Federal Arbitration Act State Laws Banning Cl Arbitration Waivers

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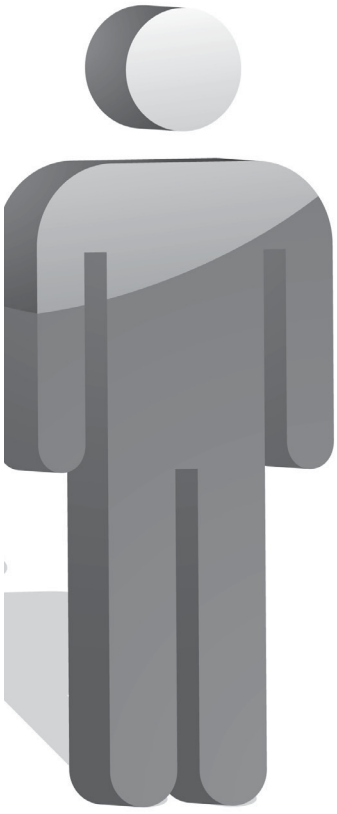
I. Introduction

Class arbitration waivers are used widely in consumer contracts, requiring consumers to arbitrate their disputes on an individual basis and not as a class. A company offering goods and services at a modest price may view arbitration as preferential to litigation because it is, theoretically, quicker, less formal, inexpensive, and allows for confidentiality. Arbitrating disputes on a class-wide basis similar to the procedure permitted under Federal Rule of Civil Procedure 23, however, may remove the advantages of arbitration and create burdens even greater than litigation because of the requisite notice of claims to the class, which destroys efficiency, confidentiality, and amasses potential damages far too great for many companies willing to risk, even if the claims are suspect. Also, appellate review of arbitration awards is far less robust than appeal rights available when litigating a dispute in court



On the other hand, consumer rights advocates argue that companies can act unfairly or improperly without any threat of legal action by consumers because any monetary damages are nominal on an individual basis and no rational consumer would proceed with litigation that would

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cost more than the monetary damages the consumer could recoup. These advocates believe that if monetary damages are pursued by consumers on a collective basis, monetary damages will be worth pursuing, which will prevent companies from escaping liability and reaping substantial windfalls to which they should not be entitled. These two competing views and public policies collided in *AT&T Mobility LLC v. Concepcion.*[2] In that case, the U.S. Supreme Court ruled the Federal Arbitration Act (FAA) preempted California's common law, which, as applied by federal courts in California, had ruled class arbitration waivers found in consumer contracts were unconscionable.[3]

II. Facts and Procedural History of *AT&T Mobility v. Concepcion*

In 2002, the Concepcions entered into an agreement for purchase and service of cellular telephones. The Concepcions purchased telephones that were advertised as "free" phones, but the Concepcions "were charged $30.22 in sales tax based on the phones' retail value."[4]

"The [AT&T Mobility] contract provided for arbitration of all disputes between the parties, but required that [any and all] claims be brought" on an individual basis, not a class basis.[5] The contract also provided that, if a dispute arose with AT&T Mobility, customers could "initiate dispute [resolution] proceedings by completing a one-page … form [that was] available on AT&T [Mobility's] Web site."[6] Once a claim was submitted, AT&T Mobility could offer to settle the claim, but if the claim was "not resolved within 30 days, the customer [could] invoke arbitration by filing a separate Demand for Arbitration, [which was] also … on AT&T [Mobility's] Web site."[7] If the parties proceeded to arbitration, AT&T Mobility agreed to pay for all costs if the claim was not frivolous, and the "arbitration must take place in the county" where the customer received his or her bill.[8] Also, for any "claims of $10,000 or less, the customer [could] choose whether the arbitration proceed[ed] in person" or by telephone, or the case could be submitted on documents alone.[9] In lieu of arbitration, "either party could [initiate] a claim in small claims court."[10] If the claim proceeded to arbitration, the arbitrator could award any form of relief, including injunctive relief, punitive damages, and consequential damages. The arbitration agreement prevented AT&T Mobility from seeking "reimbursement of its attorneys' fees, and, in the event that a customer receive[d] an arbitration award greater than … the last written settlement offer" by AT&T Mobility, the company agreed to pay a minimum of $7,500 (later raised to $10,000) in damages "and twice the amount of the claimant's attorneys' fees."[11]

Despite those terms, the Concepcions chose not to file a demand for arbitration, but proceeded to file a complaint in the U.S. District Court for the Southern District of California. The Concepcions filed suit for false advertising and fraud because of the allegedly undisclosed sales tax on the phones that were advertised as free.[12] "In … 2008, AT&T [Mobility] moved [the court] to compel arbitration [pursuant to] the terms of [the arbitration agreement] with the Concepcions", but "[t]he Concepcions opposed [AT&T Mobility's] motion [and argued] that the arbitration

agreement was unconscionable … under California law."[13]

The California Supreme Court had previously ruled in *Discover Bank v. Superior Court*[14] that class action waivers in arbitration agreements are unconscionable when the following factors are present: (1) the waiver is in an adhesion consumer contract; (2) the waiver involves disputes with small monetary damages; and (3) when "the party with the superior bargaining power [is alleged to have] carried out a scheme to deliberately [defraud a] large number of consumers out of individually small sums of money" (the "*Discover Bank* rule").[15]

Relying on the *Discover Bank* rule, the district court ruled that the arbitration provision in AT&T Mobility's agreement with the Concepcions was unconscionable.[16] On appeal, the 9th Circuit affirmed the decision ruling that the class arbitration waiver was unconscionable under California's *Discover Bank* rule, and that the FAA did not pre-empt the California Supreme Court's ruling.[17] The U.S. Supreme Court granted *certiorari* to determine whether the FAA preempted California's *Discover Bank* rule finding that class arbitration waivers in consumer contracts were unconscionable.[18]

Section 2 of the FAA provides that arbitration agreements are unenforceable "upon such grounds as exist at law or in equity for the revocation of any contract."[19] The FAA permits courts to declare arbitration agreements invalid based on "generally applicable [state] contract defenses, such as fraud, duress, or unconscionability," which apply to all contracts, but not defenses that apply solely to arbitration agreements.[20] The California Supreme Court based its ruling in *Discover Bank* on § 2 of the FAA, ruling that class arbitration waivers are unconscionable and, thus, unenforceable under § 2 of the FAA as a generally applicable state law basis for invalidating contracts.[21]

The U.S. Supreme Court acknowledged that this "inquiry becomes more complex when a doctrine normally thought to be generally applicable, such as duress or, as relevant here, unconscionability, is alleged to have been applied in a fashion that disfavors arbitration."[22] The Supreme Court, however, also acknowledged that "[t]he FAA was enacted … in response to widespread judicial hostility to arbitration agreements[,]" and that federal courts should have a "liberal federal policy favoring arbitration."[23] Balancing those competing policies (*i.e.*, favoring arbitration, but allowing generally applicable state contract defenses to invalidate arbitration agreements), the Supreme Court ruled nothing in § 2 of the FAA preserves state law defenses that are obstacles directed specifically to arbitration agreements and, thus, frustrating the FAA's objectives.[24]

In ruling that the *Discover Bank* rule was directed purposefully and solely at arbitration agreements, thus frustrating the objectives of the FAA, the Supreme Court looked to the purposes behind arbitration and how class-wide arbitration "interferes with fundamental attributes of arbitration and thus creates a scheme inconsistent with the FAA."[25] The Court noted that class-wide arbitration requires the inclusion of absent parties, which involves different procedures for providing notice and involves higher stakes than were originally bargained for under typical bilateral consumer arbitration contracts.[26] The Court noted that "[c]onfidentiality becomes more difficult[,]" and that arbitrators would necessarily require some sort of relevant expertise in class certification questions, including the protection of absent parties.[27] The Court also noted that "class arbitration greatly increases risks to defendants" based, in part, on the alleged monetary damages of the collective class.[28] The Court noted that the informal procedures typically found in bilateral arbitration come with a cost, including the absence of appeal rights, which a defendant is more willing to accept when the "impact [of an adverse decision] is limited to the size of [an] individual dispute," as opposed to a class.[29] However, "when [potential] damages allegedly owed to tens of thousands[, if not hundreds of thousands,] of potential claimants are aggregated and decided [in one decision], the risk of an error will … become unacceptable" to most defendants, according to the Court.[30] Defendants facing substantial risk "will be pressured into settling questionable claims."[31] Finally, the Court noted that review of arbitration agreements is far different from review of judgments issued by courts. Review of an arbitration agreement is strictly limited, based solely on the enumerated reasons for vacating arbitration awards found in the FAA.[32] Based on all of those reasons, the Supreme Court ruled that it was "hard to believe that defendants would bet the company with no effective means of review, and even harder to believe that Congress would have intended to allow state courts to force such a decision."[33]

The Supreme Court also reasoned that although the *Discover Bank* rule does not require a consumer to pursue class-wide arbitration, it effectively allows any party in a consumer contract to demand class-wide arbitration after entering into an agreement that specifically revoked this right, which drastically alters the parties' expectations and agreement to arbitrate on a bilateral basis.[34] The Court found instructive its prior ruling in *Stolt-Nielsen S.A. v. AnimalFeeds International Corp.*,[35] in which the Supreme Court ruled that an arbitration panel exceeded its powers under § 10(a)(4) of the FAA by imposing class arbitration based on policy judgments, as opposed to

the terms of the arbitration agreement itself. The Court's decision in *Stolt-Nielsen* ruled that, when an arbitration agreement is silent on the question of class-wide arbitration, a court and/or arbitration panel cannot require class-wide arbitration if the parties did not agree to it originally.[36] Therefore, the Supreme Court ruled California's *Discover Bank* rule is preempted by the FAA based on: (1) the intent of the FAA, (2) the *Discover Bank* rule is not generally applicable to all contracts, but unlawfully singles out arbitration agreements, and (3) the plain terms of AT&T Mobility's arbitration agreement.[37]

AT&T Mobility was a 5-4 decision, with Justice Scalia writing the opinion, joined by Justices Roberts, Kennedy, Thomas, and Alito. The dissent included Justices Breyer, Ginsburg, Sotomayor, and Kagan.

Justice Thomas, who filed a concurring opinion, explained that he would rule in favor of AT&T Mobility, but he would have based the Court's decision on prior precedent regarding what the Court may analyze to determine whether the arbitration agreement should be enforced. Justice Thomas opined § 2 of the FAA applies only to those defenses related to the formation of agreements to arbitrate.[38] According to Justice Thomas, this requires a court to enforce "an agreement to arbitrate unless a party [can] successfully" raise "defenses concerning the formation of the" arbitration provision itself through contractual defenses "such as fraud, duress, or mutual mistake[,]" as opposed to defenses to the contract as a whole (wherein the arbitration provision is but one term) within the agreement.[39] From Justice Thomas's perspective, a public policy decision such as that proclaimed in the *Discover Bank* rule is unrelated to the parties' formation of the arbitration agreement alone and could not be the basis for a court to invalidate an arbitration agreement.[40]

The *Discover Bank* rule, according to Justice Thomas, is not a basis "for the revocation of any contract" as provided for under § 2 of the FAA.[41] Justice Thomas's reasoning would not break any new ground with respect to the FAA. It hinged on long-standing Supreme Court precedent regarding whether a contract that happens to include a class arbitration waiver is unconscionable at the time of entering into the agreement.

The dissenting opinion, authored by Justice Breyer, argued § 2 of the FAA reserves state contractual defenses such as fraud, duress and unconscionability to invalidate arbitration agreements, and the *Discover Bank* rule simply followed § 2 of the FAA.[42] The dissent set forth an opinion reminiscent of many conservative jurists arguing for states' rights. The dissent claimed that Congress retained the important role for the states to decide whether to enforce arbitration agreements pursuant to § 2 of the FAA, and because states are independent sovereigns within a federal system, Congress cannot "cavalierly pre-empt" causes of actions under state law.[43] The dissent charged that the "recognition of that federalist ideal, embodied in specific language in this particular statute, should lead us to uphold California's law, not to strike it down. We do not honor federalist principles in their breach."[44]

III. Implications in Missouri Based on *AT&T Mobility, LLC v. Concepcion*

The U.S. Supreme Court's decision in *AT&T Mobility* will likely have widespread ramifications across the country, including Missouri. On May 2, 2011, the Supreme Court granted certiorari and simultaneously vacated the Supreme Court of Missouri's decision in *Brewer v. Missouri Title Loans, Inc.* and remanded the case back to the Supreme Court of Missouri for further consideration in light of the decision in *AT&T Mobility.*[45] As of the date this article was submitted for publication, the Supreme Court of Missouri had not ruled on *Brewer* since the Supreme Court's decision to vacate and remand the case. Oral argument was docketed for November 9, 2011.

Brewer was a case involving a borrower's claim against a lender alleging predatory lending tactics, which allegedly violated the Missouri Merchandising Practices Act. The plaintiff borrowed $2,215, which was secured by the title to the plaintiff's car, and "[t]he annual percentage rate on the loan was 300 percent."[46] The loan agreement included a waiver of plaintiff's right to class arbitration, which defendant sought to enforce after plaintiff filed a class action petition.[47] The Supreme Court of Missouri ruled that the arbitration class waiver was unconscionable because "individual arbitration [would] deny the injured party a remedy" as no attorney would agree to accept the representation if he or she could not pursue the case on a class basis because individual damages were negligible.[48]

The *Brewer* decision was not inconsistent with prior Missouri cases handed down before the *AT&T Mobility* decision. In essence, before *AT&T Mobility v. Concepcion,* enforcement of class arbitration waivers in Missouri was largely dependent on whether a case was pending in state court or federal court.

In determining whether waivers of class arbitrations should be enforced, Missouri courts look to aspects of substantive unconscionability and procedural unconscionability.[49] When substantive unconscionability is considerable, a court need not find significant procedural unconscionability, and vice versa.[50] That analysis also applied to whether class arbitration waivers were unconscionable.[51] However, the over-arching principle behind decisions from Missouri state courts ruling class arbitration waivers are unconscionable is that they are unconscionable when the

practical effect is to allow a corporate defendant complete immunity because no consumer is likely to pursue an individual claim involving small amounts of damages, and because attorneys will only agree to represent consumers if claims are aggregated on a class basis to justify pursuing the case.[52]

In 2010, the Supreme Court of Missouri ruled that an arbitration agreement between a consumer and an automobile dealer, in which the buyer waived her right to pursue class arbitration, was unconscionable and struck down the entire agreement to arbitrate.[53] The Supreme Court of Missouri relied on the U.S. Supreme Court's decision in *Stolt-Nielsen* to rule that a party cannot be subjected to class arbitration unless both parties consent.[54] The Supreme Court of Missouri concluded that, because the automobile dealer did not consent to class arbitration, the Court could not sever the unconscionable class waiver from the arbitration agreement and invalidated the entire arbitration agreement.[55] The *Ruhl* decision also ruled that the waiver of class arbitration was unconscionable because the actual damages totaled $200, and there was substantial evidence to support the trial court's determination that the damages would be too low for any attorney to be willing to represent consumers on these claims on an individual basis.[56] The Court in *Ruhl* ruled that the "class waiver provision would immunize Honda from individual consumer claims, likely bought without the assistance of counsel, and allow it to continue in its alleged deceptive practices against individuals purchasing a new car."[57]

Other decisions in Missouri state courts ruled that class arbitration waivers could be unconscionable depending on the terms of the arbitration agreement. Agreements that are contracts of adhesion and limit the location of the arbitration to a jurisdiction favoring the defendant company, making the expense of pursuing a claim greater than the amount in controversy, have been held to be substantively unconscionable.[58] Courts in Missouri have also struck class arbitration waivers when font sizes of the arbitration agreement are extremely small, resulting in the terms to be hidden, and where there are high pressure tactics involved, including economic compulsion.[59]

However, even before the U.S. Supreme Court's decision in *AT&T Mobility*, federal courts sitting in Missouri were more likely to rule that class arbitration waivers are enforceable. In those instances, many federal courts sitting in Missouri ruled that class arbitration waivers are not unconscionable because the arbitration agreements did not insulate or prevent defendants from potential claims brought by individual consumers, no matter how small the damages. Most of the federal court decisions in Missouri were not persuaded by the argument that damages were too inconsequential to provide a reason to pursue claims on an individual basis.[60] And the 8th Circuit was inclined, before the U.S. Supreme Court's *AT&T Mobility* decision, to enforce class arbitration waiver provisions despite Missouri state court decisions otherwise.[61] It is likely that federal courts in Missouri will continue to follow their existing precedent, with affirmation from the *AT&T Mobility* decision.

IV. Conclusion

Although the decision in *AT&T Mobility* arose out of the California Supreme Court's decision in *Discover Bank*, companies throughout the nation are likely to rely upon the U.S. Supreme Court's holding in *AT&T Mobility* to argue that class arbitration waivers are enforceable under the FAA, and that contrary state laws are preempted. To the extent that any state statutes or state court rulings are purposely directed toward invalidating arbitration agreements only, thereby frustrating the purpose of the FAA, courts in Missouri and throughout the United States will likely follow the *AT&T Mobility* decision.

Consumer rights advocates, however, may argue that the decision of *AT&T Mobility* should be limited to the facts and law as found in California's *Discover Bank* rule. Although the Supreme Court's decisions often do not result in black and white rules of law, the *AT&T Mobility* decision appears to impact all judicial rulings targeted toward arbitration agreements with class waivers. To the extent that arbitration agreements have class arbitration waivers, and the arbitration agreements provide procedural safeguards and identifiable remedies to the claimant, arbitration waivers will likely be upheld. However, this question, as it relates to Missouri precedent and any nuances concerning the application of *AT&T Mobility,* remains pending with the Supreme Court of Missouri.

Endnotes

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2 131 S. Ct. 1740 (2011).

3 *AT&T Mobility, LLC v. Concepcion*, 131 S. Ct. 1740, 1753 (2011).

4 *Id.* at 1744.

5 *Id.*

6 *Id.*

7 *Id.*

8 *Id.*

9 *Id.*

10 *Id.*

11 *Id.*

12 *Id.*

13 *Id.* at 1744-45.

14 36 Cal.4th 148 (Cal. 2005).

15 36 Cal. 4th at 162-63.

16 *AT&T Mobility*, 131 S. Ct. at 1745.

17 *Id.*

18 *Id.*

19 9 U.S.C. § 2.

20 *Doctor's Associates, Inc. v. Casarotto*, 517 U.S. 681, 687 (1996).

21 *Discover Bank*, 36 Cal. 4th at 164.

22 *AT&T Mobility*, 131 S. Ct. at 1747.

23 *Id.* at 1745 (citing *Hall Street Assocs., LLC v. Mattel, Inc.*, 552 U.S. 576, 581 (2008) and *Moses H. Cone Mem'l Hosp. v. Mercury Constr. Corp.*, 460 U.S. 1, 24 (1983)).

24 *AT&T Mobility*, 131 S. Ct. at 1748.

25 *Id.*

26 *Id.* at 1750.

27 *Id.*

28 *Id.* at 1752.

29 *Id.*

30 *Id.*

31 *Id.*

32 *Id.* at 1752; *see* 9 U.S.C. § 10; *Hall Street Associates*, 552 U.S. at 578.

33 *AT&T Mobility*, 131 S. Ct. at 1752.

34 *Id.* at 1750.

35 130 S. Ct. 1758 (2010)

36 *Id.* at 1773-76.

37 *AT&T Mobility*, 131 S. Ct. at 1748-51.

38 *Id.* at 1753 (J. Thomas, concurring).

39 *Id.* at 1755 (citing *Prima Paint Corp. v. Flood & Conklin Mfg. Co.*, 388 U.S. 395, 403-404 (1967) (holding § 4 of the FAA permits federal courts to determine "claims of 'fraud in the inducement of the arbitration [agreement] itself' because such claims" concern the formation of the agreement to arbitrate, but not the entire contract itself in which the arbitration clause is included)).

40 *AT&T Mobility*, 131 S. Ct. at 1755-56 (J. Thomas, concurring).

41 *Id.* at 1756.

42 *Id.* at 1756-57 (J. Breyer, dissenting).

43 *Id.* at 1762 (citing *Medtronic, Inc. v. Lohr*, 518 U.S. 470, 485 (1996)).

44 *Id.* at 1762.

45 *Brewer v. Mo. Title Loans, Inc.*, 323 S.W.3d 18, 22 (Mo. banc 2010), vacated and remanded, 131 S.Ct. 2875 (2011).

46 *Brewer*, 323 S.W.3d at 20.

47 *Id.*

48 *Id.* at 21.

49 *Ruhl v. Lee's Summit Honda,* 322 S.W.3d 136, 140 (Mo. banc 2010).

50 *Id.; Brewer*, 323 S.W.3d at 22, *vacated and remanded*, 131 S. Ct. 2875 (2011).

51 *See Ruhl v. Lee's Summit Honda*, 322 S.W.3d 136-40 (Mo. banc 2010); *Brewer*, 323 S.W.3d at 22, vacated and remanded, 131 S.Ct. 2875 (2011).

52 *See Brewer*, 323 S.W.3d at 23; *see also, Shaffer v. Royal Gate Dodge, Inc.*, 300 S.W.3d 556, 560 (Mo. App. E.D. 2009).

53 *Ruhl*, 322 S.W.3d at 140.

54 *Id.* at 139.

55 *Id.* at 140.

56 *Id.* at 139-40.

57 *Id.* at 140.

58 *See, e.g., Whitney v. Alltel Commc'ns, Inc.*, 173 S.W.3d 300, 312 (Mo. App. W.D. 2005).

59 *See, e.g., Woods v. QC Fin. Servs., Inc.*, 280 S.W.3d 90, 97 (Mo. App. E.D. 2008).

60 *See Bass v. Carmax Auto Superstores, Inc.*, No. 07-0883-CV-W-ODS, 2008 WL 2705506, at *3 (W.D. Mo., July 9, 2008); *Guiterrez v. State Line Nissan, Inc.*, No. 08-0285-CV-W-FJG, 2008 WL 3155896, at *3-4 (W.D. Mo., Aug. 4, 2008); *Fay v. New Cingular Wireless, PCS, LLC*, No. 4:10CV883 HEA, 2010 WL 4905698, at *2-*4 (E.D. Mo., Nov. 24, 2010); *Kates v. Chad Franklin Nat'l Auto Sales N., LLC*, No. 08-0384-CV-W-FJG, 2008 WL 5145942, at *5 (W.D. Mo., Dec. 1, 2008); *but see*, *Doerhoff v. Gen. Growth Props., Inc.*, No. 06-04099-CV-C-SOW, 2006 WL 3210502, at *7 (W.D. Mo., Nov. 6, 2006) (holding the arbitration waiver provision was unconscionable because it violated Missouri public policy); *Sprague v. Household Int'l*, 473 F.Supp. 2d 966, 973-74 (W.D. Mo. 2005) (holding that "the prohibition of class action" arbitrations weighs "in favor of a finding of substantive unconscionability.").

61 *See Cicle v. Chase Bank USA*, 583 F.3d 549, 556-57 (8th Cir. 2009); *Pleasants v. Am. Express Co.*, 541 F.3d 853, 858-59 (8th Cir. 2008).