As the dissent correctly pointed out, a precedent does not exist that suggest proceeding as an individual is a "fundamental attribute of class actions." A third—and more just—result would have been for the Court to strike the lopsided arbitration clause in its entirety and allow the case to be litigated as a consumer class action.<sup>95</sup>

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89. *Id.* at 859.

90. *Id.*

91. *AT&T Mobility, LLC.*, 131 S. Ct. at 1761.

92. *See, e.g., Doctor's Assocs., Inc. v. Casarotto*, 517 U.S. 681 (1996).

93. *AT&T Mobility, LLC.*, 131 S. Ct. at 1761 (citing *Prima Paint Corp. v. Flood & Conklin Mfg. Co.*, 388 U.S. 395, 404, n. 12 (1967) (Breyer, J., dissenting)).

94. *Id.* at 1748.

95. The *Concepcion* case illustrates the unjustness of the rule adopted by the majority. No lawyer in his or her right mind is going to represent the Concepcions in an individual claim -- whether arbitrated or litigated—for \$30.22. The Concepcions get redress from AT&T, if at all, only through a class proceeding. The AT&Ts of the world know this, and no doubt are busy drafting class-action-waiver arbitration clauses. But these are not really "arbitration" clauses, because few of these claims will ever go to arbitration. These clauses are more accurately described as "liability-waiver clauses", because they permit large companies to escape liability entirely.

For this reason, there is a good chance that *Concepcion* – or perhaps even more likely, a later case applying *Concepcion* to reach a patently unfair result – will galvanize Congress to amend the FAA to effectively reverse *Concepcion*. When Congress does so, that will present a perfect opportunity to amend the FAA to address also the ethical issues presented in this article. Until then, class

### III. SELECTING CLASS COUNSEL

In class litigation, the trial judge selects the counsel to represent the class.<sup>96</sup> Currently, arbitrator(s) select class counsel in arbitration.<sup>97</sup> When arbitrators fill this role traditionally held by judges, conflicts of interest and partiality occur.<sup>98</sup> Judges must follow strict rules in selecting class counsel.<sup>99</sup> When arbitrators play that role, issues of bias toward the original counsel in return for selecting the arbitrator and for advanced fee payments appear.<sup>100</sup>

#### A. How the Courts Select Class Counsel

The trial judge, in class-action litigation, selects the counsel that will represent the class.<sup>101</sup> The judge must use the standard established in Rule 23 of the FRCP to select the counsel that is most capable of fully representing the class.<sup>102</sup> In 2003, the Supreme Court amended Rule 23 to, among other things, adopt the completely new subsection (g).<sup>103</sup> The Supreme Court approved subdivision (g) to ensure the aptitude of proposed lead class counsel, and to ensure the successful handling of complex class-action litigation.<sup>104</sup> This addition emphasized the importance of adequate class representation and counsel.<sup>105</sup>

Rule 23(g) sets out four factors that a judge must consider when appointing class counsel:<sup>106</sup> First, "the work counsel has done in identifying or investigating potential claims in the action;"<sup>107</sup> second, "counsel's experience in handling class actions, other complex litigation, and claims of the type asserted in the action;"<sup>108</sup> third, "counsel's knowledge of the applicable law,"<sup>109</sup> and fourth, "the resources counsel will commit to representing the class."<sup>110</sup> Rule 23(g) (2) of the FRCP states, "[w]hen one applicant seeks appointment as class counsel, the court may appoint that applicant only if the applicant is adequate under Rule 23(g)(1-4)."<sup>111</sup> This rule calls for class counsel to be qualified, have adequate experience, and possess the necessary resources to conduct the litigation.<sup>112</sup> If more than one ade-

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arbitration will proceed only in cases in which the arbitration agreement does not expressly limit class actions and cases in which both parties agree to proceed by class arbitration.

96. FED. R. CIV. P. 23(g)(1).

97. See *Green Tree Fin. Corp.*, 539 U.S. 444 (2003).

98. See Doyle, *supra* note 6, at 30.

99. See FED. R. CIV. P. 23.

100. See Doyle, *supra* note 6, at 30.

101. FED. R. CIV. P. 23(g)(2).

102. *Id.* at 23 (g)(1), (4).

103. CHARLES ALAN WRIGHT, ARTHUR R. MILLER & MARY KAY KANE, *FEDERAL PRACTICE & PROCEDURE CIVIL* § 1802.3 (3d ed. 2010).

104. *Id.*

105. *Id.*

106. FED. R. CIV. P. 23 (g)(1)(A).

107. *Id.* at 23(g)(1)(A)(i).

108. *Id.* at 23(g)(1)(A)(ii).

109. *Id.* at 23(g)(1)(A)(iii).

110. *Id.* at 23(g)(1)(A)(iv).

111. *Id.* at 23(g)(2).

112. *In re Drexel Burnham Lambert Group, Inc.*, 960 F.2d 285, 291 (2d Cir. 1992).

quate applicant seeks appointment, the court must appoint the applicant best able to represent the interests of the class.<sup>113</sup>

An example where a court found that the proposed lead counsel was not adequate under Rule 23 is *LeBeau v. U.S.*, a 2004 Federal District of South Dakota class action case disputing the improper distribution of a prior judgment.<sup>114</sup> The proposed lead class counsel in *LeBeau* was a solo practitioner without staff assistance.<sup>115</sup> The attorney applied to be the only counsel for the class.<sup>116</sup> The counsel was to represent a class of nearly 2,000.<sup>117</sup> Nothing in the class certification motion explained how the attorney would be able to handle the work on a large, complex class action.<sup>118</sup> There was evidence neither that the attorney had previously handled class actions, nor that he had any knowledge of class-action law.<sup>119</sup> The court found that the lead counsel was not equipped to adequately represent the class without assistance from other counsel.<sup>120</sup> Based on Rule 23 and the courts application of the standard, the courts denied appointment of the proposed counsel because attorney did not appear qualified and lacked adequate experience.<sup>121</sup> The court then appointed counsel that the court found adequate due to his many years of complex litigation experience and belonged to a law practice that was equipped handle the action.<sup>122</sup>

Another example of where a court grants an application for lead counsel based on Rule 23 can be found in *In re Rubber Chemicals Antitrust Litigation*, a 2005 Northern District of California case.<sup>123</sup> *In re Rubber Chemicals* was a suit alleging conspiracy to fix the prices of rubber chemicals sold in the United States.<sup>124</sup> The district court again used the standard established by Rule 23(g) to appoint class counsel.<sup>125</sup> The court noted the lead counsel's extensive experience and expertise in antitrust and class action litigation.<sup>126</sup> The court also praised the lead counsel for the extensive research that counsel had conducted as to the economic effects of the case and the amount of attorney resources the firm was capable of dedicating to the action.<sup>127</sup> The court ultimately appointed the lead counsel as class counsel and certified the class.<sup>128</sup>

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113. FED. R. CIV. P. 23(g)(2).

114. *LeBeau v. U.S.*, 222 F.R.D. 613 (D.S.D. 2004).

115. *Id.*

116. *Id.*

117. *Id.*

118. *LeBeau*, 222 F.R.D. at 619.

119. *Id.* at 613.

120. *Id.* at 619.

121. *Id.*

122. *Id.* at 619.

123. *In re Rubber Chem. Antitrust Litig.*, 232 F.R.D. 346 (N.D. Cal. 2005).

124. *Id.* at 349.

125. *Id.* at 355.

126. *Id.*

127. *Id.*

128. *Id.*

### B. How Arbitrators Select Class Counsel

The Federal Arbitration Act does not provide guidelines for class arbitration but the American Arbitration Association (AAA) provides supplementary rules.<sup>129</sup> The AAA officially began facilitating class arbitrations by releasing its “Supplementary Rule for Class Arbitrations” on October 3, 2008.<sup>130</sup> Except for a short statement in the AAA’s Supplementary Rules, there are no provisions found in the AAA’s rules that govern the selection of class counsel in arbitration.<sup>131</sup> As such, arbitrators face possible ethical challenges in selecting class counsel.<sup>132</sup>

#### 1. The Selection Process

The AAA maintains a roster of over 8,000 trained neutral arbitrators (“neutrals”) that serve as arbitrators for all types of conflicts.<sup>133</sup> When the AAA appoints an arbitrator, the AAA holds the arbitrator to the AAA’s Commercial Arbitration Rules and Code of Ethics for Arbitrators in Commercial Disputes.<sup>134</sup> The AAA administers class arbitration only if “(1) the underlying agreement specifies that disputes arising out of the parties’ agreement shall be resolved by arbitration in accordance with any of the Association’s rules, and (2) the agreement is silent with respect to class claims, consolidation or joinder of claims.”<sup>135</sup> Section 4(a)(5) of the Supplementary Rules for Class Arbitrations established by the AAA states that “[c]ounsel selected to represent the class will fairly and adequately protect the interests of the class.”<sup>136</sup> However, there is no further standard established for the arbitrator’s selection of class counsel.

Unless there is another method in the contracted arbitration clause, the AAA provides a four-step system for counsel to select an arbitrator.<sup>137</sup> First, the AAA sends each party a copy of the same prepared list of possible arbitrators.<sup>138</sup> Second, the guidelines provide the parties 15 days to strike names they object to and order the remaining possible arbitrators.<sup>139</sup> Third, after the parties return the lists, the AAA notes the mutual selections for assignment of an arbitrator.<sup>140</sup> Fourth, if the parties cannot agree on an arbitrator, the AAA will administratively appoint

129. See 9 U.S.C. §§ 1-14 (2006).

130. See Am. Arbitration Ass’n, *supra* note 15. It should be noted that the AAA’s rules do not cover all arbitrations. The rules and standards established by the AAA apply only to arbitrations where the parties have agreed to be bound by the AAA rules. These Supplementary Rules were promulgated in response to the *Green Tree* case. See *supra* § II (b).

131. See *id.* § 4(a)(5).

132. See Doyle, *supra* note 6, at 30-31.

133. AM. ARBITRATION ASS’N, A GUIDE TO MEDIATION AND ARBITRATION FOR BUSINESS PEOPLE 4 (2007), available at <http://www.adr.org/si.asp?id=4121>.

134. *Id.* at 19.

135. Am. Arbitration Ass’n, AAA Policy on Class Arbitrations, July 14, 2005, <http://www.adr.org/Classarbitrationpolicy> (AAA does not administer class hearings on claims where the arbitration agreement prohibited class claims). See also *Stolt-Nielson S.A. v. AnimalFeeds Int’l Corp.*, 548 F.3d 85 (2d Cir. 2008), cert. granted, 129 S. Ct. 2793 (2009).

136. Am. Arbitration Ass’n, *supra* note 15, § 4(a)(5).

137. AM. ARBITRATION ASS’N, *supra* note 133, at 19-20.

138. *Id.* at 19.

139. *Id.* at 20.

140. *Id.*

one.<sup>141</sup> Once the original counsel has selected the arbitrator, the arbitrator then must certify the class in a fashion similar to the Federal Rules class certification process for judges.<sup>142</sup>

The AAA's model arbitration clause for contracts contains no language regarding class arbitration.<sup>143</sup> In AAA arbitrations, when an arbitrator finds that class certification is appropriate, meaning neither the type of conflict nor the arbitration clause prohibits class certification, the arbitrator gives a Clause Construction Award<sup>144</sup> and a Class Determination Award<sup>145</sup> to both parties.<sup>146</sup> The Class Determination Award contains the class definition, the class representatives, and class counsel.<sup>147</sup>

## 2. *Potential Conflicts*

Arbitrators select counsel for the certified class in an arbitration proceeding.<sup>148</sup> If counsel participated in the selection of the arbitrator, filed the claim, and/or advanced fees to the arbitrators, at minimum, this creates the appearance that an arbitrator would be more likely to choose the original counsel as class counsel.<sup>149</sup> The standard of conduct for arbitrators is not as well defined as for judges, and the arbitration process itself creates conflicts for arbitrators.<sup>150</sup>

### *a. The Original Class Counsel Chose the Arbitrator(s)*

Once the original counsel selects the arbitrator, the arbitrator then must certify the class counsel in a fashion very similar to Rule 23 for class counsel appointment for judges.<sup>151</sup> The process of selecting an arbitrator and the counsel's initial communication with the arbitrator before rendering class certification create a familiarity between the arbitrator and the class counsel. This would not only

141. *Id.*

142. Am. Arbitration Ass'n, *supra* note 15, §§ 4-5. *See also* FED. R. CIV. P. 23(a)-(c).

143. AM. ARBITRATION ASS'N, DRAFTING DISPUTE RESOLUTION CLAUSES: A PRACTICAL GUIDE 7 (2007), available at <http://www.adr.org/si.asp?id=4125>. The model arbitration clause reads:

Any controversy or claim arising out of or relating to this contract, or the breach thereof, shall be settled by arbitration administered by the American Arbitration Association in accordance with its Commercial Arbitration Rules, and judgment on the award rendered by the arbitrator(s) may be entered in any court having jurisdiction thereof.

144. Am. Arbitration Ass'n, *supra* note 15, § 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").

145. *Id.* at § 5 ("The arbitrator's determination concerning whether an arbitration should proceed as a class arbitration shall be set forth in a reasoned, partial final award").

146. *Id.* at §§ 3, 5.

147. *Id.* at § 5(b).

148. *Id.* at § 5.

149. *See* Richard A. Bales & Sue Irion, *Building the Civilization of Arbitration: How Congress Can Make a More Equitable Federal Arbitration Act*, 113 PENN ST. L. REV. 1081, 1098 (2009). *See also* Doyle, *supra* note 6, at 30.

150. The American Arbitration Association released its Supplementary Rules for Class Arbitrations to regulate the procedure of class arbitration and conduct of arbitrators during class proceedings. *See* Am. Arbitration Ass'n, *supra* at note 15.

151. *Id.* §§ 4-5. *See also* FED. R. CIV. P. 23(a)-(c).

indicate collegiality between the counsel and arbitrator but also the counsel's partiality toward the counsel who took part in the arbitrator selection process.<sup>152</sup>

Here is how arbitrator and class counsel selection can play out hypothetically: Counsel X chose Arbitrator Y for a potential class arbitration proceeding. This selection may be financially lucrative for Arbitrator Y, especially if the class action is complex. Counsel X may also like to have an appointment as class counsel because the selection is financially lucrative. Counsel X will then apply to Arbitrator Y for the financially lucrative appointment as class counsel. If Arbitrator Y appoints Counsel X as class counsel, the appointment may appear as an unspoken quid pro quo for the Counsel X's appointment of Arbitrator Y. At the very least, this arrangement creates a strong appearance of impropriety and may create a conflict of interest for Arbitrator Y.

The first Canon of the American Bar Association's Model Code of Judicial Conduct requires that a judge must act at all times in ways that build public confidence in the impartiality of the judiciary.<sup>153</sup> The second Canon in the Model Code continues that judges must uphold and apply the law as well as perform all duties of the office "fairly and impartially."<sup>154</sup> Lastly, the second Canon goes on to say that a judge should not permit financial interests or relationships to influence their judicial conduct or judgment.<sup>155</sup>

Federal law states that a judge or justice at any time his or her impartiality might reasonably be questioned, he or she must recuse himself or herself.<sup>156</sup> If a judge has a personal bias for or against a party, he or she must disqualify himself or herself.<sup>157</sup> If the standards applied to judges applied to arbitrators, the influence of the arbitration process on his/her decision in appointing class counsel would violate the judicial canons.<sup>158</sup> However, arbitrators are not subject to Judicial Canons. Thus, the strong possibility and at minimum the appearance of misconduct is prevalent in the class arbitration process. The less strict and informal nature of arbitration expands too far if it causes arbitrators to face unavoidable influences.<sup>159</sup>

#### *b. The Original Class Counsel Advanced Payments/Fees to the Arbitrator(s)*

Arbitrators normally charge a consistent fee rate beginning as soon as the parties agree on the arbitrator.<sup>160</sup> The discovery, motions, and class-certification process mentioned in the examples above are billable hours for the arbitrator, which the arbitrator will submit in his/her fee statement to class counsel. It is then up to the parties to each pay their share. The AAA has rules governing the suspen-

152. See Doyle, *supra* note 6, at 30.

153. MODEL CODE OF JUDICIAL CONDUCT R. 1.2 (2007). The Code defines impartiality as "absence of bias or prejudice in favor of . . . particular parties or classes of parties, as well as maintenance of an open mind in considering issues that may come before a judge."

154. *Id.* at R. 2.2.

155. *Id.* at R. 2.4.

156. 28 U.S.C. § 455(a) (2006). See discussion *infra* Part IV.

157. 28 U.S.C. § 455(b)(1) (2006). See discussion *infra* Part IV.

158. See Doyle, *supra* note 6, at 30-31.

159. *Id.*

160. AM. ARBITRATION ASS'N, *supra* note 133, at 19.

sion of proceedings if the AAA and/or the arbitrator do not receive the fees on time.<sup>161</sup> This creates a conflict of interest for the arbitrator because the arbitrator may show partiality to the original counsel who arranges for these fees to be paid.<sup>162</sup>

At times, parties pay fees and make advanced payments to the arbitrator before commencement of the proceeding, determination of class counsel and certification of the class.<sup>163</sup> Counsel seeking class certification and class counsel appointment has established a working relationship with the selected arbitrator and forwarded the required advanced fees, thus creating at least the perception of partiality.

The same judicial rules previously mentioned apply equally to the advanced fees problem.<sup>164</sup> Judges are to avoid ex parte communications except for circumstances such as administrative purposes.<sup>165</sup> Paying advanced fees to an arbitrator could be considered an acceptable communication for administrative purposes of the arbitration proceeding; however now a financial interest presents itself.<sup>166</sup> Arbitrators would be hard pressed to deny that such direct and strong financial interest—already receiving payment from an attorney applying to be class counsel—at least indicates the perception that it might affect her judgment in selecting class counsel.

To state more clearly, suppose parties selected Arbitrator Y to arbitrate a potential class arbitration claim. Counsel X participated with opposing counsel in the process of selecting Arbitrator Y and has advanced fees to Arbitrator Y. The next step is for Arbitrator Y to certify the class and select the counsel to represent the class. Arbitrator Y may not pick Counsel X, but Arbitrator Y is undeniably familiar with Counsel X. In a perfect world, the Arbitrator Y selects the best-qualified attorneys as filtered through the test provided by the Federal Rules. However, unlike a judge, Arbitrator Y has already been *selected and paid* by Counsel X. This pushes the conflict of interest even further because the Arbitrator Y may appoint Counsel X as class counsel because Counsel X has selected and paid Arbitrator Y. If Arbitrator Y does in fact appoint Counsel X as class counsel, this arrangement creates a strong appearance of impropriety.

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161. Am. Arbitration Ass'n., *supra* note 15, § 11. Section 11 reads:

11. Administrative Fees and Suspension for Nonpayment

(c) If an invoice for arbitrator compensation or administrative charges has not been paid in full, the AAA may so inform the parties in order that one of them may advance the required deposit. If such payments are not made, the arbitrator may order the suspension or termination of the proceedings. If no arbitrator has yet been appointed, the AAA may suspend the proceedings.

(d) If an arbitration conducted pursuant to these Supplementary Rules is suspended for nonpayment, a notice that the case has been suspended shall be published on the AAA's Class Arbitration Docket.

162. *See* Doyle, *supra* note 6, at 30.

163. Am. Arbitration Ass'n., *supra* note 15, § 11.

164. *See* discussion *supra* § III (B)(2)(a).

165. MODEL CODE OF JUD. CONDUCT R. 2.9 (2007).

166. *See id.*



## IV. ALLOCATING FEES AND AWARDS TO CLASS COUNSEL

Final awards by arbitrators carry the binding authority of judicial awards but are considerably harder to vacate.<sup>167</sup> These final awards can include attorney's fees and costs to class counsel.<sup>168</sup> Both the courts and academia have debated the propriety of an arbitrator giving awards that include his or her fees.<sup>169</sup> In class-action litigation, judges must play "guardian" of class members and protect their interests in the suit against collusion by counsel or the represented parties.<sup>170</sup> Arbitrators play the same role as judges, but the questions of bias and financial interest flourish because the parties pay the arbitrators as the hearings progress, and often the fees and awards that arbitrators give contain the fees that the parties are to pay back to the arbitrator.<sup>171</sup> As financial exchanges between the parties and their umpire(s) increase, the perception of impropriety follows suit.

Arbitral and judicial standards are considerably different.<sup>172</sup> The impartiality standards that apply to arbitrators by the federal courts and ethics committees are greatly relaxed compared to judges.<sup>173</sup> 28 U.S.C. § 455 states the reasons for which a judge or justice should disqualify himself from a proceeding:

(a) Any justice, judge, or magistrate judge of the United States shall disqualify himself in any proceeding in which his impartiality might reasonably be questioned.

(b) He shall also disqualify himself in the following circumstances:

(1) Where he has a personal bias or prejudice concerning a party, or personal knowledge of disputed evidentiary facts concerning the proceeding;

...

(4) He knows that he, . . . has a financial interest in the subject matter in controversy or in a party to the proceeding, or any other interest that could be substantially affected by the outcome of the proceeding;<sup>174</sup>

These personal biases for a judge and financial interest are grounds for recusal from hearing cases;<sup>175</sup> however, there is not an equivalent standard applicable to

167. See *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Clemente*, 272 Fed. App'x. 174 (3d Cir. 2008).

168. See David S. Clancy & Matthew M. K. Stein, *An Uninvited Guest: Class Arbitration and the Federal Arbitration Act's Legislative History*, 63 BUS. LAW. 55, 73-74 (2007).

169. See Am. Arbitration Ass'n, *Commercial Arbitration Rules and Mediation Procedures*, R. 43(d)(ii), available at <http://www.adr.org/sp.ask?id=22440#R43> (last visited September 21, 2011).

170. *Mirfasihi v. Fleet Mortgage Corp.*, 450 F.3d 745, 748 (7th Cir. 2006).

171. See Doyle, *supra* note 6, at 31.

172. Compare 9 U.S.C. § 10 (2006) with 28 U.S.C. § 455 (2006).

173. See Steven J. Goering, *The Standard of Impartiality As Applied to Arbitrators by Federal Courts and Codes of Ethics*, 3 GEO. J. LEG. ETHICS 821 (1990).

174. 28 U.S.C. § 455 (2011).

175. See *U.S. v. Grinnell Corp.*, 384 U.S. 563, 583 (1966) ("The alleged bias and prejudice must stem from an extrajudicial source and result in an opinion on the merits on some basis other than what the judge learned from his participation in the case."); *Tumey v. State of Ohio*, 273 U.S. 510, 524 (1927) (finding that due process is denied if the judge has "the slightest pecuniary interest" in the case); and *Mims v. Shapp*, 541 F.2d 415, 417 (3d Cir. 1976) (A personal bias has been defined as "an attitude

arbitrators.

### A. *How the Courts Allocate Fees and Awards*

FRCP's Rule 23(e) allows for class settlements, voluntary dismissals, or compromises under certain scenarios and with judicial approval.<sup>176</sup> However, in class action proceedings, the trial judge continually plays "guardian" for the members of the class not directly represented.<sup>177</sup> Rule 23(d)(2) allows judges to order class representatives to send notice of the proceedings to all members of the class for their protection and fairness.<sup>178</sup> Courts also have discretion in determining and awarding "reasonable" fees in a class action.<sup>179</sup>

In *Mirfasihi v. Fleet Mortgage Corporation*, a Seventh Circuit case, a class of 1.6 million people sued Fleet Mortgage Corporation, which owned the home mortgages of the plaintiffs.<sup>180</sup> Fleet had sold mortgage information such as loan amounts, types of loans, and repayment histories to third-party telemarketing companies.<sup>181</sup> The class alleged that Fleet violated the Truth-in-Lending Act (TILA),<sup>182</sup> the Fair Credit Reporting Act,<sup>183</sup> and other state consumer protection laws.<sup>184</sup>

In 2004, the parties entered into an initial settlement agreement, which provided for two plaintiff classes: a telemarketing class of approximately 190,000 people and an information-sharing class of around 1.4 million members.<sup>185</sup> In the first settlement, the amount the telemarketing class and the fees for the class lawyers would receive were substantial,<sup>186</sup> but the information sharing class received nothing.<sup>187</sup> Members of the class appealed and the court of appeals agreed, but

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toward petitioner that is significantly different from and more particularized than the normal, general feelings of society at large . . .").

176. FED. R. CIV. P. 23(e) states:

(e) Settlement, Voluntary Dismissal, or Compromise.

The claims, issues, or defenses of a certified class may be settled, voluntarily dismissed, or compromised only with the court's approval.

The following procedures apply to a proposed settlement, voluntary dismissal, or compromise:

(1) The court must direct notice in a reasonable manner to all class members who would be bound by the proposal.

(2) If the proposal would bind class members, the court may approve it only after a hearing and on finding that it is fair, reasonable, and adequate.

...

(5) Any class member may object to the proposal if it requires court approval under this subdivision (e); the objections may be withdrawn only with the court's approval.

177. *Mirfasihi*, 450 F.3d at 748.

178. WRIGHT, MILLER, KANE & MARCUS, *supra* note 103, §1793. *See also* FED. R. CIV. P. 23(d)(2).

179. WRIGHT, MILLER, KANE & MARCUS, *supra* note 103, §1803.1.

180. *Mirfasihi*, 450 F.3d at 746.

181. *Id.*

182. 15 U.S.C. § 1601-1667(f) (2006).

183. 15 U.S.C. § 1681 (2011).

184. *Mirfasihi*, 450 F.3d at 746.

185. *Id.* at 746-47.

186. *Id.* at 747. The telemarketing class would receive \$2.4MM and the class attorneys would receive \$750K.

187. *Id.* at 746-47.

rather than focusing on the issues of the case, the court closely dissected the actions of the district court in failing to protect all members of the class.<sup>188</sup>

The court stated that judges must be very vigilant “in scrutinizing proposed settlements of class actions to consider whether the settlement is ‘fair, adequate, and reasonable, and not a product of collusion.’”<sup>189</sup> The court also stated that a trial court should evaluate the probability of plaintiff winning its claims, the predicted costs of future litigation, and hints of collusion.<sup>190</sup> Even under an abuse of discretion standard, the court of appeals found that the district court committed reversible error in not determining the potential value of the class’ claim to allow proper evaluation of the reasonableness of the proposed settlement.<sup>191</sup>

The Seventh Circuit in *Mirfasihi* showed how a trial judge should have acted to protect all members of a class action suit.<sup>192</sup> Judges are to protect the rights of unrepresented members and Rule 23 establishes this standard.<sup>193</sup> This consistent standard offers ensured protection for unrepresented members and in cases that protection fails, appeals are available.<sup>194</sup>

### B. How Arbitrators Allocate Fees and Awards

These protections that are laid out in Rule 23 for all members of a class in litigation do not extend into arbitration.<sup>195</sup> The FAA does not contain statutory protection for unrepresented members of class arbitration.<sup>196</sup> However, arbitrators’ final awards, which can include attorney’s fees, are binding and hard to vacate.<sup>197</sup> The AAA requires its “neutrals” to play the guardian role for the class members,<sup>198</sup> but the counsel pays fees to arbitrators as the claims progress and the arbitrators’ final awards can contain amounts for his/her own fees.<sup>199</sup> This gap in professional and ethical standards between arbitrators and judges is most likely a byproduct of what is sought in arbitration—more informal proceedings, less expense, less stringent structure.<sup>200</sup> However, such informal proceedings require ethical scrutiny when it comes to class arbitrations and the rights of all parties.<sup>201</sup>

#### 1. The Allocation Process

The FAA provides that arbitrators’ awards may be vacated “where the award was procured by corruption, fraud, or undue means; or where there was evident

188. *Id.* at 747.

189. *Id.* at 748 (citing *Reynolds v. Beneficial Nat’l Bank*, 288 F. 3d 277, 279 (7th Cir. 2002)).

190. *Mirfasihi*, 450 F.3d at 748; *see also* *Mars Steel Corp. v. Cont’l Illinois Nat’l Bank & Trust Co.*, 834 F. 2d 677, 681-82 (7th Cir. 1987).

191. *Mirfasihi*, 450 F.3d at 751.

192. *Id.*

193. *See* FED. R. CIV. P. 23(d)(2) & (e).

194. *See, e.g., Mirfasihi*, 450 F.3d 745.

195. *See* Doyle, *supra* note 6, at 29-30.

196. *See* 9 U.S.C. § 1 (2011).

197. *See* *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Clemente*, 272 Fed. Appx. 174, 176 (3d Cir. 2008).

198. Am. Arbitration Ass’n, *supra* note 15, § 8.

199. *See* Doyle, *supra* note 6, at 30.

200. STONE & BALES, *supra* note 17, at 1-2.

201. *See* Doyle, *supra* note 6, at 30.

partiality or corruption in the arbitrators . . .”<sup>202</sup> “Corruption,” “fraud,” or “undue means” and “evident partiality” have been very hard to prove to vacate an arbitrator’s award.<sup>203</sup>

There is no statutory equivalent protection specifically for class members in arbitration as in the FRCP and *Mirfasihi*,<sup>204</sup> but organizations like the AAA have codes of ethics for their neutrals.<sup>205</sup> The AAA’s rules are generally silent in regards to awarding attorney’s fees.<sup>206</sup> However, parties may modify their arbitration clauses and agreements to allow an arbitrator to award attorney’s fees.<sup>207</sup> The AAA’s Supplementary Rules for Class Arbitrations states, “[t]he arbitrator may approve a settlement, voluntary dismissal, or compromise that would bind class members only after a hearing and on finding that the settlement, voluntary dismissal, or compromise is fair, reasonable, and adequate.”<sup>208</sup> This lack of statutory protection expected from arbitrators allows the arguments of possible conflicts of interest to rise when it comes to awards and settlement approval in class arbitration.<sup>209</sup>

## 2. Potential Conflicts

When a judicial class action settles, the trial court judge plays a significant role in insuring and protecting all the members of the class.<sup>210</sup> The judge must ensure that class counsel act as honest fiduciaries for the entire class.<sup>211</sup> Courts, for many years, have been aware of the high probability that defendants in class actions are interested in minimizing the sum of damages paid to the class, and defendants are therefore willing to pay high attorney’s fees in exchange for small damages.<sup>212</sup> There is no statutory rule requiring arbitrators to provide the same protection for class members, but the AAA has established similar protections to those in the FRCP for judicial class actions.<sup>213</sup> Given that the arbitrator(s) were (1) selected by the representative counsel and (2) have been receiving payment for his/her services since the onset of the class arbitration proceeding,<sup>214</sup> questions arise regarding the arbitrators approval of a settlement and actions as “guardian” of the class.<sup>215</sup> It is the view of some scholars that market forces drive arbitrators

202. 9 U.S.C. § 10(a)(1)-(2) (2011).

203. See, e.g., *Clemente*, 272 Fed. Appx. 174.

204. *Mirfasihi*, 450 F.3d at 745.

205. See Am. Arbitration Ass’n, *The Code of Ethics for Arbitrators in Commercial Disputes*, <http://www.adr.org/sp.asp?id=32124> (last visited April 11, 2011).

206. AM. ARBITRATION ASS’N, DRAFTING DISPUTE RESOLUTION CLAUSES: A PRACTICAL GUIDE 37 (2004).

207. *Id.* The AAA’s model arbitration clause for awarding attorney’s fees reads, “The prevailing party shall be entitled to an award of reasonable attorney fees.”

208. Am. Arbitration Ass’n, *supra* note 15, § 8.

209. See Doyle, *supra* note 6, at 31.

210. See FED. R. CIV. P. 23(e).

211. *Mirfasihi*, 450 F.3d at 748 (quoting *Mirfasihi v. Fleet Mortgage Corp.*, 356 F.2d 781, 785 (7th Cir. 2004)).

212. See *Alleghany Corp. v. Kirby*, 333 F.2d 327, 347 (2d Cir. 1964); see also *Thorogood v. Sears, Roebuck & Co.*, 547 F.3d 742, 745 (7th Cir. 2008).

213. Am. Arbitration Ass’n, *supra* note 15, § 8.

214. *Id.* § 11.

215. *Id.* § 8.

to act neutrally or “fairly” to both parties. This assumes that both parties are actively involved in many class arbitrations. However, most consumers and their counsel are not regularly involved in class arbitration, while businesses may be perpetually involved in class arbitrations. Therefore, the point is driven further that arbitrators may be more inclined to prefer the business entity of certain class arbitrations proceedings, especially consumer-based class arbitrations, with the goal of perpetuating future business.

*a. Conflicts After Having Been Paid by Class Counsel*

In arbitrations, the parties directly compensate the arbitrator(s) involved in the dispute.<sup>216</sup> Arbitrators normally charge a consistent fee rate and compensation begins with the first day of the arbitration hearing.<sup>217</sup> This creates a connection to the parties that independent judges do not face. A judge who had this type of financial connection and questionable bias to a party would have to disqualify himself under Federal law;<sup>218</sup> however, the arbitration system allows arbitrators to conduct arbitration hearings with these connections to the parties.<sup>219</sup>

Section 8 of the AAA’s Supplementary Rules for Class Arbitrations requires that an arbitrator approve any settlement between the parties.<sup>220</sup> Counsel for the class is required to send notice to the class members affected or bound by such a settlement, dismissal, or compromise.<sup>221</sup> However, the reliance on the ethics and moral impartiality of an arbitrator is not enough to ensure the protection of a class from collusion of opposing counsels—and especially not opposing counsels and the arbitrators.<sup>222</sup> This raised issue will surely give rise to objections from unrepresented class members in accordance with the AAA’s rules.<sup>223</sup> Section 8(d) of the AAA’s Supplementary Rules for Class Arbitrations allows any class member to object to a settlement, dismissal, or compromise.<sup>224</sup> However, the arbitrator can approve the withdrawal of these objections.<sup>225</sup>

*b. Awards of Expenses which Include Arbitrator’s Fees*

To begin arbitration with the AAA, the demanding party must advance a non-refundable filing fee.<sup>226</sup> The arbitrator can then apportion the fee between the parties.<sup>227</sup> Counsels for the parties in arbitrations are normally responsible to pay the arbitrator(s) fees.<sup>228</sup> Arbitrators have stated, in their own opinions, their personal

216. AM. ARBITRATION ASS’N, *supra* note 133, at 30.

217. *Id.* at 19.

218. 28 U.S.C. § 455 (2011).

219. Am. Arbitration Ass’n, *supra* note 15, § 8.

220. *See id.*

221. *See id.*

222. *See Mirfasihi*, 450 F.3d at 748 (quoting *Reynolds v. Beneficial Nat’l Bank*, 288 F.3d 277, 279 (7th Cir.2002)).

223. Am. Arbitration Ass’n, *supra* note 15, § 8.

224. *See id.*

225. *Id.*

226. AM. ARBITRATION ASS’N, *supra* note 133, at 18.

227. *Id.*

228. *Id.* at 30.

conflict of interest regarding award determinations and their fees in class arbitration.<sup>229</sup>

Arbitrators often face questions in the claim that might affect their fee and therefore their award.<sup>230</sup> Such factors that can affect their fee as well as the final award include, for example, the ethics and professionalism of the arbitrators themselves.<sup>231</sup> Conflicts also arise because arbitrators are also interested in promulgating business, which creates financial incentives of the arbitrators and the arbitration forums to appear unbiased in order to attract this continued business.<sup>232</sup> The appearance of conflicts of interest where an arbitrator makes an award, which the parties will use to pay her or him, is not faced by judges in class litigation.<sup>233</sup>

If Arbitrator Z finds for party X and awards a dollar amount from opposing party Y, that monetary award will likely include Arbitrator Z's fee. Therefore, in determining the award, Arbitrator Z must also determine her or his compensation. Arbitrator Z cannot ethically undertake determining a dollar amount to award class X from company Y that includes the amount he will be paid. It is also likely if company Y is a big corporation that has used Arbitrator Z multiple times in the past that Arbitrator Z would like to continue this working relationship. Arbitrator Z is unable to overcome this ethical conundrum of finding for and determining an award for class X while desiring to maintain a working relationship with company Y.

### 3. Judicial Certification

In such instances where class arbitration settles, judicial certification is a possibility to aid arbitrators in avoiding such conflicts.<sup>234</sup> However, this proposition raises more issues than viable answers. If there is a judicial certification, the parties' agreement to decide their suit in arbitration is lost.<sup>235</sup> If there was no pending case, and the parties from the onset agreed to arbitration, the court has no jurisdiction to issue such a certification.<sup>236</sup>

For example, if X is a class of residents that is engaged in class arbitration as required by their service contract with local cable provider Y for overcharging its customers, "X v. Y" would not exist on any docket in any court system. If Y makes an offer that the class of X accepts, there is no opportunity or means for judicial certification/oversight of such an agreement to ensure that the arbitrators were not exposed to the conflicts mentioned above. When there is no jurisdiction;

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229. *Hobby v. Snap-on Tools Co. LLC*, AAA No. 111140188404, at 12 n. 5 (2005) (Mathews, Arb.), <http://www.adr.org/si.asp?id=3695>.

230. David S. Clancy & Matthew M. K. Stein, *An Uninvited Guest: Class Arbitration and the Federal Arbitration Act's Legislative History*, 63 *BUS. LAW* 55, 73 (2007).

231. Thomas Burch, *Necessity Never Made A Good Bargain: When Consumer Arbitration Agreements Prohibit Class Relief*, 31 *FLA. ST. U. L. REV.* 1005, 1034 (2004). "[A]rbitrators may have a financial incentive to certify a class because the longer the arbitrator spends on the case the more money the arbitrator receives," but stating that "arbitration institutions, and arbitrators as well, have incredibly strong financial incentives to avoid any appearance of bias."

232. *Id.*

233. Clancy & Stein, *supra* note 230, at 73-74.

234. *STONE & BALES*, *supra* note 17, at 508.

235. *Id.*

236. *See* *FED. R. CIV. P.* 12.

there is no case. Even if there was a case filed, this possible bouncing back and forth between judicial and arbitral proceedings could destroy the economic and durational attractiveness of arbitration.<sup>237</sup>

## V. POSSIBLE ADDITIONS AND REVISIONS TO THE FAA

It is unlikely that Congress envisioned class arbitration in 1925 when it passed the FAA. If Congress amends the FAA in reaction to *Concepcion* to allow class arbitration, it also has the opportunity to alleviate some of these unavoidable ethical issues for arbitrators. However, the more regulations Congress places on class arbitrations, the less viable the option becomes. Amendments must therefore be made while being cognizant of what renders class arbitration beneficial. Congress might develop an entirely new section of the FAA focused exclusively on class arbitration. Congress could then systematically approach all of the issues in class arbitration. However, absent a dedicated section to class arbitration in the FAA, Congress could also alleviate the ethical issues by amending a few of the current sections.

### A. Counsel Selection

The Section 5 of the FAA authorizes a court to appoint an arbitrator or arbitrators if the parties' agreement does not contain an arbitrator-selection process and if the parties cannot agree on an arbitrator.<sup>238</sup> Congress should amend Section 5 to require judicial appointment/certification arbitrators in class arbitrations. This would alleviate the arbitrator's ethical issue regarding appointing class counsel after competing counsel selected and paid advanced fees to the arbitrator.

Section 5 currently contains one paragraph prescribing how a federal court shall designate an arbitrator to preside over the controversy if the parties' agreement does not provide for a method of choosing an arbitrator and the parties cannot reach an agreement.<sup>239</sup> Congress should re-label this paragraph as subsection (a), and then add a subsection (b) stating that parties to class arbitrations must file, in a court that would have had jurisdiction over the underlying controversy, a petition for the selection of arbitrator(s) who will preside over the controversy. This section should further state that upon judicial selection of the arbitrator, the court then would stay the "proceeding" in accordance with Section 3 of the FAA, until a party brings the issue back before the court for certification of the award in accordance with the proposed revisions suggested below.<sup>240</sup>

### B. Award Certification

Section 9 of the FAA describes how a party may obtain a court order confirming the arbitrator's award if the arbitration agreement calls for such an or-

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237. W. Mark C. Weidemaier, *Arbitration and the Individuation Critique*, 49 ARIZ. L. REV. 69 (2007).

238. See 9 U.S.C. § 5 (2011).

239. *Id.*

240. See *id.* at § 3 (2011).

der.<sup>241</sup> Congress should re-label the existing language as subsection (a), and add a subsection (b) that would provide that class-action arbitration awards and settlements are not enforceable until confirmed by a court that would have had jurisdiction over the underlying controversy, and that would permit any party to obtain this confirmation by petitioning the court to lift the stay that was ordered following the judicial selection of the arbitrator pursuant to the amended Section 5. Congress should add a subsection (c) to import the Rule 23 protections for absent class members, by requiring close judicial scrutiny of class action arbitration awards and settlements.

## VI. CONCLUSION

The inherent ethical issues surrounding class arbitrations will not disappear on their own. Congress could and should consider possibilities to most adequately subdue the ethical problems in class arbitration proceedings. These simple proposed additions and revisions to the FAA would allow courts more oversight in order to protect the rights of parties and the respect of the system.

Class arbitration grew increasingly prevalent, particularly in consumer claims prior to *Concepcion*.<sup>242</sup> Without regulation, however, it significantly compromises arbitrator neutrality, both in the arbitrator-selection process and in the process of issuing arbitration awards or approving settlements. If Congress amends the FAA to allow class arbitration, it should to permit limited judicial supervision of these processes. Doing so will allow Congress to eliminate the conflicts of interest while retaining the benefits of class arbitration.

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241. *See id.* at § 9 (2011).

242. The AAA currently has 301 Class Arbitration Proceedings active as of April 11, 2011. *See* Searchable Class Arbitration Docket, AM. ARBITRATION ASS'N, <http://www.adr.org/sp.asp?id=25562> (last visited Apr. 11, 2011).



