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Courts explore future of consumer class actions

By Gary Zhao

To insulate from class-action liability, large businesses often insert arbitration clauses in consumer contracts that specifically preclude or waive the right of the consumer to participate in any collective or class actions. These arbitration provisions do not need to be negotiated or signed to take effect. Courts frequently confront the issue of whether such an arbitration clause or provision is unconscionable or otherwise unenforceable under state contract law.

In *AT&T Mobility LLC v. Concepcion,* the Supreme Court considered whether the Federal Arbitration Act (FAA) prohibits states from conditioning the enforceability of certain arbitration agreements on the availability of classwide arbitration procedures. The court held that the FAA preempted California's *Discover Bank* rule, which deemed class-action waivers in mandatory arbitration agreements unenforceable.

On its face, *Concepcion* mandates that state laws that broadly prohibit class-action waivers in arbitration agreements are preempted by the FAA. Some legal commentators quickly called *Concepcion* a pro-business decision and a "death blow" to all forms of consumer class actions. While several lower courts have applied the decision broadly to compel arbitrations of consumer class-action suits that had been pending for years, other courts have continued to find ways to avoid or limit the mandate.

In *Concepcion,* the customer-respondents purchased AT&T wireless service based on AT&T's promise of free phones in its advertisements. The customers were not charged for the phones, but were charged a sales tax based on the phones' retail value. The customers sued, alleging that AT&T engaged in false advertising and fraud by charging sales tax on free phones. The suit was later consolidated with a putative class action in the Southern District of California.

To date, Concepcion certainly has not brought the apocalyptic ending to consumer class actions as some had speculated. The short-term ramifications of Concepcion are debatable while the long-term ramifications are unknown.

The cellular-phone contract between AT&T and its customer-respondents provided for arbitration of all disputes, but did not permit classwide arbitration. Based on this provision, AT&T moved to compel arbitration. The customers opposed the motion, contending that the arbitration provision of the contract was unconscionable because it disallowed classwide procedures.

Relying on the California Supreme Court's decision in *Discover Bank v. Superior Court,* which rendered most waivers of class-action arbitration in consumer transactions unenforceable, the district court dismissed AT&T's motion, holding that AT&T did not show that bilateral arbitration adequately substituted for the deterrent effects of class actions. The 9th U.S. Circuit Court of Appeals affirmed the dismissal of AT&T's motion, similarly finding the provision that disallowing a class-action procedure was unconscionable under California law.

The Supreme Court reversed and remanded. The court found that the purpose of the FAA is to ensure and encourage the enforcement of terms and conditions of private arbitration agreements. The *Discover Bank* decision relied upon by lower courts and the customer-respondents conflicted with the principal purpose of the FAA, by allowing a party to a consumer contract to demand class-wide arbitration ex post. The Supreme Court held that *Discover Bank* was therefore preempted by the FAA.

Writing for the 5-4 majority, Justice Antonin G. Scalia noted that, under the "liberal federal policy favoring arbitration agreements, notwithstanding any state substantive or procedural policies to the contrary," the FAA pre-empts any state law that "prohibits outright the arbitration of a particular type of claim."

Supreme Court decisions do not always result in clear mandates or black and white rules of law. *Concepcion* is no exception. Since its release in April, not every lower court has been so willing to view the decision as a mandate requiring the enforceability of arbitration provisions barring class-action or collective procedures.

For example, the *Concepcion* holding has not carried over to other groups of plaintiff classes and claims. In *Chen-Oster,* a Title VII gender discrimination class action against Goldman Sachs, the U.S. District Court for the Southern District of New York denied Goldman Sachs' motion to reconsider the court's denial of its motion to compel arbitration based on *Concepcion.* The district court instead applied the law of the 2nd Circuit to deny the motion. It found that no change is "clearly mandated" by *Concepcion* because the Supreme Court did not address how the FAA affects arbitration with respect to federal statutory rights, in *Chen-Oster,* Title VII. It is therefore not a "controlling decision."

In *Ferguson v. Corinthian Colleges,* the U.S. District Court for the Northern District of California held that California law creating a private right to bring injunctive relief claims on behalf of the public is not pre-empted by the FAA, even after *Concepcion*.

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Lower courts continue to recognize that arbitration agreements may be invalidated by generally applicable contract defenses, such as fraud, duress or unconscionability. In the *In Re Checking Account Overdraft Litigation,* the U.S. District Court for the Southern District of Florida held that bank customers with debit cards attached to checking accounts are not compelled to use arbitration rather than class-action lawsuits because the subject arbitration agreements are "unconscionable."

Likewise, in *Cmty. State Bank v. Strong,* the 11th Circuit recognized that the *Concepcion* court preserved these generally applicable contract defenses so long as the defenses do not apply only to arbitration. The ability of such contractual defects to invalidate arbitration agreements is not affected by *Concepcion.*

It should further be noted that the *Concepcion* decision should not extend beyond cases involving consumer contracts. Some consumer class actions are brought by consumers who have not entered into adhesion contracts similar to the one used by AT&T in *Concepcion*. It follows that *Concepcion*, arguably, on its face, is not applicable in this type of consumer class actions.

To date, *Concepcion* certainly has not brought the apocalyptic ending to consumer class actions as some had speculated. The short-term ramifications of *Concepcion* are debatable while the long-term ramifications are unknown. What we know is that the courts are quickly laying out a roadmap for post-*Concepcion* unconscionability analysis.

Because boundaries and lines are still being drawn by courts, businesses looking to protect themselves from class-action liability should not simply copy AT&T arbitration provisions and insert them into standard customer contracts.