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ARBITRATION

Expert Analysis

# Preemption of California's Standard Of Review of Class Arbitration Waivers

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This fall, the U.S. Supreme Court will consider whether the standard that California courts use for deciding whether contracts containing class-action waivers are unconscionable is preempted by the Federal Arbitration Act (FAA). In *Stolt-Nielsen S.A. v. AnimalFeeds International Corp.*,[1] the Court held invalid an arbitration panel's decision imposing class arbitration on parties whose agreement was silent on the issue. The Court reasoned that such a decision violated the FAA because the parties did not affirmatively agree to classwide arbitration.

Prior to *AnimalFeeds*, responding to the Court's earlier ruling in *Green Tree Financial Corp. v. Bazzle*,[2] companies began including express class-action waivers in their predispute arbitration agreements. As discussed in prior columns,[3] plaintiffs challenging such class arbitration waiver clauses on the basis of unconscionability have found success in some jurisdictions, such as California and New Jersey, and failed in others, such as Tennessee.[4] On May 24, 2010, the Supreme Court granted review in a case from the U.S. Court of Appeals for the Ninth Circuit, *AT&T Mobility LLC v. Concepcion*,[5] to decide whether California's application of the unconscionability doctrine is preempted by the FAA.

### Procedural History

In *AT&T Mobility*, Vincent and Liza Concepcion initially filed a complaint in federal court against AT&T Mobility LCC, alleging false advertising based on the company's sales tax charges on a cell phone it promoted as "free." The district court consolidated the Concepcions' case with *Laster v. T-Mobile USA, Inc.*,[6] a putative class action addressing the same issue. Upon receiving the "free" phones, the claimants had signed Wireless Service Agreements containing both an arbitration clause, which required any disputes to be submitted to arbitration, and a class-action waiver clause, which required any disputes between the parties to be brought in an individual capacity.

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After the Concepcions filed suit, AT&T modified the arbitration agreement to include what they termed a "premium payment clause." Under this clause, AT&T would pay a customer $7,500 if the arbitrator issued an award in favor of a California customer greater than AT&T's last written settlement offer made before the arbitrator was selected. After this revision of the arbitration agreement, AT&T filed a motion to compel the plaintiffs to submit their claims to individual arbitration. The U.S. District Court for the Southern District of California denied the motion, holding the class-waiver provision of the arbitration agreement unconscionable under California law.

### The Ninth Circuit's Opinion

AT&T made an interlocutory appeal, asking the Ninth Circuit to overturn the district court order and compel arbitration. The Ninth Circuit held that the district court did not err when it declared AT&T's class-action waiver unconscionable and unenforceable under California law.

The appeals court found the class-action waiver provision both procedurally and substantively unconscionable under the three-part test established by the California Supreme Court in *Discover Bank v. Superior Court*.[7] According to the Ninth Circuit panel, the waiver in the AT&T agreement was unconscionable under California law because it: (1) was included in an agreement of adhesion; (2) involved a dispute between the contracting parties likely to involve small amounts of damages; and (3) involved a party with superior bargaining power, alleged to have carried out a scheme to cheat large numbers of consumers out of individually small sums of money.

Additionally, the court found no merit in AT&T's argument that the premium-payment provision negated unconscionability, reasoning that "if a customer files for arbitration against AT&T, predictably, AT&T will simply pay the face value of the claim….Thus, the maximum gain to a customer for the hassle of arbitrating a $30.22 dispute [like the sales tax at issue here] is still just $30.22."[8]

The Ninth Circuit panel rejected AT&T's

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claim that the FAA preempts California unconscionability law. It concluded that the FAA did not bar federal or state courts from "applying generally applicable state contract law principles."[9] In the court's view, there is no FAA preemption as long as the state is applying principles that it invokes for any contract and not a special doctrine applicable only to arbitration agreements.

The appeals court identified two main purposes for the FAA: "first, to reverse judicial hostility to arbitration agreements by planting them on the same footing as any other contract, and second to promote the efficient and expeditious resolution of claims."[10] The court concluded that, since Section 2 of the FAA "expressly permits a court to decline enforcement of an arbitration agreement on grounds…such as unconscionability," Congress could not have intended that "implied preemption principles would be applied to mandate the opposite result."[11] Moreover, the court rejected the "contention that class proceedings will reduce the efficiency and expeditiousness of arbitration in general."[12] By contrast, other courts have ruled that the FAA preempts state law limitations on class-action arbitration waivers.[13]

### Supreme Court Grants Review

AT&T successfully petitioned the Supreme Court for review. In its petition for certiorari, AT&T presented the question before the Court as whether the FAA "preempts States from conditioning the enforcement of an arbitration agreement on the availability of particular procedures—here, classwide arbitration—when those procedures are not necessary to ensure that the parties to the arbitration agreement are able to vindicate their claims."[14]

AT&T argued that the Ninth Circuit's decision, and the California law on which it is based, conflicts both with the FAA's purpose to ensure that arbitration agreements are enforced according to their terms, as well as "generally applicable unconscionability principles [by creating] a new rule that is applicable only to dispute-resolution provisions."[15] In AT&T's view, "[b]y holding that the States are free to condition enforcement of arbitration provisions on the availability of classwide arbitration, the Ninth Circuit has endorsed the functional equivalent of a ban on consumer arbitration provisions…because class arbitration eliminates all of the benefits of traditional, individual arbitration while multiplying the risks exponentially."[16]

AT&T's petition maintained that California applies a special doctrine for arbitration cases that it does not apply to contract cases generally. In deciding to declare agreements precluding class actions unconscionable even where vindication through individual claims is feasible, AT&T urged, "the Ninth Circuit severely distorted generally applicable unconscionability principles to create a new rule that is applicable only to dispute resolution provisions (virtually all of which are arbitration provisions)."[17] The petitioner further criticized the California standard set out in *Discover Bank*, stating that the three-part test there "bears no resemblance to the foregoing generally applicable unconscionability principles."[18]

In their opposition, the consumers insisted that California state court rulings like that in *Discover Bank* invoke generally applicable state law, as authorized by Section 2 of the FAA, which applies "regardless of whether a class ban is found in an arbitration agreement or some other contract…"[19]

On the one hand, the FAA expressly contemplates the application of generally applicable state contract law to determine the enforceability of agreements providing for arbitration. California high courts purport to be applying such generally applicable law. Yet, there is certainly suspicion from the defense perspective that a special set of rules for, and inhospitable to, arbitration is being developed.

Combined with the Court's ruling in *AnimalFeeds*, this case may result in a cutback on the emerging state law jurisprudence that arbitration clauses containing class action waivers run afoul of the unconscionablity doctrine. *AnimalFeeds* may eliminate the practical need for such clauses, from the company's standpoint, and a decision adverse to the consumers in the *AT&T* case may signal to state and federal courts that cases still in the pipeline involving such provisions need to be reviewed in a manner more hospitable to arbitration. Yet even if the Court rules in this manner, there remains an open question whether such provisions can be invoked by companies to preclude class claims in litigation. Stay tuned.

1. 130 S. Ct. 1758 (2010).

2. 539 U.S. 444 (2003).

3. See Samuel Estreicher and Steven C. Bennett, "California High Court Weighs in on Class Action Waivers," NYLJ, Dec. 20, 2005; Samuel Estreicher and Steven C. Bennett, "New Jersey Weighs in on Class-Action Waivers," NYLJ, Jan 4, 2007.

4. See *Pyburn v. Bill Heard Chevrolet*, 63 S.W.3d 351, 365 (Tenn. Ct. App. 2001) (noting that Supremacy Clause of the U.S. Constitution precludes a court "from invalidating an arbitration agreement otherwise enforceable under the FAA simply because a plaintiff cannot maintain a class-action").

5. 584 F.3d 849 (9th Cir. 2009), cert. granted, — S. Ct. —, 2010 WL 303962 (U.S. May 24, 2010).

6. 2008 WL 5216255 (S.D. Cal. Aug. 11, 2008).

7. 36 Cal. 4th 148 (Cal. 2005).

8. *AT&T*, 584 F.3d at 856.

9. Id. at 856 (quoting *Shroyer v. New Cingular Wireless Servs., Inc.*, 498 F.3d 976, 987 (9th Cir. 2007)).

10. Id. at 857 (quoting *Shroyer*, 498 F.3d at 989).

11. Id. at 858 (quoting *Shroyer*, 498 F.3d at 989-90).

12. Id.

13. See *Gay v. CreditInform*, 511 F.3d 369, 383 (3d Cir. 2007) ("[A] state law expressly precluding arbitration might not be valid as the FAA could preempt an anti-arbitration clause.").

14. Petition for Writ of Certiorari of Petitioners at (i), *AT&T Mobility LLC v. Vincent and Liza Concepcion*, No. 09-893 (Jan. 25, 2010).

15. Id. at 26.

16. Id. at 25.

17. Id. at 25-6.

18. Id. at 6.

19. Respondent's Brief in Opposition at 16, *AT&T Mobility LLC v. Vincent and Liza Concepcion*, No. 09-893 (April 26, 2010).