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COMPLEX LITIGATION & E-DISCOVERY

Arbitrating Complex Litigation

The impact of AAA and JAMS class action arbitration rules

By Michael Dore

Complex litigation involves a wide variety of tort, contract, statutory and other claims. Those claims have been presented in many formats — the most significant of which over the past quarter century has been the class action. The United States Supreme Court has now made it clear that arbitration can be used to resolve class actions — and the class action arbitration rules of the American Arbitration Association (AAA) and Judicial Arbitration and Mediation Services (JAMS) promise to play a significant role in determining how effective the arbitration forum will be in resolving these complex litigation matters.

Class actions have been both a serious problem and a significant opportunity for defendants since they began to be widely utilized in state and federal courts in the mid-20th century.

Such actions have sometimes resulted in the imposition of massive damages on those defendants. Certification of a class has been said to “turn a \$20,000 case into

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a \$200 million dispute” and leave the fate of an entire industry in the hands of a single jury. Indeed, numerous courts and commentators have noted that such proceedings can be tantamount to judicial blackmail — forcing huge settlements of highly questionable claims.

At the same time, however, both federal and state class action proceedings have often permitted corporate defendants to achieve cost-effective resolutions of nationwide claims that could not have been universally resolved without the class action mechanism. Thus, claims ranging from defective tires to overpriced securities have been collected and resolved through state and federal class actions.

Concerns about the excesses of class action litigation and settlements led to the enactment of the Class Action Fairness Act. While this statute did not impact parties' ability to file class action claims, under its provisions significant multistate class action proceedings are now primarily confined to federal courts. It remains unclear, however, how these courts will address the difficult issue of whether federal class actions should be certified on the basis of expansive state court determinations of state substantive law. If such proceedings are permitted in federal courts, the Class Action Fairness Act may provide substantially less protection to class action defendants than was originally anticipated.

In addition, following the Supreme Court's decisions rejecting classwide set-

tlements of asbestos claims in *Amchem Products, Inc. v. Windsor*, 521 U.S. 591 (1997), and *Ortiz v. Fibreboard Corp.*, 527 U.S. 815 (1999), federal courts have often been hostile to efforts to utilize federal class action procedures to resolve commercial and personal injury disputes. Thus, federal courts have made it clear that class action requirements “demand undiluted, even heightened, attention in the settlement context.”

In parallel with the evolution of federal class action law, however, arbitration law and procedure have developed in directions which may well turn out to be far more significant to class action defendants.

Thus, in 2003 in *Green Tree Financial Corp. v. Bazzle*, 123 Sup. Ct. 2402 (2003) a plurality of the Supreme Court agreed that, in circumstances where the right to arbitrate was clear and class-wide arbitration was not prohibited in the agreement itself, parties who sought class-wide arbitration were entitled to have arbitrators rather than the courts decide whether such class-wide arbitration was to be permitted. While the Supreme Court gave little guidance as to the procedures which were constitutionally required in such class-wide arbitrations — it has become clear that arbitration is a viable alternative forum for the presentation, resolution and settlement of complex class action claims.

Following the Supreme Court's *Green Tree Financial* decision, the two major United States arbitration providers established special procedures addressing class arbitration. The differences in these rules may play a significant role in determining the scope of class action claims that can be

addressed in arbitration and the viability of this forum as a means of addressing some of the shortcomings of judicial class actions.

AAA issued its Supplementary Rules for Class Arbitrations in October 2003. See American Arbitration Association, *Supplementary Rules for Class Arbitrations* (2003), available at <http://www.adr.org/sp.asp?id=21936>. JAMS issued its Class Action Procedures in February 2005. See JAMS, *Class Action Procedures* (2005), available at <http://www.jamsadr.com/rules/classaction.asp>.

Both the AAA and JAMS Rules are patterned after the class action procedures set forth in Rule 23 of the Federal Rules of Civil Procedure. These class action arbitration rules, however, also contain special provisions that modify certain standard arbitration procedures. For example, unlike most arbitrations, which are confidential, the AAA rules provide for public disclosure of class arbitration hearings and filings. In addition, the AAA also maintains a case docket on its Web site that details key information about the class action case. AAA class action rules also provide for the selection of arbitrators from a national roster of class action qualified arbitrators.

The JAMS rules provide for no comparable public disclosure or special handling procedures. They do, however, set out a detailed plan for the administration of class action arbitrations.

Perhaps most significantly, both the AAA and JAMS rules essentially provide for a three-step process for determining whether or not the arbitration will proceed on a classwide basis. In step one, the arbitrator makes an initial determination of whether the arbitration clause at issue permits a class action and enters a "Clause Construction Award."

AAA rules then provide for a stay of at least 30 days to permit either party to seek judicial relief to confirm or vacate the Clause Construction Award. Once this time period has run without a challenge to the award, or once a challenge has been denied by the court, the arbitrator proceeds with the arbitration. The arbitrator may also continue the stay of the arbitration while the court is considering the parties' application.

In step two, the arbitrator determines whether to certify the proposed class. If the arbitrator determines to certify a class, the arbitrator submits a "Class Determination Award." This award must "define the class, identify the class representative(s) and counsel, and...set forth the class claims, issues, or defenses." It must also state "when and how members of the class may be excluded from the class arbitration." Once again, the AAA rules provide for a 30-day stay of proceedings following the issuance of the Class Determination Award to permit any party to seek judicial review of the Class Determination Award.

After certification, the arbitrator issues a "Notice of Class Determination," which directs that class members be provided the "best notice practicable under the circumstances." This notice is required for "all members who can be identified through reasonable effort" and must describe (1) the nature of the action; (2) the definition of the class certified; (3) the class claims, issues or defenses; (4) that a class member may enter an appearance through counsel if the member so desires, and that any class member may attend the hearings; (5) that the arbitrator will exclude from the class any member who requests exclusion, stating when and how members may elect to be excluded; (6) the binding effect of a class judgment on class members; (7) the identity and biographical information about the arbitrator, the class representative(s) and class counsel that have been approved by the arbitrator to represent the class; and, under AAA rules, (8) how and to whom a class member may communicate about the class arbitration, including information about the AAA Class Arbitration Docket.

Following notice, the class action arbitration proceeds to the "litigation" stage where the arbitrator hears the evidence and arguments of both parties. The arbitrator then renders a "Final Award" on the merits — that AAA rules require "shall be reasoned and shall define the class with specificity."

JAMS class action arbitration rules provide very similar procedures — but with somewhat fewer explicitly required expressions of the arbitrator's rationale for the Clause Construction Award and fewer

required particulars for the Class Determination Award. In addition, under JAMS' rules, judicial review of the determination that the arbitration clause permits a class arbitration and the arbitrators' class certification itself, are subject to immediate judicial review only if the arbitrator decides to permit them.

Moreover, not only is the availability of judicial review of the class determination treated differently under the AAA and JAMS rules, but the actual subject matter of the arbitration itself is also significantly different.

Under both rules, the arbitrator is permitted to determine whether the arbitration should proceed as a class arbitration. For that purpose the arbitrator is directed to permit a representative of one or more members of a class to act in the arbitration as representative parties on behalf of all members of the class only if: 1) the class is so numerous that joinder of separate arbitrations on behalf of all members is impracticable; 2) there are questions of law or fact common to the class; 3) the claims or defenses of the representative parties are typical of the claims or defenses of the class; and 4) the representative parties will fairly and adequately protect the interests of the class.

Significantly, however, AAA also requires a finding that counsel selected to represent the class will fairly and adequately protect the interests of the class, and that each class member has entered into an agreement containing an arbitration clause which is substantially similar to that signed by the class representative(s) and each of the other class members. These requirements are not imposed under the JAMS procedures.

After these basic class action requirements have been met, both AAA and JAMS require that the arbitrator find that the questions of law or fact common to the members of the class predominate over any questions affecting only individual members, and that a class arbitration is superior to other available methods for the fair and efficient adjudication of the controversy. The matters pertinent to these findings include: 1) the interest of members of the class in individually controlling the prose-

cution or defense of separate arbitrations; 2) the extent and nature of any other proceedings concerning the controversy already commenced by or against members of the class; 3) the desirability or undesirability of concentrating the determination of the claims in a single arbitral forum; and 4) the difficulties likely to be encountered in the management of a class arbitration.

JAMS, however, unlike AAA, also permits class wide arbitration in circumstances where: 1) the prosecution of separate actions by or against individual members of the class would create a risk of A) inconsistent or varying adjudications with respect to individual members of the class which would establish incompatible standards of conduct for the party opposing the class, or B) adjudications with respect to individual members of the class that would, as a practical matter, be dispositive of the interests of the other members not parties to the adjudications or substantially impair or impede their ability to protect their interests; or (2) the party opposing the class has acted or refused to act on grounds generally applicable to the class, thereby making appropriate final injunctive relief or corresponding declaratory relief with respect to the class as a whole.

These Rule 23 incompatible standard/limited fund (hereinafter "limited fund") and injunction-based class action proceedings are not addressed under the AAA rules.

Both AAA and JAMS' class action arbitration rules also deal with efforts to settle or compromise the claims raised in these proceedings. Thus, the rules of both organizations provide that:

- (a)(1) Any settlement, voluntary dismissal, or compromise of the claims, issues, or defenses of an arbitration filed as a class arbitration shall not be effective unless approved by the arbitrator.
- (2) The arbitrator must direct that notice be provided in a reasonable manner to all class members who would be bound by a proposed settlement, voluntary dismissal, or compromise.
- (3) The 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.

(b) The parties seeking approval of a settlement, voluntary dismissal, or compromise under this Rule must submit to the arbitrator any agreement made in connection with the proposed settlement, voluntary dismissal, or compromise.

(c) The arbitrator may refuse to approve a settlement unless it affords a new opportunity to request exclusion to individual class members who had an earlier opportunity to request exclusion but did not do so. [and]

(d) Any class member may object to a proposed settlement, voluntary dismissal, or compromise that requires approval under this Rule. Such an objection may be withdrawn only with the approval of the arbitrator.

As can be seen from the foregoing discussion, while the AAA and JAMS will accommodate class action proceedings, their rules present very different substantive and procedural approaches.

AAA provides for more public disclosure and for mandatory judicial review at each critical stage of the class action determination process. These rules also limit arbitrable class actions to Rule 23(b)(3) damage claims and prohibit arbitration involving class members who have not entered into an agreement containing an arbitration clause which is substantially similar to that signed by the class representative and each other class member.

JAMS, on the other hand, imposes fewer disclosure requirements on its arbitrators, and does not compel interim judicial review of the class action arbitration process. This organization also permits the adjudication of limited fund and other injunction-based class action proceedings and does not require that class members have entered into an agreement containing

an arbitration clause which is substantially similar to that signed by the class representative.

At first blush, the AAA class action arbitration rules appear to be far more protective of the interests of class action defendants. These rules limit permissible class actions to traditional Rule 23(b)(3) damage claims; require that all class members have executed substantially similar arbitration clauses; and require stays of class arbitration proceedings to allow judicial review of the Clause Construction and Class Determination awards. All of these provisions reduce the chances of the sort of unfair "drive-by certifications" that led to the enactment of the Class Action Fairness Act.

In fact, however, each of these provisions is, at best, a two-edged sword for class action defendants. Whether limited fund and injunction-based class actions are permitted under the AAA rules is not completely clear. Support for the position that such claims are allowed can be found in AAA Rule 5(c) which, in connection with the Class Determination award, provides that "if an arbitrator concludes that some exceptional circumstances, such as the need to resolve claims seeking injunctive relief or claims to a limited fund, make it inappropriate to allow class members to request exclusion, the class determination award shall explain the reasons for that conclusion."

Thus, it appears that, at least when the primary focus of the arbitration is a Rule 23(b)(3) damage claim, ancillary limited fund or injunction-based claims can be heard by the arbitrator. Given the extensive judicial development of the distinctions between the different types of Rule 23 class action proceedings, however, it remains unclear whether an arbitrator can hear independent limited fund and injunctive class action claims under the AAA rules. This uncertainty creates a situation that is not beneficial to any arbitration participant. It is clear under *Green Tree Financial* that, at least initially, it is for the arbitrator to decide whether such limited fund or injunction-based claims are subject to arbitration. If such claims are sustained, however, the relationship between that arbitrator's deter-

mination and the absence of specific authority under the AAA rules for the administration of such proceedings will leave all parties uncertain as to whether state or federal courts will confirm the ultimate award that arises out of that proceeding.

Of perhaps equal significance is the fact that the same uncertainty will apply with respect to any proposed class-based settlement of a limited fund or injunction-based claim. To the extent that the authority of the arbitrator to rule on the dispute is subject to question, the finality and binding effect of any settlement will be equally uncertain. The requirement that all class members have entered into arbitration agreements substantially similar to those signed by the class representatives is comforting for corporate defendants because the scope of the arbitration will be limited to parties with whom that defendant has had direct contractual dealings. In addition, the limitation on the scope of the potential class members will reduce due process concerns that would be raised by the arbitrated resolution of claims of parties who never directly consented to such a resolution through the execution of an arbitration agreement. Once again, however, the limitation on the potential scope of the claims is also a limitation on the scope of the resolution or settlement of those claims. If class arbitrations will apply only to parties who entered into arbitration agreements, claimants who have not entered into such agreements will be beyond the scope of any proposed class resolution.

Thus, before due process concerns are even addressed, the AAA's procedural requirements limit the parties who can be compelled to participate in the arbitrated resolution and thereby limit the use of this class-action mechanism as an effective means of resolving broad-based class-action claims. Due process concerns with respect to the resolution or settlement of the claims of nonsignatories to arbitration agreements will undoubtedly be difficult to overcome. Making it procedurally impossible to even attempt to address those concerns, however, is probably not in the long-term best interest of corporate

defendants in class action arbitrations.

With respect to the AAA's requirements that the Clause Construction and Class Determination awards be stayed in order to permit judicial review, two significant difficulties are presented. The first is the issue of whether such interlocutory appeal procedures in the context of arbitrations violate the Federal Arbitration Act's requirement that arbitration proceed swiftly and without undue judicial intervention. At least one commentator has noted that "[a]llowing such judicial involvement is not only inconsistent with the [Federal Arbitration Act] and with the spirit of federal arbitration law, but also undermines some of the fundamental benefits of arbitration such as avoiding the expense and delays inherent in litigation, including the lengthy appellate process."

Of even greater significance is the question of whether the interlocutory review of arbitrators' class-related determinations provides sufficient involvement by the courts in the arbitration forum to require that full due process protections be afforded to all participants in that forum. Numerous courts have refused to impose strict due process requirements on non-class-based arbitration procedures that have been agreed to by the parties. In essence, the absence of state action in these proceedings has been seen as a basis for avoiding the due process analysis that would be required in a judicial forum. The integrated relationship between the AAA's class action determinations and the available judicial review of those determinations, raises the question of whether judicial involvement in this process is so pervasive as to impose full-scale due process requirements on the AAA's arbitration class action proceedings.

It can be anticipated that due process requirements will ultimately be imposed by the courts to the extent that class action arbitrations in fact resolve the claims of parties who have not explicitly consented to the resolution of their claims in the arbitration forum. At least theoretically, however, those due process concerns could be limited to application of the arbitration procedures and results to non-signatory participants. The AAA's judicial interven-

tion rules make it more likely that comparable due process requirements will be imposed upon the signatory participants themselves.

The JAMS rules, which allow limited fund and injunctive class action claims; permit the arbitrator, rather than the participants, to determine when judicial review will be allowed; and do not limit class arbitrations to parties who have executed substantially similar arbitration clauses, may well turn out to be more beneficial for corporate defendants. These rules keep the scheduling of judicial review in the hands of the arbitrator rather than the parties and have the potential to reduce the likelihood of a finding that judicial involvement in the arbitration process is so pervasive as to trigger broad-based due process requirements. They also make it clear what types of class action arbitration claims are permitted and recognize at least the possibility of formulating a binding class action arbitration resolution with parties who have not executed arbitration agreements and may have exclusively non-damage-based claims. The potentially broader scope of JAMS class action arbitrations may be of concern to corporate defendants. The availability of expanded class action arbitration resolutions may be just what corporate defendants need, however, now that the Class Action Fairness Act appears to have limited the availability of these remedies in state courts.

Legislative limitations on state class actions are relatively recent. In addition, the rules of AAA and JAMS have not yet been in force for a sufficient time to determine how well they will address the issues raised by class action arbitrations.

It can be anticipated, however, that in the coming months and years, arbitration will play an increasingly important role in the resolution of class action claims. As that process evolves, it will become clearer how the different approaches of the class action arbitration rules of AAA and JAMS will benefit and limit the process of collecting, resolving and settling class-based claims. ■