Limiting Exposure to Class-Action Litigation

by ANTHONY LANZA

On April 27, 2011, the U.S. Supreme Court issued its decision in *AT&T Mobility LLC v. Concepcion*, 563 U.S. __, 131 S. Ct. 1740 (2011), holding that the Federal Arbitration Act (FAA) preempted a California rule that invalidated most class-action waivers in consumer contracts on grounds of unconscionability. In addition to confirming the general enforceability of mandatory arbitration provisions containing class-action waivers, *Concepcion* compels even the most reluctant jurisdictions (like California) to recognize the enforceability of such provisions—within certain notable parameters.

Courts in many jurisdictions have shown hesitation to enforce arbitration clauses in consumer contracts. Typically, arbitration clauses have been invalidated in the context of the savings clause of section 2 of the FAA, which permits courts to invalidate arbitration agreements only upon "generally applicable contract defenses, such as fraud, duress, or unconscionability." *Concepcion*, however, changes the playing field; the question becomes, instead, whether the state rule's effect is to obstruct the accomplishment of the FAA's objectives.

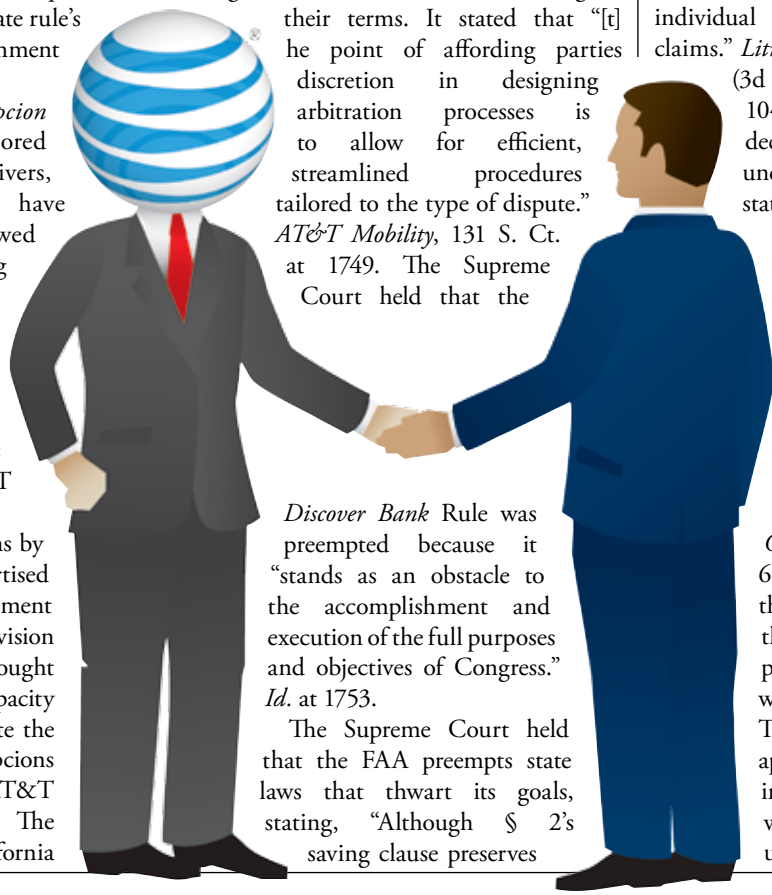
This article will discuss *Concepcion* and the cases that have honored it to validate class-action waivers, plus certain cases that have distinguished *Concepcion*, followed by a brief guidance in drafting class-action waivers.

AT&T Mobility LLC v. Concepcion (April 27, 2011)

Concepcion involved a dispute between consumers (the Concepcions) and AT&T Mobility (AT&T) over sales taxes charged to the Concepcions by AT&T for a cellular phone advertised as free. The parties' agreement contained an arbitration provision requiring all claims to be brought in the parties' individual capacity and not as a class action. Despite the arbitration provision, the Concepcions sued AT&T in federal court. AT&T moved to compel arbitration. The federal district court in California denied AT&T's motion, finding the arbitration provision to be unconscionable, relying upon the California Supreme Court's decision in *Discover Bank v. Superior Court*, 36 Cal. 4th 148 (2005), *abrogated by AT&T Mobility*, 131 S. Ct. 1740 (2011).

In *Discover Bank*, the California Supreme Court held that class waivers in consumer arbitration agreements are unconscionable if: (1) the agreement is in an adhesion contract, (2) disputes between the parties are likely to involve small amounts of damages, and (3) the party with inferior bargaining power alleges a deliberate scheme to defraud (known as the "*Discover Bank* Rule"). The Ninth Circuit affirmed the denial of AT&T's motion to compel arbitration, finding that the *Discover Bank* Rule was not preempted by the FAA.

The United States Supreme Court reversed, holding that California's *Discover Bank* Rule was preempted by the FAA. The Supreme Court stressed that the principal purpose of the FAA is to ensure that private arbitration agreements are enforced according to their terms. It stated that "[t]he point of affording parties discretion in designing arbitration processes is to allow for efficient, streamlined procedures tailored to the type of dispute." *AT&T Mobility*, 131 S. Ct. at 1749. The Supreme Court held that the *Discover Bank* Rule was preempted because it "stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress." *Id.* at 1753.



The Supreme Court held that the FAA preempts state laws that thwart its goals, stating, "Although § 2's saving clause preserves generally applicable contract defenses, nothing in it suggests an intent to preserve state law rules that stand as an obstacle to the accomplishment of the FAA's objectives." *Id.* at 1743.

Concepcion Applied to Enforce Class-Action Waivers

Concepcion verifies that many (but *not* all) prior holdings that invalidate arbitration agreements because they contain class-action waivers under state law doctrines, such as unconscionability, are preempted by the FAA. The following is a list of decisions that have interpreted *Concepcion* broadly to enforce class-action waivers.

Subsequent to *Concepcion*, the Third Circuit held, "Because . . . *Concepcion* holds that state law . . . requiring the availability of class-wide arbitration . . . is inconsistent with the FAA[,] we now endorse the District Court's decision to reject . . . law holding that waivers of class arbitration are unconscionable, and we will [compel] individual arbitration of the appellants' claims." *Litman v. Cellco P'ship*, 655 F.3d 225 (3d Cir. 2011), *cert. denied*, 132 S. Ct. 1046 (2012). The *Litman* court's decision adopted a "broad and clear" understanding of *Concepcion*: "[A] state law that seeks to impose class arbitration despite a contractual agreement for individualized arbitration is inconsistent with, and therefore preempted by, the FAA, irrespective of whether class arbitration is desirable for unrelated reasons." *Id.* at 231.

The Eleventh Circuit has likewise adopted an expansive interpretation of *Concepcion*. In *Cruz v. Cingular Wireless, LLC*, 648 F.3d 1205 (11th Cir. 2011), the court, citing *Concepcion*, held that a class-action waiver in the plaintiffs' arbitration agreement was enforceable under the FAA. The plaintiffs in *Cruz* argued on appeal that the class-action waiver in the arbitration provision of their wireless service agreement was unenforceable because it "hindered

the remedial purposes" of the Florida Deceptive and Unfair Trade Practices Act by insulating the defendant from liability for unlawful business practices, which, plaintiffs argued, was a "violation of public policy." *Id.* at 1208. The Eleventh Circuit dismissed the public policy argument. Relying upon *Concepcion*, the *Cruz* court held that the Florida law the plaintiffs relied upon was preempted by the FAA to the extent it would require class-wide arbitration "simply because the case involves numerous small-dollar claims by consumers against a corporation, many of which will not be brought unless the [p]laintiffs proceed as a class." *Id.* at 1215.

Concepcion need not be considered a mandate to enforce every arbitration agreement.

On August 31, 2011, the United States District Court for the Eastern District of Pennsylvania applied *Concepcion* broadly when it granted a defendant's motion to compel arbitration. In *King v. Advance Am.*, CIV. A. 07-237, 2011 WL 3861898 (E.D. Pa. Aug. 31, 2011), the court considered a motion to compel arbitration in two related class actions seeking damages for high-interest-or-fee "payday loans." Plaintiffs resisted arbitration by asserting that the arbitration clauses were unconscionable under Pennsylvania law. The *King* court concluded that "the FAA preempts Pennsylvania law," specifically stating that the "defenses can be disposed of with only a brief discussion in light of" *Concepcion*. *Id.*

On March 16, 2012, the Ninth Circuit Court of Appeals considered whether the Washington State Supreme Court's unconscionability rule as to class-action waivers was invalidated under *Concepcion*, like the *Discover Bank* Rule in California. *Coneff v. AT&T Corp.*, 673 F.3d 1155 (9th Cir. 2012). The Ninth Circuit concluded that the two states' rules are "almost identical," thus holding that "if California's substantive unconscionability rule is preempted by the FAA, then so is Washington's similarly reasoned rule." *Id.* at 1160.

Concepcion Distinguished

Not every court has been willing to view *Concepcion* as a broad mandate requiring the enforceability of arbitration provisions. Here are some recent cases that have distinguished *Concepcion*.

The *In re Checking Account Overdraft Litig.*, MDL 2036, 2012 WL 1564007 (S.D. Fla. Apr. 30, 2012) court considered whether bank customers with debit cards attached to checking accounts should be compelled to use arbitration rather than class-action lawsuits because the subject arbitration agreements are "unconscionable." According to the Florida court, a "case-by-case analysis of the applicable state law doctrine of unconscionability" may be applied to an arbitration agreement to find that it is unenforceable. "*Concepcion*," the court stated, "has not relieved courts from their obligation to scrutinize arbitration agreements for enforceability on a case-by-case basis where one party resists arbitration . . . *Concepcion* provides guidance as to what courts may consider when fulfilling that obligation." *Id.* Ultimately, the court conducted an unconscionability analysis as to several arbitration contracts at issue and found that they were each unconscionable for a variety of reasons. The judge expressly distinguished the "extremely consumer friendly" arbitration agreement in *Concepcion*.

Sutherland v. Ernst & Young LLP, 768 F. Supp. 2d 547 (S.D.N.Y. 2011), *reconsideration denied*, 10 CIV. 3332 KMW MHD, 2012 WL 130420 (S.D.N.Y. Jan. 17, 2012) involved an employment case. The judge concluded that an arbitration clause was unenforceable where the plaintiff (employee) had persuasively demonstrated that the maximum recovery obtainable in an individual arbitration pursuant to the subject arbitration clause was not large enough to make it practical to pursue arbitration on an individual basis.

In *Mayers v. Volt Management Corp.*, 203 Cal. App. 4th 1194 (2012), *review granted*, 142 Cal. Rptr. 3d 807 (June 13, 2012), the court ruled that an arbitration clause in an employment agreement was unconscionable, and therefore unenforceable, primarily because it permitted the arbitrator to award attorney fees to the employer on Fair Employment and Housing Act (FEHA) discrimination claims, which was a substantive alteration of the FEHA statute. The court in *Mayers* concluded that *Concepcion* did not foreclose the application of general contract defenses to arbitration agreements, provided that doing so would not obstruct the FAA's promotion of arbitration. It should be noted that *Mayers* did not include a class-action waiver, and review has been granted.

These decisions show that *Concepcion* need not be considered a mandate to enforce every arbitration agreement. Rather, state law defenses—such as unconscionability—remain available to plaintiffs so long as they do not "stand as an obstacle to the accomplishment of the FAA's objectives."

Viable Class-Action Waivers in California

In this author's view, the most cautious means of implementing an enforceable class-action waiver is to follow, as closely as possible, the "consumer friendly" waiver clause validated in *Concepcion*. It provided certain procedural safeguards to consumers, which partially explains the Supreme Court's ruling. It is summarized as follows:

A customer must initiate a dispute proceeding on a company's website. The company may then offer to settle the claim. If not resolved in 30 days, the customer may invoke arbitration. The company must pay all costs for non-frivolous claims. Venue must be in the county where the customer is billed. Small Claims Court is permissible in lieu of arbitration. An arbitrator may award any form of individual relief, but not class-action relief (no representative actions). The company is denied the ability to seek reimbursement for its attorney fees. If the customer receives an arbitration award greater than a company's last written settlement offer, the company must pay $10,000 minimum recovery and twice the amount of the claimant's attorney fees.

Conclusion

While *Concepcion* will enable companies to limit exposure to class-action liability, the scope of this protection will be limited. California's *Discovery Bank* Rule has clearly been abrogated. However, many companies will not be willing to offer the concessions to consumers included in AT&T's "consumer friendly" arbitration provision. As such, courts will be free, at least in many instances, to invalidate less consumer friendly clauses on the premise that the FAA is not thereby obstructed.

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