

AT&T MOBILITY LLC V. CONCEPCION

**CLASS ACTION WAIVERS AND THE
PREEMINENCE OF THE FEDERAL ARBITRATION ACT**

By

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In a much anticipated decision, the U.S. Supreme Court held 5-4 that a California rule which invalidated mandatory arbitration clauses unless they permitted class actions was preempted by the Federal Arbitration Act ("FAA"). *AT&T Mobility LLC v. Concepcion*, ____U.S.____, 131 S.Ct. 1740 (2011). The decision has significant implications for the future conduct of arbitration proceedings and class actions.

The Dispute and the Arbitration Clause

AT&T offered a "free" phone to anyone who signed up for its service. However, AT&T charged, as it was required to do by California law, a sales tax on the retail value of each phone. The Conceptions received the two free cell phones but were charged \$30.02 as sales tax. They filed suit alleging that AT&T's requirement for payment of the sales tax on a "free" phone was fraudulent and sought to represent a class of all similar purchasers.¹

The Wireless Service Agreement ("WSA") signed by the Conceptions contained an arbitration clause and a class action prohibition which required any dispute to be brought only in an individual capacity.² However, the WSA also contained a number of provisions dealing with procedural safeguards and financial incentives for consumers.

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¹ 131 S.Ct. and 1744.

² *Laster v. AT&T Mobility LLC*, 584 F.3d 849, 852-53 (9th Cir. 2009).

The procedural safeguards included:

- **Cost-free arbitration for non-frivolous claims:** “[ATTM] will pay all [American Arbitration Association (“AAA”)] filing, administration and arbitrator fees” unless the arbitrator determines that the claim “is frivolous or brought for an improper purpose (as measured by the standards set forth in Federal Rules of Civil Procedure 11(b))”;
- **Convenience:** Arbitration takes place “in the county * * * of [the customer’s] billing address,” and for claims of \$10,000 or less, customers have the exclusive right to choose whether the arbitrator will conduct an in-person hearing, a hearing by telephone, or a “desk” arbitration in which “the arbitration will be conducted solely on the basis of documents submitted to the arbitrator.”
- **Flexible consumer procedures:** Arbitration is conducted under the AAA’s Commercial Dispute Resolution Procedures and the Supplementary Procedures for Consumer-Related Disputes, which the independent, non—profit AAA designed with consumers in mind;
- **Small claims court option:** Either party may bring a claim in small claims court in lieu of arbitration;
- **Full remedies available:** The arbitrator may award the claimant any form of individual relief (including statutory attorneys’ fees, statutory damages, punitive damages, and injunctions) that a court could award; and
- **No confidentiality requirement:** Customers and their attorneys are not required to keep the results of the arbitration confidential.

The features that are designed to encourage consumers to pursue claims through bilateral arbitration include:

- **\$7,500 minimum recovery if arbitral award exceeds ATTM's last settlement offer:** If the arbitrator awards a California customer relief that is greater than ATTM's last "written settlement offer made before an arbitrator was selected" but less than \$7,500, ATTM will pay the customer \$7,500 rather than the smaller arbitral award;
- **Double attorneys' fees:** If the arbitrator awards the customer more than ATTM's last written settlement offer, then ATTM will "pay [the customer's] attorney, if any, twice the amount of attorneys' fees, and reimburse any expenses, that [the] attorney reasonably accrues for investigating, preparing, and pursuing [the] claim in arbitration"; and
- **ATTM disclaims right to seek attorneys' fees:** "Although under some laws [ATTM] may have a right to an award of attorneys' fees and expenses if it prevails in an arbitration, [ATTM] agrees that it will not seek such an award [from the customer]."³

In addition to these provisions, the WSA provided for simplified notice of dispute, demand for arbitration and a layman's guide on how to arbitrate a claim.

AT&T moved to compel arbitration. The Concepcions, relying on California case law, opposed arbitration arguing that the class action waiver made the arbitration requirement unconscionable and thus unenforceable under the FAA.

The District Court Decision

Based on the California Supreme Court's decision in *Discovery Bank v. Superior Court*,⁴ the District Court refused to enforce the arbitration clause and class action waiver. Relying on California's stated policy of favoring class litigation to "deter fraudulent conduct in cases involving large numbers of consumers with small amounts of damages" the Court found the

³ *Id.* at 856 n. 10.

⁴ 36 Cal. 4th 148, 113 P.3d 1100 (2005).

class action waiver to be unconscionable.⁵ However, the Court recognized that nearly all consumers who pursue the informal claims process are very likely to be compensated promptly and in full.⁶

The Ninth Circuit Decision

The Ninth Circuit affirmed finding that although the arbitration provision would “guarantee that the company will make any aggrieved customer whole who files a claim,” which the Court described as “a good thing,” the fact that “not every aggrieved customer will file a claim,” invalidated the arbitration/class action waiver provision.⁷

The Supreme Court Decision

Considering the Supreme Court's recent and most favorable treatment of arbitration, and the Ninth Circuit's track record generally in the Supreme Court, it was hardly a surprise when the decision was reversed. If there was a surprise it was the breadth of the majority opinion favoring arbitration. The Court could have written very narrowly simply finding that the AT&T clause was not unconscionable since it was so consumer oriented. Also, the Court could have taken the position that unconscionability determinations are to be made only as of the time of contracting as Justice Thomas suggested in his concurring opinion.⁸ Rather the Court elected to address the more encompassing issue of preemption.

Section 2 of the FAA Is Not a Thoroughfare But a Narrow Path

Section 2 of the FAA permits arbitration agreements to be declared unenforceable “upon such grounds as exist at law or in equity for the revocation of a contract.” Of course Section 2 would not permit a state law which simply prohibited the arbitration of a claim.⁹ However, the

⁵ *Laster v. T-Mobile USA, Inc.*, 2008 WL 5216255 *7. (S.D. Cal. Aug. 11, 2008).

⁶ *Id.* at 10-11.

⁷ 584 F.3d at 856 n. 9.

⁸ 131 S.Ct. at 1753.

⁹ 131 S.Ct. at 1747.

issue becomes more complex if a nominally neutral concept such as duress or unconscionability is applied in a fashion to disfavor arbitration.¹⁰

Although recognizing the savings clause of Section 2, the Court held that there was no intent to preserve state-law rules "that stand as an obstacle to the accomplishment of the FAA's objectives." For example a state case law rule requiring judicially monitored discovery, application of the Federal Rules of Evidence or ultimate disposition by a jury would be invalid even though applicable to all contracts.¹¹

In reaching the decision to invalidate the California rule, the Court outlined several principles for evaluating arbitration clauses. First the Court noted that a prime objective of an agreement to arbitrate is to achieve "streamlined proceedings and expeditious results."¹² The change from bilateral to class arbitration is "fundamental" and has inherent problems involving higher stakes litigation, confidentiality and the use of arbitrators who have little or no experience in class certification issues.¹³ Switching from bilateral to class arbitration makes the process "slower, more costly and more likely to create a procedural morass than final judgment."¹⁴

The Court also recognized that class arbitration sacrificed the "principal advantage of arbitration" because it "requires procedural formality" to pass constitutional muster.¹⁵ Further, arbitration is poorly suited to "the higher stakes of class litigation because of the limitations on review of the arbitrator's decision" and "defendants would not bet the company with no effective means of review."¹⁶ The Court concluded that because the California rule "stands as an obstacle to the accomplishment and execution of the full purposes and objectives" of the FAA, the *Discover Bank* rule is preempted.¹⁷

¹⁰ *Id.*

¹¹ *Id.*

¹² 131 S.Ct. at 1749.

¹³ 131 S.Ct. at 1750-51.

¹⁴ 131 S.Ct. at 1751.

¹⁵ *Id.*

¹⁶ 131 S.Ct. at 1752.

¹⁷ 131 S.Ct. at 1753.

The four dissenting justices relied on the savings clause of Section 2 of the FAA arguing that so long as all contracts were treated equally, then a state court could invalidate an arbitration clause disregarding whether the impact on arbitration was disproportionate.¹⁸

Of more interest is the concurring opinion of Justice Thomas. Fully joining the majority opinion, he notes that it would "be absurd to suggest that § 2 requires only that a defense apply to "any contract." Rather it means that "courts cannot refuse to enforce arbitration agreements because of a state public policy."¹⁹

However, the concurrence offers a different approach to determining the scope of Section 2. Relying on an analysis of the entirety of the FAA, the concurring opinion concludes that "the FAA requires that an agreement to arbitrate be enforced unless a party successfully challenges the formation of the arbitration agreement."²⁰ Thus any evaluation of Section 2 must be based on "defects in the making of an agreement."²¹ Since the *Discover Bank* rule is based on public policy reasons, it does not concern whether the arbitration agreement "was properly made."²²

Lessons from AT&T

The full impact of the decision will not be known for some time. The Supreme Court granted certiorari in *Cellco Partnership v. Litman*, No. 10-398, 2011 WL 1631041 (U.S. May 2, 2011) and vacated the decision of the Third Circuit which had held that an unconscionability challenge to a class action waiver under New Jersey law was not preempted by the FAA. Other courts have granted motions to compel arbitration based on *AT&T Mobility*.²³

¹⁸ 131 S.Ct. at 1762.

¹⁹ 131 S.Ct. at 1753.

²⁰ *Id.*

²¹ *Id.*

²² 131 S.Ct. at 1756.

²³ See e.g. *Cruz v. Cingular Wireless, LLC*, 2011 WL 3505016 (11th Cir. August 11, 2011); *Hancock v. AT&T*, 2011 WL 3626785 (W.D. Okla. Aug. 11, 2011); *Kanbar v. O'Melveney & Myers*, 2011 WL 2940690 (N.D. Cal. July 27, 2011); *Day v. Persels & Assocs.*, 2011 WL 1770300 (M.D. Fla. May 9, 2011).

Pending further case law development, at least three principles can be derived from the decision. First, a simple incantation that a state rule applies to all contracts will not allow entry into the safe harbor of Section 2. If the state law rule "interferes with fundamental attributes of arbitration," it is preempted.²⁴ Facial impartiality will not suffice to invalidate the clause if the rule, as applied, adversely impacts arbitration.

Second, one seeking to avoid being compelled to arbitrate in a non-class action format, must find a reason based on something other than "public policy." The grounds are limited and if Justice Thomas' concurring opinion should commend itself to a majority of the Court, those grounds may narrow further.

Third, the decision would counsel a party who wishes to enforce a class action waiver and a mandatory arbitration clause to analyze its current terminology. Although the Supreme Court did not directly base its decision on the terms of the specific AT&T arbitration clause,²⁵ it is clear that the clause was tilted far on the side of being consumer friendly. One can speculate that that fact coupled with the fact that the sales tax was required by California law (knowledge with which the plaintiffs would have presumably been charged) may have impacted the decision. The careful company would certainly review existing agreements and forms to try to combat more subtle claims of unfairness, duress or overreaching in new attacks on arbitration/class waiver clauses.

Possible Areas of Challenge

The breadth of the Supreme Court's opinion raises the question of whether there are any grounds upon which an arbitration clause mandating class action waiver may be challenged. In the only reported decision of an appellate court addressing these issues since *AT&T Mobility*, the Eleventh Circuit has posited some possibilities.²⁶

²⁴ 131 S.Ct. at 1748.

²⁵ 131 S.Ct. at 1753.

²⁶ *Cruz, supra*, 2011 WL 3505016 at *8.

First, an arbitration/class action waiver clause should remain subject to challenge on the ground that it “prevents the claimant from vindicating her statutory cause of action.”²⁷ Large arbitration costs could be a significant factor in such preclusion.²⁸ However, a clause that is the same as the AT&T Mobility clause clearly satisfies this requirement.²⁹

Second, the Eleventh Circuit found that like the Concepcions, the plaintiffs had not alleged “any defects in the formation of the contract.”³⁰ Relying on Justice Thomas’ concurring opinion the Court quoted, “the FAA requires that an Agreement to arbitrate be enforced unless a party successfully challenges the formation of the arbitration agreement, such as by proving fraud and duress.”³¹

Third, it is likely that challenges will also be mounted utilizing the general concept of unconscionability. However, this challenge faces a number of obstacles. Unless the unconscionability reaches the bar of *Mitsubishi* or *Green Tree* on financial impairment or defects in formation, it requires some effort to posit a situation that otherwise satisfies the *AT&T Mobility* standard.

Finally, it is likely that consumer class plaintiffs will seek to take discovery on the operations, rules, procedures, history and financial compensation of the arbitration provider. Depositions or other testimony may likewise be offered by attorneys along the lines of “no lawyer would take a case this small without a potential class recovery.” The Supreme Court’s opinion lauding the “streamlined proceedings” and “expeditious results” of arbitration would seem to argue against the former approach. As to the second, it would seem that the amount in controversy would have to be less than that involved in *AT&T Mobility* to have much chance of prevailing.

²⁷ *Id. Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*, 473 U.S. 614, 637 (1985).

²⁸ *Cruz, supra*, at *8. *Green Tree Fin. Corp. v. Randolph*, 531 U.S. 79, 90 (2000).

²⁹ *Cruz, supra*, *8.

³⁰ *Id.* at *9.

³¹ *Id.*

Conclusion

AT&T Mobility appears to be a significant impediment to efforts to avoid compelled arbitration as individual claims of what might otherwise be brought as consumer class actions.