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Recent Cases Highlight Risks of Contractual Individual Arbitration Clauses

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Many businesses seeking ways to manage the risk of litigation, especially class action litigation, have turned to contractual clauses requiring mandatory individual arbitration, meaning that any claim must be arbitrated, not litigated, and must be arbitrated only on an individual basis, not on a class basis. In a series of cases, the US Supreme Court has upheld the enforceability of such contract provisions. It thus appeared that contractually mandating individual arbitration was an especially effective tool for managing litigation risk, at least in cases arising out of contractual relationships, such as many employment relationships and purchase transactions.

Recent developments and cases have exposed chinks in the contractual armor. Businesses implementing these arbitration provisions may have anticipated that few claimants would actually initiate arbitration. But innovative plaintiffs' law firms have successfully used social media to "recruit" large numbers of claimants and initiate thousands, tens of thousands, or even more arbitration proceedings. The businesses have discovered that arbitrating masses of proceedings may be even less palatable than defending class action proceedings in court. Among other things, arbitration administrative fees for defendants are often quite substantial, while there are no such fees in court. Similarly, judges work for free, while arbitrators do not. Further, it is often easier and cheaper to settle masses of cases through a class action settlement in court, rather than one-off settlements in arbitration. As a result, businesses have attempted to revert to class action settlements, notwithstanding the mandatory individual arbitration provisions. But businesses' attempts to avoid the contractual arbitration provision on which they insisted have not always been warmly received by courts.

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Most recently, in the case of "*In re Intuit Free File Litigation*," a federal court in the Northern District of California refused to grant preliminary approval to a proposed $40 million class-action settlement that would have resolved claims against Intuit, the publisher of TurboTax, for allegedly "steering" millions of people into paying for tax preparation services even though they were eligible for free services.

The TurboTax terms of use said:

> ANY DISPUTE OR CLAIM RELATING IN ANY WAY TO THE SERVICES OR THIS AGREEMENT WILL BE RESOLVED BY BINDING ARBITRATION, RATHER THAN IN COURT . . . WE EACH AGREE THAT ANY AND ALL DISPUTES MUST BE BROUGHT IN THE PARTIES' INDIVIDUAL CAPACITY AND NOT AS A PLAINTIFF OR CLASS MEMBER IN ANY PURPORTED CLASS OR REPRESENTATIVE PROCEEDING. . .

Based on these terms of use, Intuit moved successfully to require individual arbitration proceedings, rather than class action litigation.

Perhaps to Intuit's surprise, a plaintiffs' law firm (not the attorneys who filed the class-action lawsuit) signed up more than 100,000 Intuit customers to file individual arbitration demands, with the law firm fronting the claimants' arbitration fees. After Intuit had paid $13 million in defense arbitration fees and was facing an upcoming deadline for another $23 million, Intuit returned to the original class action attorneys and negotiated a proposed class action settlement. Like all class action settlements, it required court approval and procedural protections permitting claimants dissatisfied with the settlement to "opt-out" and continue to pursue their claims. The parties who had filed arbitration claims then challenged the proposed settlement, principally on the ground that it would wrongly extinguish their arbitration claims because of unfair opt-out procedures.

In December 2020, the court held a settlement approval hearing. Although the judge has not yet issued a final written opinion to explain his reasoning, he issued an order denying approval and expressed significant concern that the proposed settlement was indeed unfairly taking away the rights of the arbitrating claimants. The judge expressed particular disapproval at the settlement's opt-out procedures requiring class members who wanted to opt-out to personally sign the opt-out form in ink, not electronically, and did not allow them to be opted-out by their counsel. He observed, quoting Hamlet and seemingly with some satisfaction, that Intuit was being "hoisted by (its) own petard."

One of the issues many companies have to consider is whether it is advantageous to require arbitration rather than litigation to resolve disputes. Businesses that have adopted or are considering adopting mandatory individual arbitration provisions should take note of the Intuit case and related developments. To be clear, the lesson of *Intuit* is not that mandatory individual arbitration provisions should never be used. But the case gives cause to be wary. Such contract provisions are not a magic bullet. They have risks, as well as benefits. And they should be adopted only after thoughtfully weighing those risks and benefits.

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