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ARBITRATION

Arbitration Clauses and Class Action Waivers in *AT&T v. Concepcion*: Will the Roberts Court Provide Businesses a Silver Bullet to Deter Class Actions?



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Businesses providing consumer goods and services cheered when the U.S. Supreme Court decided to address the enforceability of class action waivers in mandatory arbitration agreements. And their optimism appears well-founded.

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In *AT&T Mobility v. Concepcion*,¹ the Supreme Court will address whether the Federal Arbitration Act (FAA) preempts states—specifically California—from conditioning the enforcement of an arbitration agreement on the availability of particular procedures, namely class-wide arbitration.

The lawsuit, brought originally in the U.S. District Court for the Southern District of California, is a consumer class action charging that AT&T Mobility acted fraudulently when it offered a “free” phone to new subscribers, but then charged sales tax based on the full retail value of the phone—amounting to \$30.22. Vincent and Liza Concepcion, new AT&T customers who had received the “free” phone, fought back. They charged that AT&T violated California’s unfair competition and false advertising laws, the Consumer Legal Remedies Act, and committed fraud. When the Conceptions sought to litigate their claim as a class action in federal court, AT&T demanded individual arbitration, citing an arbitration clause that prohibited class actions.

¹ 2010 WL 303962, 79 U.S.L.W. 3293, argued (U.S. 11/9/10) (No. 09-893).

The Supreme Court is poised to give businesses a significant victory on “one of the most important—and controversial—issues in modern day class action litigation.”

Both the district court and the U.S. Court of Appeals for the Ninth Circuit found the class action prohibition unenforceable, relying on California unconscionability law. The district court and the Ninth Circuit reasoned that because the Concepcions’ consumer agreement was an adhesion contract and the damages were predictably small, AT&T’s class action waiver acted as an exculpatory clause insulating the company from liability and was, therefore, unenforceable.

Now the Supreme Court is poised to give businesses a significant victory on “one of the most important—and controversial—issues in modern day class action litigation.”² Based on two Federal Arbitration Act cases issued last term—*Stolt-Nielsen SA v. AnimalFeeds International Corp.*³ and *Rent-A-Center West Inc. v. Jackson*⁴—the widespread belief is that the court will enforce AT&T’s “consumer friendly” arbitration regime. The pressing question is: How far is the court prepared to go in ruling that class action waivers are enforceable? And what impact will this have for businesses. The answer can be discerned, in part, from what the court did this last term.

Class Action Waivers After *Green Tree Financial Corp. v. Bazzle*

The enforceability of class action waivers in arbitration clauses has vexed courts ever since the Supreme Court’s 2003 decision in *Green Tree Financial Corp. v. Bazzle*.⁵ Prior to *Green Tree*, arbitration clauses in consumer contracts were routinely used to defeat class certification. The argument went something like this: the corporation has the right to demand arbitration of each and every dispute it has with its customers. The corporation further has the right to resolve these disputes on an *individual basis*, prohibiting the aggregating of claims into powerful class actions. In this way, arbitration clauses were used as a way of neutralizing the plaintiffs’ class action bar. It was touted in business journals as a “panacea” to the formidable problem of consumer class action lawsuits. Well, not quite.

In *Bazzle*, a plurality of the court concluded that, where an arbitration agreement is “silent” on the permissibility of class action claims, an *arbitrator* is to decide whether the class claim may proceed in an arbitration. Rather than insulating itself from class actions, businesses had now subjected themselves to the unappealing prospect of class action arbitration with its accompanying limited judicial review of any adverse

award. Not wanting to miss an intriguing business opportunity, the American Arbitration Association and JAMS promulgated rules for administering class action arbitrations. The purported “panacea” had turned out to be a bust for business.

Businesses responded to the *Bazzle* predicament by inserting class action prohibitions in their consumer arbitration agreements to ensure that an arbitrator could not entertain class claims. This was accomplished through explicit class action waivers or language that limited the arbitrator’s jurisdiction to hear class claims. And it worked in many jurisdictions. Courts applying the laws of 26 different states (and the District of Columbia) enforced such provisions requiring that arbitration be conducted on an individual basis. But not California.

The California Supreme Court adopted a three-part test for determining the enforceability of class action prohibitions. Under that test, an agreement is unenforceable if it “[i] is found in a consumer contract of adhesion, [ii] in a setting in which disputes between the contracting parties predictably involve small amounts of damages, and [iii] when it is alleged that the party with the superior bargaining power has carried out a scheme to deliberately cheat large numbers of consumers out of individually small sums of money.” *Discover Bank v. Super. Ct.*⁶ In practice, the *Discover Bank* test rendered class action prohibitions in cases involving “predictably small” claims categorically unenforceable.

The consequences of the split created risks for businesses serving consumers nationwide: you could prevent class actions in certain parts of the country but not in California. Moreover, claims by out-of-state customers against California-based companies may be adjudicated under California law—even when their contracts call for applying the law of the states in which the customers reside.

This risk profile, coupled with a rising tide of consumer discontent with certain arbitration providers (e.g., the National Arbitration Forum), prompted leading banks and consumer goods companies to re-think their use of arbitration in customer agreements.

The Federal Arbitration Act In the October 2009 Term

Now, the predicament businesses found themselves in the wake of *Bazzle* may be coming at an end. The October 2009 Term included no less than three FAA cases, two involving the question of class actions. The collective impact of the cases will likely be a blow to consumers and a boon to businesses using arbitration clauses or standard form agreements. Reversing the Ninth Circuit’s decision in *AT&T* will strengthen the enforceability of class action waivers in the consumer arena, making it more difficult for consumers to argue unconscionability of such adhesion agreements.

The first of the Supreme Court’s class action/arbitration cases is *Stolt-Nielsen*.⁷ In *Stolt-Nielsen*, the court, in a 5-3 split (Justice Sonia Sotomayor recused), held that class action arbitration is not allowed in cases where the agreement was silent on the issue of the arbitrability of class claims. Faced with the absence of any

² Zambrano, *Wavering Over Consumer Class Actions*, 27 No. 12 BANKING AND FINANCIAL SERVS. POL’Y REP. 4, 4 (2008).

³ 78 U.S.L.W. 4328 (U.S. 2010).

⁴ 78 U.S.L.W. 4643 (U.S. 2010).

⁵ 539 U.S. 444 (2003).

⁶ 113 P.3d 1100 (Cal. 2005).

⁷ No. 08-1198, slip op. (U.S. Apr. 27, 2010).

evidence of the parties' intent, the court concluded that class action arbitration was fundamentally different from individual arbitration. On this point, advocates on both sides agree. It is the implications they draw that differ. Businesses object to class-wide arbitration because it creates the unsettling risk that an arbitrator could award class-wide relief involving literally millions of customers (and millions of dollars) in a process subject to limited judicial review. In contrast, consumer advocates believe it is *because* class-wide arbitration is different that it should be protected as a means of vindicating consumer claims. As Justice Ruth Bader Ginsburg observed in her dissent: "[t]he realistic alternative to a class action is not 17 million individual suits, but zero individual suits, as only a lunatic sues for \$30."⁸ That very concern leads Ginsburg and others to conclude that class action arbitration waivers are essentially exculpatory clauses.

Previewing *AT&T*, Ginsburg questioned the majority opinion, suggesting that if, as *Slott-Nielsen* held, there "were no right to proceed on behalf of a class in the first place . . . a provision banning or waiving recourse to [class action arbitration] would be superfluous."⁹ The court will address that precise issue this fall. Through actions this term, the court has signaled that it will find class action waivers in consumer agreements enforceable—at least when joined with the consumer friendly attributes of AT&T's dispute resolution system.

The second FAA case this term—*Rent-A-Center West Inc. v. Jackson*,¹⁰ addressed the question of who decides a challenge to the enforceability of arbitration agreement where the agreement includes a "delegation provision" providing that the arbitrator will resolve questions relating to arbitrability. In a 5-4 split, the court held that the district court will hear disputes over the enforceability of agreements to arbitrate only when the particular arbitrability agreement is challenged. When the party challenges the agreement as a whole, as *Jackson* did, that dispute is left for the arbitrator to decide.

The Supreme Court in *AT&T* will likely follow the path begun in *Slott-Nielsen* and continued in *Jackson* and chip away at the role of the courts as an avenue for consumer disputes.

Antonio Jackson, the respondent, a former Nevada Rent-A-Center employee, claimed his employment contract, containing an agreement to arbitrate disputes, was unconscionable. He cited three provisions: (1) the agreement was one-sided, requiring discrimination to be arbitrated, but not claims relating to trade secrets; (2) discovery was limited to one witness and one expert; and (3) the arbitrator's fee would be split equally between the parties.

⁸ *Id.* dissent at 12, quoting *Carnegie v. Household Int'l.*, 376 F. 3d 656, 661 (7th Cir. 2004).

⁹ *Id.* at 11, n.10.

¹⁰ No. 09-497, slip op. (U.S. June 21, 2010).

Jackson skirts the issue of determining whether a contract is unconscionable, focusing instead on who determines unconscionability—a judge or an arbitrator. Tipping his hand towards the eventual outcome, at oral argument, Chief Justice John G. Roberts suggested if you sign an arbitration agreement you are "in a for penny, you're in for a pound. If you agree to arbitrate, then it's at least for the arbitrator to decide particular provisions, whether they are unconscionable."¹¹

Dissenting, Justice Stevens replied that the majority had added a new layer of severability "something akin to Russian nesting dolls": Courts may now pluck from a potentially invalid *arbitration agreement* even narrower provisions that refer particular arbitrability disputes to an arbitrator."¹² The effect of *Jackson* is to apply a heightened pleading standard to unconscionable challenges and elevate severability as a tool for protecting arbitration agreements. It further reflects confidence in the arbitrator, allowing the arbitrator to render the gateway determination, and limits access to the courts for reviewing arbitrability challenges issues.

A third action by the court this last term is also viewed as suggesting the outcome in *AT&T v. Conception*. After deciding *Slott-Nielsen* in late-April, the court vacated and remanded to the Second Circuit another arbitration case, *American Express Co. v. Italian Colors Restaurant*.¹³ In *American Express*, merchants brought an action against American Express alleging antitrust violations. The company traditionally charges vendors higher rates on transactions involving their charge cards which, unlike credit cards, do not have revolving balances. Later, American Express required that merchants accepting American Express cards also accept other products, specifically traditional credit and debit cards. These new cards carried rates that were higher than credit and debit cards from other companies. The cards also included a class action waiver.

American Express has a very similar procedural posture to *AT&T*, so why vacate one only to grant certiorari to another? A key point in Justice Samuel A. Alito Jr.'s majority opinion in *Slott-Nielsen* was that "the parties are sophisticated business entities," meaning that the court "spares from its affirmative-authorization requirement contracts of adhesion presented on a take-it-or-leave-it basis" limiting the scope of the opinion. *Slott-Nielsen*.¹⁴

Both *AT&T* and *American-Express* identify class action waivers in adhesion contracts, but *AT&T* has a more favorable fact pattern for addressing the questions posed in Ginsburg's dissent. By choosing a case involving individual consumers, the *Slott-Nielsen* majority can turn the implications of *Slott-Nielsen* into law, holding that class-action waivers are both enforceable (if not superfluous) and enforceable for non-sophisticated parties outside the antitrust arena.

¹¹ Transcript of Oral Argument at 44, *Jackson v. Rent-A-Center West Inc.*, No. 09-497, filed (U.S. Oct. 23, 2009).

¹² *Id.* dissent at 10.

¹³ No. 08-1473, 2010 U.S. LEXIS 3744, 78 U.S.L.W. 3642 (U.S. May 3, 2010).

¹⁴ No. 08-1198, at 20.

***AT&T Mobility v. Concepcion:* Class Action Waivers Packaged With Consumer ‘Friendly’ Protections**

In *AT&T*, the court will decide whether the FAA preempts states from enforcing arbitration agreements based on class-wide arbitration availability when other remedies are available.

The *AT&T* contract is notable because it provides a number of consumer protections. In addition to following AAA rules, *AT&T*'s agreement provides: (1) the forum is in the county of the consumer's billing address; (2) for claims of \$10,000 or less, the consumer has the right to determine if arbitration will be in person, by phone, or by “desk,” where the arbitrator uses only documents; (3) *AT&T* offers to pay all costs of non-frivolous arbitrations; (4) small claims court is an alternative to the arbitration; and (5) full remedies, including punitive damages and injunctions, are available to the arbitrator. Finally, as an incentive, in arbitration, *AT&T* waives the right to seek attorney's fees, and if the arbitration award exceeds the last written settlement offer, *AT&T* guarantees a \$7500 minimum recovery and doubles attorneys fees. In order to begin the process, the consumer simply fills out a one page complaint on the website.

AT&T resolves a large majority of its claims, quickly and in full, during the informal phase, prior to arbitration. The opposition agrees. The problem, the opposition argues, is that this “favorable” process offers little incentive for individuals to file low-stakes claims. The result, they argue, creates an opportunity for companies to cheat large numbers of consumers out of individually

small amounts, adding up to big gains for the corporation.

Looking to the Future: Consequences of a Broad vs. Narrow Ruling On Enforceability of Class Action Waivers in Arbitration Agreements

The consequences of reversing *AT&T* depend on how the court chooses to do it. It has the option to either create a bright-line rule for class action waivers or instead, set a standard within the narrow fact pattern presented by *AT&T*. While the business community and the U.S. Chamber of Commerce would welcome a broad ruling, issuing one would provoke a reaction from the consumer advocate community and potentially Congress. A narrow ruling would most immediately result in an increase in litigation as companies push up against the “*AT&T* standard.”

Those hoping for a bright-line ruling validating class action waivers are likely to be disappointed, but not surprised.

Instead, the court will likely follow the path begun in *Stolt-Nielsen* and continued in *Jackson* and chip away at the role of the courts as an avenue for consumer disputes. Expect the court in *AT&T* to create a ruling that applies to the facts of the case at hand. It can state that the “consumer friendly” class arbitration waiver regime that *AT&T* adopted is valid, without taking a stand on all class arbitration waivers. That ruling will result in the drafting of new arbitration regimes (with class action waivers) that are modeled on the consumer-friendly provisions in *AT&T*.