

Commentary: Concepcion allows companies to avoid the morass of class actions

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In *AT&T Mobility LLC v. Concepcion*, (2011), a 5-4 majority of the U.S. Supreme Court determined that the Federal Arbitration Act (FAA), pre-empts a California rule, which California courts had previously applied to invalidate “unconscionable” consumer arbitration agreements. California’s so-called *Discover Bank* rule had classified most class action waivers contained in consumer contracts as unconscionable and therefore unenforceable. In invalidating the *Discover Bank* rule, *Concepcion* expressly approved arbitration clauses that contain class action waivers in consumer contracts not only in California, but nationwide.

The Court held that the FAA pre-empts the *Discover Bank* rule, because, in the words of the majority, the rule presented “an obstacle to the accomplishment and execution of the full purposes and objectives of Congress.” Specifically, the Court invalidated the *Discover Bank* rule because of its interference with the twin goals of the FAA identified by the Court: 1) the enforcement of private agreements according to their terms; and 2) the encouragement of efficient dispute resolution. In holding that class action waivers in arbitration agreements are enforceable, the Court highlighted and praised AT&T’s consumer-friendly agreement for its substantive and procedural fairness to customers, a fact often overlooked by critics of *Concepcion*.

The *Concepcion* decision arose out of a dispute between a cellphone company, AT&T Mobility LLC, and Vincent and Liza Concepcion, a couple who objected to being charged \$30.22 in sales tax for what AT&T had advertised as a free cellphone under their service contract. The Conceptions sued AT&T in federal court, and their suit was subse-

quently consolidated with a factually related class action. The class alleged that AT&T had engaged in false advertising and fraud by charging sales tax on its “free” phones.

AT&T moved to compel arbitration under the cellphone contract. The U.S. District Court for the Southern District of California “described AT&T’s arbitration agreement favorably, noting, for example that the informal dispute-resolution process was ‘quick, easy to use’ and likely to ‘promptly full or...even excess payment to the customer without the need to arbitrate or litigate.” The district court further opined “that the Conceptions were better off under their arbitration agreement with AT&T than they would have been as participants in a class action, which ‘could take months, if not years, and which may merely yield an opportunity to submit a claim for recovery of a small percentage of a few dollars.’ “ Nevertheless, the Southern District of California denied AT&T’s motion. Relying on the California Supreme Court’s decision in *Discover Bank v. Superior Court*, 113 P. 3d 1100 (Calif. 2005), the court determined that the arbitration clause was unconscionable under California law.

The U.S. Court of Appeals for the 9th Circuit affirmed the district court’s decision, finding the provision unconscionable under California law, holding that the *Discover Bank* rule was not pre-empted by the FAA and rejecting AT&T’s argument that the *Discover Bank* rule undermined well-settled federal policy in favor of arbitration. The 9th Circuit so found, notwithstanding its acknowledgment that AT&T’s arbitration procedures benefitted its customers, noting “that aggrieved customers who filed claims would be ‘essentially guarantee[d]’ to be made whole.” The Supreme Court granted certiorari to hear AT&T’s appeal.



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JUSTICE SCALIA’S DECISION

In an opinion written by Justice Antonin Scalia, the majority began its analysis by reaffirming the federal policy favoring arbitration as embodied by the FAA. The Court devoted a large part of its opinion to illustrating how class arbitration undermines one of arbitration’s most appealing characteristics. The Court explained that “the switch from bilateral to class arbitration sacrifices the principal advantage of arbitration — its informality — and makes the process slower, more costly and more likely to generate procedural morass than final judgment.”

Despite the FAA’s pro-arbitration stance, the FAA’s saving clause permits arbitration agreements to be declared unenforceable “upon such grounds as exist at law or in equity for the revocation of any contract,” including unconscionability. Under California law, a finding of

unconscionability requires both a procedural and a substantive element, “the former focusing on ‘oppression’ or ‘surprise’ due to unequal bargaining power, the latter on ‘overly harsh’ or ‘one-sided’ results.” The California Supreme Court had employed this two-prong test in *Discover Bank*, when it found that class action waivers in arbitration agreements are necessarily unconscionable. The Concepcions contended that the *Discover Bank* rule, with its origins in California’s unconscionability jurisprudence, constituted “grounds as exist at law” for revoking the class action waiver clause contained in AT&T’s agreement. AT&T contended that such an interpretation of California law “discriminated against arbitration” and therefore could not be adopted.

Although the majority agreed with the Concepcions’ contention that the FAA’s saving clause preserves generally applicable contract defenses, it disagreed with the Concepcions’ application of the saving clause to their agreement with AT&T. The Court concluded that nothing in the FAA’s saving clause “suggests an intent to preserve state-law rules that stand as an obstacle to the accomplishment of the FAA’s objectives,” reiterating that the “principal purpose” of the FAA is to ensure enforcement of private arbitration agreements according to their terms. Scalia concluded that California’s *Discover Bank* rule interfered with arbitration, and opined that, in general, arbitration is “poorly suited to the higher stakes of class litigation.” The Court therefore held that California’s *Discover Bank* rule is pre-empted by the FAA, and otherwise remanded for further proceedings consistent with the opinion.

AT&T’S ARBITRATION AGREEMENT

In rejecting the Concepcions’ argument that the FAA’s saving clause permitted the invalidation of the class action-waiver provision, the Court emphasized the overall fairness of AT&T’s arbitration agreement. The majority stressed that both the district court and the 9th Circuit had acknowledged the agreement’s procedural and substantive benefits.

As recounted by the Court, the arbitration agreement’s benefits to AT&T’s customers were myriad. AT&T’s customers could initiate dispute proceedings by completing a one-page notice of dispute form available on the company’s Web site. If AT&T chose not to settle the claim, or if

the dispute was not resolved within 30 days, the customer could invoke arbitration by filing a separate demand for arbitration also available on AT&T’s Web site. In the event that the parties proceeded to arbitration, the agreement required AT&T to pay all costs for nonfrivolous claims, and required the arbitration to take place in the customer’s county.

For claims of \$10,000 or less, the customer could choose whether the arbitration would proceed in person, by telephone or based solely on submissions. Either party had the right to bring a claim in small claims court in lieu of arbitration. Further, AT&T’s agreement afforded the arbitrator discretion in crafting individual relief, including injunctions and, presumably, punitive damages. The agreement, moreover, precluded AT&T from seeking reimbursement for any of its attorney fees. Finally, in the event that a customer received an arbitration award greater than AT&T’s last written settlement offer, the agreement required AT&T to pay a \$7,500 minimum recovery and twice the amount of the claimant’s attorney fees.

In light of these provisions, the Court concluded that the Concepcions’ claim “was most unlikely to go unresolved,” and appeared most impressed by AT&T’s agreement to pay claimants a minimum of \$7,500 and twice their legal fees if they obtained an arbitration award greater than AT&T’s last settlement offer. In the opinion’s penultimate paragraph, Scalia reiterated that both the district court and the 9th Circuit had acknowledged the procedural and substantive merits of AT&T’s agreement.

WHAT THIS MEANS FOR COMPANIES

Concepcion provides an opportunity for companies to potentially avoid the morass of class actions and their attendant costs by requiring the arbitration of certain grievances and the waiver of class actions. Further, it appears likely that the decision’s scope extends beyond agreements in the consumer context (such as agreements for cellphones, credit cards and computers), and includes any agreement in which it is appropriate to include an arbitration provision and request a class action waiver. For example, in addition to consumer agreements, the opinion’s application is well suited for agreements in the employment context. No matter the context, however, *Concepcion* instructs that when drafting arbitration provisions, companies should strive for fairness to consumers or employees.

While critics of *Concepcion*, including consumer advocacy groups, have argued that the decision turns the FAA into a shield against corporate accountability, proponents of the decision point out that the Court recognized that arbitration frequently benefits consumers, with AT&T’s agreement with the Concepcions serving as a prime example. Indeed, and despite their divergent holdings, each court involved in the Concepcions’ case identified incentives and benefits afforded consumers by AT&T’s specific agreement. Nevertheless, after *Concepcion* was decided, Senate Judiciary Committee Chairman Patrick Leahy (D-Vt.), immediately called for a congressional response in order to “clarify the original intent of the Federal Arbitration Act.” Subsequently, Sen. Al Franken (D-Minn.), introduced the “Arbitration Fairness Act of 2011,” which would preclude forced arbitration clauses in employment, consumer and civil rights cases. It remains to be seen what action Congress will take with respect to this proposed legislation.

In the meantime, and in light of this monumental decision, companies should review their agreements in order to determine whether arbitration is appropriate and feasible for them, and should further consider whether the waiver of class actions is also in their best interest. As a matter of caution, the Supreme Court did not negate the FAA’s saving clause and, therefore, has not ruled out the possibility of finding an arbitration agreement unconscionable under circumstances different from those presented in *Concepcion*. Therefore, any arbitration agreement and its attendant class action waiver should be fair to consumers or employees in both procedure and outcome so as to withstand any “unconscionability” analysis. Proper application of this decision to consumer and employee contracts, and beyond, can ensure that those who believe they have been aggrieved are provided a fair forum in which to express their complaint, while at the same time, protect companies from the extreme costs and uncertainties of class action litigation.

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