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Consumer Class Action Waivers Post-Concepcion

Law360, New York (May 16, 2012, 1:48 PM ET) -- Consumer class actions threaten businesses with significant liability for damages, attorneys' fees and injunctions, arising out of disputes that would otherwise involve very small amounts of money on a per-plaintiff basis.

Seeking to prevent class actions that arise from consumer contract disputes, many companies have inserted into their contracts arbitration provisions that not only require arbitration, but also prohibit consumers from bringing disputes in the form of a class action.

Last year, the U.S. Supreme Court ruled in AT&T Mobility LLC v. Concepcion,131 S. Ct. 1740 (2011) that the Federal Arbitration Act (FAA) preempted California's refusal to enforce class action waivers in consumer arbitration agreements.

Since then, plaintiffs have attempted to distinguish Concepcion, arguing that certain state laws that prohibit the enforcement of consumer arbitration agreements are different either substantively or procedurally from the California law preempted in Concepcion.

The United States Court of Appeals for the Ninth Circuit recently issued two opinions that shut the door on these arguments and provide businesses with significant guidance on how broadly they can write and enforce consumer arbitration agreements.

AT&T Mobility LLC v. Concepcion

The Federal Arbitration Act provides that written contracts to arbitrate a dispute involving commerce are "valid, irrevocable and enforceable, save upon such grounds as exist in law or in equity for the revocation of any contract." 9 U.S.C. § 2.

Section 2 thus requires courts to enforce arbitration agreements affecting commerce, irrespective of state law to the contrary, unless an agreement is invalid under "generally applicable contract defenses, such as fraud, duress or unconscionability." Doctor's Associates Inc. v. Casarotto, 517 U.S. 681, 687 (1996).

However, the words "any contract" in Section 2 mean that courts may not "invalidate arbitration agreements based on state laws applicable only to arbitration agreements." Id. In other words, by enacting the FAA, "Congress precluded States from singling out arbitration provisions for suspect status, requiring instead that such provisions be placed 'upon the same footing as other contracts.'" Id. (quoting Scherk v. Alberto-Culver Co., 417 U.S. 506 (1974)).

In Concepcion, the court addressed a California rule that prohibited businesses from enforcing arbitration agreements that preclude consumers from bringing claims in the form of class actions. AT&T's cellular telephone contract with the plaintiffs required that the parties arbitrate any dispute arising out of the agreement.

The contract also required that any claims be brought in the parties' "individual capacity, and not as a plaintiff or class member in any purported class or representative proceeding."

The plaintiffs filed a putative class action against AT&T in federal court in California, contending that AT&T breached the contract by charging sales tax based on the retail value of the phones they purchased. When AT&T moved to compel arbitration, the plaintiffs opposed on the ground that the arbitration agreement was unconscionable under California law because it disallowed class actions.

The district court and the Ninth Circuit agreed with the plaintiffs that the class action waiver in the arbitration agreement was unconscionable and unenforceable under the rule established by the California Supreme Court in Discover Bank v. Superior Court, 36 Cal. 4th 148 (2005).

In Discover Bank, the court examined California's law of unconscionability, which provides that courts can refuse to enforce a contract that was unconscionable at the time it was made and which focuses on unequal bargaining power and "overly harsh" or "one-sided" results.

The California Supreme Court held that a class action waiver is unconscionable and unenforceable when the waiver is "found in a consumer contract of adhesion in a setting in which disputes between the contracting parties predictably involve small amounts of damages, and when it is alleged that the party with superior bargaining power has carried out a scheme to deliberately cheat large numbers of consumers out of individually small sums of money." Id. at 162.

Because these elements are present in virtually every circumstance in which a defendant attempts to enforce a class action waiver in a consumer arbitration agreement, the effect of the Discover Bank rule was to foreclose defendants from enforcing these waivers and compelling individual arbitration.

In Concepcion, the Supreme Court rejected California's Discover Bank rule and reversed the judgment of the Ninth Circuit. The Supreme Court began its analysis by explaining that "[w]hen state law prohibits outright the arbitration of a particular claim, the analysis is straightforward: The conflicting rule is displaced by the FAA." 131 S. Ct. at 1747.

But the court observed that the analysis is more complex when a generally applicable doctrine such as unconscionability "is alleged to have been applied in a fashion that disfavors arbitration." Id. The court noted that although Section 2 "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 1748.

One of those objectives was to "ensure the enforcement of arbitration agreements according to their terms so as to facilitate streamlined proceedings." Id. Among other things, that means that "parties may agree to limit the issues subject to arbitration." Id.

In holding that that the Discover Bank rule "interferes with arbitration," the court pointed out that the limiting principles set forth in Discover Bank were not really limits, effectively meaning that California law required parties to an arbitration agreement to permit class arbitration, even when the parties agreed otherwise.

Because the Discover Bank rule "stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress," the court held that it was preempted by the FAA. Id. at 1753.

After Concepcion, there remained a question about how courts would interpret that decision in addressing state laws that were different than California's Discover Bank rule but that interfered with arbitration.

In two cases decided in March 2012, the Ninth Circuit relied on Concepcion to tighten the noose on consumers who attempt to avoid class action waivers and other restrictions in arbitration agreements.

Coneff v. AT&T Corp.

In Coneff v. AT&T Corp., No. 09-35563 (9th Cir. 2012), the plaintiffs attempted to pursue a class action against AT&T in federal court in the state of Washington. The plaintiffs were customers of AT&T Wireless who claimed that, among other things, after AT&T merged with Cingular Wireless they were charged improper fees for wireless service.

The plaintiffs sued under various state consumer protection statutes as well as the Federal Communications Act. The district court held that the arbitration agreement contained in the plaintiffs' cellular telephone contracts was unconscionable under Washington's law of "substantive" unconscionability, particularly because the low amount of money sought by each plaintiff precluded effective relief in the absence of a class action.

The plaintiffs made three arguments in their attempt to distinguish Concepcion, each of which the Ninth Circuit rejected in holding that the FAA preempts Washington's law invalidating class action waivers.

First, the plaintiffs argued that there was an "implied exception" to the rule articulated in Concepcion under which class action waivers could be unconscionable if "such waivers precluded effective vindication of statutory rights."

To support this argument, the plaintiffs relied on Green Tree Fin. Corp.-Ala v. Randolph, 531 U.S. 79, 90 (2000), in which the Supreme Court held that federal statutory claims are subject to arbitration "so long as the prospective litigant effectively may vindicate his or her statutory cause of action in the arbitral forum."

The court further stated that "[i]t may well be that the existence of large arbitration costs could preclude a litigant ... from effectively vindicating her federal statutory rights in the arbitral forum." Id.

In that case, however, the court held that the plaintiff had not demonstrated that she would bear such costs. In Coneff, the district court found that because each plaintiff's claim was so small, "the cost of [arbitrating] would be prohibitively expensive for a customer proceeding on an individual basis."

The Ninth Circuit disagreed, holding that Concepcion rejected the premise that "the claims at issue in this case cannot be vindicated effectively because they are worth much less than the cost of litigating them." The court pointed out that the concern raised by the plaintiffs — and the dissent in Concepcion — "is not so much that customers have no effective means to vindicate their rights, but rather that customers have insufficient incentive to do so."

In the Ninth Circuit's view, Concepcion must be read to mean that class action waivers are enforceable under the FAA, even where there is "insufficient incentive" for a single plaintiff to arbitrate. The court held that to the extent Concepcion is inconsistent with Green Tree, the court was bound to follow the Supreme Court's most recent decision.

This holding obviously is important for defendants in consumer class action cases in the Ninth Circuit. It also is inconsistent with the recent Second Circuit decision in In re American Express Merchants' Litigation, 667 F.3d 204 (2d Cir. 2012).

In that case, the court held that a consumer class action waiver could not be enforced in an antitrust action because, given the potential individual damages in the low thousands of dollars and the potential costs of several hundreds of thousands of dollars, "the cost of plaintiffs' individually arbitrating their dispute with Amex would be prohibitive, effectively depriving plaintiffs of the statutory protections of the antitrust laws." Id. at 217.

The court held that while Concepcion "plainly offers a path for analyzing whether a state contract law is preempted by the FAA," that case did not address the question of whether plaintiffs can demonstrate that a class action waiver would preclude them from vindicating federal statutory rights. Id. at 213.

Thus, there is a significant split between the Ninth and Second Circuits that defendants should be aware of whenever they have an opportunity to choose a forum in these cases.

The Coneff plaintiffs' second argument was that Concepcion only applies to state laws like California's that effectively ban class action waivers. According to the plaintiffs, Washington's unconscionability law was different than California's law because the Washington law did not completely ban class action waivers and required a fact-based analysis of the arbitration clause at issue to determine whether the waiver was exculpatory.

The Ninth Circuit held that Concepcion's broad holding "forecloses this argument." This is significant, because it means that — at least according to the Ninth Circuit — states cannot avoid Concepcion by enforcing a rule that is arguably less than a complete ban on class action waivers, if the effect of the rule is to interfere with the right of parties under the FAA to decide what they will arbitrate.

Finally, the plaintiffs argued that Concepcion only addressed the question of whether a state can invalidate a class action waiver provision in an arbitration agreement and force parties to accept class-wide arbitration. The plaintiffs argued that Washington's law would instead invalidate the entire arbitration agreement.

The Ninth Circuit held that this, too, would violate the FAA. By invalidating an arbitration agreement because it did not permit a class action lawsuit, "a court would be doing precisely what the FAA and Concepcion prohibit — leveraging 'the uniqueness of an agreement to arbitrate' to achieve a result that the state legislature cannot." (citing Concepcion).

The thread running through Coneff is the Ninth Circuit's observation that Concepcion is "broadly written." The court applied Concepcion's core holding not only to a state law that was arguably less severe that California's, but also to federal claims, which were not at issue in Concepcion.

Overall, this opinion provides little reason to believe that there are many avenues for avoiding class action waivers under any doctrine that specifically targets arbitration agreements.

Kilgore v. KeyBank Nat'l Assn.

Decided by a different Ninth Circuit panel nine days before Coneff, the court in Kilgore v. KeyBank Nat'l Assn, No. 09-16703 (9th Cir. 2012) took a similarly dim view of state laws that interfere with arbitration post-Concepcion.

The plaintiffs were former students of a vocational aviation school in California. They borrowed money from defendant KeyBank to pay for school. Each plaintiff signed a note that contained an arbitration provision, which waived class action rights.

After the vocational school closed its doors without providing the agreed education, the plaintiffs sued KeyBank in California, claiming that KeyBank loaned money to the plaintiffs and disbursed it to the school even though it knew that aviation schools were "a slowly unfolding disaster."

The plaintiffs' putative class action did not seek damages. Instead, the plaintiffs sought an injunction under California's Unfair Competition Law, Cal. Bus. & Prof. Code § 17200, et seq., prohibiting KeyBank from enforcing the notes, from collecting any debt from the plaintiffs, and from engaging in "false and deceptive acts and practices" with respect to consumer credit practices.

KeyBank moved to compel arbitration. The district court denied the motion based on two California Supreme Court decisions that developed what has become known as the Broughton-Cruz rule.

In Broughton v. Cigna Healthplans of California, 21 Cal. 4th 1066 (1999), the court held that claims for public injunctions under California's Consumers Legal Remedies Act (CLRA), Cal. Civ. Code § 1750, et seq., are not arbitrable.

After examining the legislative purpose of the CLRA, the California Supreme Court held that the legislature did not intend that a plaintiff could be forced to arbitrate claims in which the plaintiff was "functioning as a private attorney general, enjoining future deceptive practices on behalf of the general public." Id. at 76.

The court held that arbitration was not suitable for these claims and that there was an "inherent conflict between arbitration and the underlying purpose of the CLRA's injunctive relief remedy." Id. at 1082. The court further held that the FAA could not be read to "preclude states from passing legislation the purposes of which make it incompatible with arbitration, or to compel states to permit the vitiation through arbitration of the substantive rights afforded by such legislation." Id. at 1083.

In Cruz v. Pacificare Health Systems Inc., 30 Cal. 3d 303 (2003), the court extended Broughton to claims for public injunctive relief under the Unfair Competition Law (UCL), which in that case were filed in a potential class action. The court held that claims for public injunctive relief under the UCL, like those under the CLRA, fit within a "narrow exception to the rule that the FAA requires state courts to honor arbitration agreements." Id. at 312.

The question in Kilgore was whether the Broughton-Cruz rule survived Concepcion. At least two district courts already had held that Broughton-Cruz was still good law after Concepcion. In In re DirecTV Early Cancellation Fee Mktg. & Sales Practices Litig., a California district court held that because Broughton-Cruz prohibited only public injunctive relief claims, the rule did not create an "outright" prohibition of a particular type of claim and therefore did not run afoul of Concepcion.

And in Ferguson v. Corinthian Colleges, another California district court held that Concepcion did not require the arbitration of claims arising out of a state law "the purposes of which are incompatible with the enforcement of an arbitration agreement."

Rejecting the reasoning of these decisions, the Ninth Circuit again adopted an expansive view of Concepcion. The court held that the Broughton-Cruz rule "does not survive Concepcion because the rule 'prohibits outright the arbitration of a particular type of claim' — claims for broad injunctive relief." (quoting Concepcion).

The court agreed that its holding could frustrate the enforcement of California law, but that this was irrelevant under Concepcion:

It may be that enforcing arbitration agreements even when the plaintiff is requesting public injunctive relief will reduce the effectiveness of state laws like the UCL. It may be that FAA preemption in this case will run contrary to a state's decision that arbitration is not as conducive to broad injunctive relief claims as the judicial forum. And it may be that state legislatures will find their purposes frustrated.

These concerns, however, cannot justify departing from the appropriate preemption analysis as set forth by the Supreme Court in Concepcion.

According to the court, "the policy arguments justifying the Broughton-Cruz rule, however, worthy they may be, can no longer invalidate an otherwise enforceable arbitration agreement."

Kilgore appears to foreclose an argument in the Ninth Circuit that there are any substantive exceptions to Concepcion, such that states have the right to exempt a certain type of claim from arbitration. This is particularly important in the consumer class action context, where states repeatedly have attempted to provide an avenue for judicial relief and to circumvent arbitration because of the supposed inadequacy of arbitration for small individual claims.

The Kilgore court did point out that arbitration agreements are still subject to the common law doctrine of unconscionability, as long as the doctrine is not applied in a way that disfavors arbitration.

But once rules that explicitly disfavor arbitration are displaced, it is likely that most modern arbitration agreements will withstand scrutiny. If nothing else, cases like Concepcion and Kilgore provide guidance on how to structure arbitration agreements that will survive the general common law defense of unconscionability.

Taken together, Coneff and Kilgore mean that, within the Ninth Circuit, businesses should be able to rely on an arbitration agreement to prevent consumer class actions, unless an agreement is so one-sided as to be unconscionable under general state law principles.

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