Developments in Supreme Court Jurisprudence: The Court's *AT&T* Decision and the Second Circuit's Treatment of *Stolt-Nielsen*

By Sherman Kahn

After deciding four arbitration cases during the previous term, the United States Supreme Court decided only one case regarding arbitration during its 2010 term (commencing in October 2010 and extending until June 2011)—but it is a case with major implications for both arbitration and litigation practice. In addition, the Second Circuit has decided a case that takes a perhaps unexpected approach to the Supreme Court's decision last year in *Stolt-Nielsen S.A. v. Animalfeeds International Corp.*[1] ("*Stolt-Nielsen*"). Both decisions are discussed below.

A. *AT&T v. Concepcion*

The Supreme Court's sole arbitration decision this year was rendered in *AT&T v. Concepcion*,[2] which reversed on Federal Arbitration Act preemption grounds a Ninth Circuit decision upholding California's rule that class action waivers in certain consumer adhesion contracts were invalid as applied to contracts containing arbitration clauses.[3] *AT&T* builds on the Supreme Court's decision the previous term in *Stolt-Nielsen* holding that an arbitration agreement that was silent on class arbitration could not be interpreted to authorize class arbitration to create an environment in which consumer class actions may be very difficult to bring in arbitration.[4]

In *AT&T*, the named plaintiffs Vincent and Liza Concepcion had entered a mobile phone agreement with AT&T Mobility LLC ("AT&T").[5] The Concepcions' agreement with AT&T ("the Agreement") included an arbitration provision which provided for arbitration of all disputes between the parties, but required that all claims in arbitration be brought in the parties' individual capacity and not "as a plaintiff or class member in any purported class or representative proceeding."[6]

The Agreement provided that AT&T was authorized to make unilateral amendments and AT&T amended the agreement, including the arbitration provision, on several occasions.[7] As finally revised, the arbitration provision in the agreement had been amended to include a pre-arbitration demand procedure and a variety of procedural protections for the consumer party to the agreement including provisions requiring that AT&T pay all costs for non-frivolous claims; that the arbitration must take place in the county in which the customer is billed; that for claims of $10,000 or less the customer may choose whether the arbitration is conducted in person, by telephone or only by submissions; that either party may bring a claim in small claims court in lieu of arbitration; and that the arbitrator may award any form of individual relief.[8] The agreement also provided that AT&T would not be entitled to seek reimbursement of attorney's fees and that if the customer received an arbitration award greater than AT&T's last written settlement offer, AT&T would pay a $7,500 minimum recovery and twice the claimant's attorney's fees.[9]

Notwithstanding the arbitration provision, the Concepcions filed a complaint against AT&T in U.S. District Court alleging that AT&T had promised the Concepcions free phones but in fact had charged them sales tax based on the phones' retail value.[10] The Concepcions' complaint was later consolidated with a putative class action claiming that AT&T's advertising regarding free phones was deceptive.[11]

AT&T moved to compel arbitration. The Concepcions opposed the motion on the ground that the class action waiver in the Agreement was unconscionable and unlawfully exculpatory under California Law. The district court ruled in favor of the Concepcions, finding that, although the procedural protections that AT&T had put into place were helpful, the class action waiver remained unconscionable under California Law.[12] The district court relied on a rule articulated in the California Supreme Court's decision in *Discover Bank v. Superior Court*[13] ("the *Discover Bank* rule").[14]

The Ninth Circuit affirmed the district court ruling on the ground that the class action waiver provision was unconscionable under the *Discover Bank* rule.[15] The Ninth Circuit also rejected an argument by AT&T that California's *Discover Bank* rule was preempted by the Federal Arbitration Act ("FAA"), holding that the rule announced in *Discover Bank* was a refinement of the unconscionability analysis applicable to contracts generally in California.[16] The Ninth Circuit found no preemption in light of FAA § 2's provision that arbitration clauses "shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract."[17] Because California's unconscionability analysis applied to all contracts and not just contracts to arbitrate, the Ninth Circuit reasoned that the FAA did not preempt the *Discover Bank* rule.

The Ninth Circuit also examined whether the FAA impliedly preempted California unconscionability law by interfering with the accomplishment and execution of the full purposes and objectives of Congress in enacting the FAA.[18] The Ninth Circuit identified the purposes of the FAA as reversing judicial hostility to arbitration

agreements by putting arbitration agreements on an equal footing with other contracts and promoting the efficient and expeditious resolution of claims.[19] The Ninth Circuit held that the *Discover Bank* rule did not interfere with arbitration because it "placed arbitration agreement class action waivers on the *exact same footing* as ordinary contracts."[20] The Ninth Circuit also rejected AT&T's arguments that allowing class arbitration would interfere with the promotion of efficient and expeditious resolution of claims in arbitration.[21]

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The Supreme Court reversed the Ninth Circuit's decision and remanded, holding that the FAA preempts California's unconscionability law as applied to class action waivers.[22] *AT&T* was a five/four decision in which the justices were divided along ideological lines.[23] The majority opinion by Justice Scalia acknowledges that arbitration agreements can be invalidated by generally applicable contract defenses, such as fraud, duress or unconscionability.[24] However, the majority opinion frames the question before the Court as whether California's *Discover Bank* rule, even if founded in generally applicable principles of California unconscionability law, applied those principles in a fashion that disfavored arbitration.[25]

In answering this question in the affirmative, the majority opinion emphasizes the efficiency goals of the FAA as the primary goal of the statute:

> The overarching purpose of the FAA, evident in the text of §§ 2, 3, and 4, is to ensure the enforcement of arbitration agreements according to their terms so as to facilitate streamlined proceedings. Requiring the availability of classwide arbitration interferes with the fundamental attributes of arbitration and thus creates a scheme inconsistent with the FAA.[26]

After explaining that parties are generally free to determine the scope of arbitrations and applicable procedures, the opinion goes on to state "[t]he point of affording parties discretion in designing arbitration processes is to allow for efficient, streamlined procedures tailored to the type of dispute."[27]

The Court went on to conclude that California's *Discover Bank* rule interferes with arbitration because it effectively bans class action waivers in arbitration.[28] The majority opinion also found considerable fault with class arbitration, finding that class arbitration as the result of an unconscionability rule would be inconsistent with the FAA;[29] that class arbitration would be less efficient than multiple individual arbitrations and would require undue procedural formality;[30] that arbitrators are not well suited to make class certification decisions;[31] and that class arbitration "greatly increases risk to defendants."[32]

The *AT& T* Court's holding was that California's ban on class action waivers in certain consumer adhesion contract arbitration clauses was invalid. However, perhaps the most interesting aspect of the opinion was the majority's new focus on efficiency as the "overarching goal" of the FAA. The *AT&T* majority's focus on efficiency as not just one goal of the FAA but as the "overarching goal" of the FAA may signal a new approach at the Supreme Court to arbitration. For example, perhaps there is an argument to be made that AT&T's focus on efficiency gives arbitrators more "muscle" in resisting attempts by the parties to impose excessive discovery. Likewise, AT&T might be invoked to support resolution of more arbitration issues by dispositive motion.

Justice Breyer's dissent, joined by three justices, argues against the interpretation that efficiency is at the heart of the FAA:

> And this Court has acknowledged that parties may enter into arbitration agreements in order to expedite the resolution of disputes.… But we have also cautioned against thinking that Congress' primary objective was to guarantee these particular procedural advantages.[33]

Particularly in light of the political elements of the issues in *AT&T*, it is not entirely clear whether the majority's focus on efficiency will mark a lasting change in the Supreme Court's approach to arbitration issues. Nonetheless, the majority's emphasis on efficiency may lead to interesting results unrelated to *AT&T*'s specific holding regarding class arbitration going forward.

The Supreme Court vacated and remanded four cases for further consideration in light of its ruling in *AT&T*.[34] It is possible that the lower courts' resolution of the issues raised by one or more of these cases might provide additional insight into the continuing effect of the Supreme Court's decision in *AT&T*.[35]

B. Developments at the Second Circuit after *Stolt-Nielsen*

When the Supreme Court decided *Stolt-Nielsen*, many thought that the decision eliminated class arbitration except where the arbitration clause specifically authorizes the procedure. However, in a decision released in July 2011, the Second Circuit has analyzed the *Stolt-Nielsen* decision much more narrowly. The case, *Jock v. Sterling Jewelers Inc.*,[36] overturned a decision of the Southern District of

New York that had vacated an arbitration award on the ground that the arbitrator had exceeded her authority in light of *Stolt-Nielsen* by finding that the arbitration agreement did not preclude class arbitration.[37]

Jock arose out of an employment discrimination claim.[38] The employees were parties to an employment contract that required a three-step alternative dispute resolution process culminating in arbitration.[39] After receiving a favorable decision from the EEOC, the claimants in *Jock* filed a class action in the Southern District of New York alleging claims under Title VII and other statutes and also filed a class arbitration complaint with the American Arbitration Association making the same allegations.[40] The district court granted a motion by the plaintiffs, over the employer's objection, to refer the matter to arbitration and to stay the litigation, after which the parties submitted to the arbitrator the question of whether their agreement permitted class arbitration.[41]

The arbitrator found in favor of the plaintiffs and held that the arbitration agreement "cannot be construed to prohibit class arbitration."[42] The arbitration clause included, after listing a set of civil rights and employment statutes that would be subject to arbitration, the following language:

> The arbitrator shall have the power to award any types of legal or equitable relief that would be available in a court of competent jurisdiction including, but not limited to, the costs of arbitration, attorney fees and punitive damages for causes of action when such damages are available under law.[43]

The arbitrator determined, based on Ohio law, that because the contract had no express prohibition on class claims and "indeed, there is no mention of class claims" she would not read into the agreement an intent to prohibit class claims.[44] The arbitrator also noted that the employer had not changed the language of the contract to prohibit class arbitration in light of several previous court decisions permitting class claims absent an express prohibition and noted the language quoted above giving the arbitrator the right to award any type of relief available in court.[45]

The employer moved to vacate the arbitration award.[46] The district court initially denied the motion to vacate the award and the employer appealed.[47] However, after the Supreme Court's decision in *Stolt-Nielsen,* the employer moved for reconsideration under Rule 60(b) of the Federal Rules of Civil Procedure; the appeal was stayed and the district court decided that, if jurisdiction was restored to it, it would reconsider its order and vacate the arbitrator's award in light of *Stolt-Nielsen.*[48] The Second Circuit remanded the appeal and the district court reversed its decision, after which the plaintiffs appealed.[49]

On its face *Jock* might seem like it is on all fours with *Stolt-Nielsen.* The arbitrator found that the arbitration provision did not prohibit class arbitration but did not specifically allow it either and that "there is no mention of class claims." The arbitrator arguably found that the agreement was "silent" as to class arbitration and ruled in favor of class arbitration anyway. The Second Circuit did not see it that way. The Second Circuit analyzed "silence," as discussed in *Stolt-Nielsen*, significantly more narrowly.[50]

In *Jock,* the Second Circuit read *Stolt-Nielsen* to hold that the agreement at issue was silent as to class arbitration in the sense that the parties there agreed that they had not reached *any agreement* as to class arbitration.[51] In other words the parties in *Stolt-Nielsen* had agreed that there was neither express nor implicit agreement to submit to class arbitration.[52] The reason the arbitrators in *Stolt-Nielsen* had exceeded their powers, according to the Second Circuit's interpretation, was not because they had imposed class arbitration where the agreement was silent but because they had done so on public policy grounds.[53] According to the Second Circuit:

> *Stolt-Nielsen*, on which the district court relied, did not create a bright-line rule requiring that arbitration agreements can only be construed to permit class arbitration where they contain express provisions permitting class arbitration.[54]

After setting forth this analysis of *Stolt-Nielsen,* the Second Circuit examined the district court's decision to vacate the arbitration award in *Jock* under FAA Section 10(a)(4) on the ground that the arbitrator had exceeded her powers.[55] The Second Circuit concluded that the district court had erred in setting aside the award by focusing on whether the arbitrator had correctly interpreted the arbitration agreement rather than whether the arbitrator exceeded her authority.[56]

The Second Circuit's decision rested on the well-established rule that FAA Section 10(a)(4) allows only a very narrow inquiry into whether the arbitrator was authorized to adjudicate the challenged issue—*i.e.* "it is not for the district court to decide whether the arbitrator 'got it right' when the question has been properly submitted to the arbitrator and neither the law nor the agreement categorically bar her from deciding that issue."[57] Because, unlike the parties in *Stolt-Nielsen,* the parties in *Jock disagreed* about whether class arbitration was authorized or not and submitted that issue to the arbitrator, it was in the scope of the arbitrator's authority to decide that issue.[58]

According to the Second Circuit, where the arbitration agreement contains what is argued to be an implicit agreement to submit to class arbitration, the arbitrator must look to state law principles of contract interpretation to decide whether the parties had the intent to submit to class arbitration.[59] As the arbitrator had based her award on the terms of the agreement and Ohio law, the Second

Circuit found her to be within her authority to find that class arbitration was authorized by the agreement.[60]

The interpretation announced in *Jock* renders *Stolt-Nielsen* very narrow indeed. It is unlikely that there will be many more occasions when the parties agree that a contract does not, either expressly or impliedly, authorize class arbitration, but submit the issue to the arbitrator anyway.[61] The situation found in *Jock*, where the parties disagree about the interpretation of the contract is likely to be significantly more prevalent. The future will tell whether the Second Circuit's approach to *Stolt-Nielsen* holds up or is adopted by other courts.

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C. The Coming Supreme Court Term

It appears that in the coming term, the Supreme Court will continue its current focus on consumer arbitration. The Supreme Court granted certiorari in *Greenwood v. Compucredit Corp*.[62] In *Greenwood*, the Ninth Circuit had held that an arbitration clause in a credit card agreement was invalid under the Credit Repair Organizations Act[63] ("CROA") on the ground that the CROA voids any waiver of a consumer's right to sue in court for violations of the CROA. The Supreme Court granted certiorari on the question "[w]hether claims arising under the [CROA], are subject to arbitration pursuant to a valid arbitration agreement." It will be interesting to see how the Supreme Court approaches this issue.[64]

Endnotes

1. 130 S. Ct. 1758 (2010).
2. 131 S. Ct. 1740 (2011).
3. *AT&T,* 131 S. Ct. at 1753.
4. *See*, however, Section B *infra*, discussing the Second Circuit's very narrow interpretation of *Stolt-Nielsen.*
5. *AT&T,* 131 S. Ct. at 1744.
6. *Id.*
7. *Id.*
8. *Id.*
9. *Id.*
10. *Id.*
11. *Id.*
12. *AT&T,* 131 S. Ct. at 1744-45.
13. 36 Cal. 4th 148 (Cal. 2005).
14. *AT&T,* 131 S. Ct. at 1745.
15. *Laster v. AT&T Mobility LLC,* 584 F.3d 849, 852 (9th Cir. 2009), *rev'd and remanded by AT&T v. Concepcion,* 131 S. Ct. 1740 (2011).
16. *Laster,* 584 F.3d at 857.
17. *Id.*
18. *Laster,* 584 F.3d at 857-58.
19. *Laster,* 584 F.3d at 857.
20. *Id. (Emphasis in original.)*
21. *Laster,* 584 F.3d at 858. The Ninth Circuit did not specifically articulate its response to AT&T's efficiency arguments, instead relying on a prior Ninth Circuit decision, *Shroyer v. New Cingular Wireless Services, Inc.*, 498 F.3d 976 (9th Cir. 2007). In *Shroyer,* the Ninth Circuit held that, rather than reducing the efficiency of arbitration, class arbitration would increase efficiency by lessening the number of individual claims needing to be arbitrated. 498 F.3d, at 991-92 ("There is no reason to believe that the principal consideration of judicial economy that underlies the class action mechanism in Rule 23 would not operate similarly in the context of class arbitration.")
22. *AT&T,* 131 S. Ct. at 1753.
23. Justice Scalia delivered the opinion of the Court, joined by Chief Justice Roberts, Justice Alito, Justice Thomas and Justice Kennedy. Justice Thomas filed a concurring opinion. Justices Breyer, Ginsburg, Sotomayor and Kagan dissented.
24. *AT&T,* 131 S. Ct. at 1746. Justice Thomas' concurrence suggests instead that FAA §2 only allows attack on *formation* of the arbitration agreement such as by proving fraud or duress and that generally applicable contract principles not going to formation should not be used to invalidate arbitration clauses. *AT&T*, 131 S. Ct. at 1753 (Thomas J. *concurring*).
25. *AT&T,* 131 S. Ct. at 1746-47.
26. *AT&T,* 131 S. Ct. at 1748.
27. *AT&T,* 131 S. Ct. at 1749.
28. *AT&T,* 131 S. Ct. at 1750. The Court reasoned that all consumer contracts these days are adhesive; that even several thousand dollars of damages are small enough to preclude individual actions; and that the *Discover Bank* requirement that the consumer allege fraud is toothless because it requires only an allegation. *Id.*
29. *AT&T,* 131 S. Ct. at 1750-51. The Court commented based on *Stolt-Nielsen* that class-arbitration would not be appropriate based upon an invalid class action waiver as such a class action would be non-consensual. *Id.*
30. *AT&T,* 131 S. Ct. at 1751.
31. *AT&T,* 131 S. Ct. at 1750-51.
32. *AT&T,* 131 S. Ct. at 1752. The majority opinion stated that class arbitration may magnify risks of error leading to "in terrorem" settlements. *Id.* It is not entirely clear why, to the extent this problem exists, it is a feature of class arbitration and not of class actions generally.
33. *AT&T,* 131 S. Ct. at 1758 (Breyer J. *dissenting*). The dissent argues that the *Discover Bank* rule is, consistent with the Ninth Circuit's holding reversed by the majority opinion, an application of a general provision of California law without specific reference to arbitration and that therefore the ban on class action waivers should be upheld. *AT&T,* 131 S. Ct. at 1760-62.
34. *Fensterstock v. Education Finance Partners,* 611 F.3d 124 (2d Cir. 2010), *vacated and remanded by Affiliated Computer Services v. Fensterstock,* No. 10-987, 2011 U.S. LEXIS 4434 (2011) (invalidating class action waiver in arbitration clause under California law based on *Discover Bank* rule); *Herron v. Century BMW,* 693 S.E.2d 394 (S.C. 2010), *vacated and remanded by Sonic Auto, Inc. v. Watts,* No. 10-315, 2011 U.S. LEXIS (2011) (holding class action waiver in arbitration clause invalid based on South Carolina public policy in light of South Carolina statute making class actions non-waivable against auto-dealers); *Litman v. Cellco Partnership,* 381 Fed. Appx. 140 (3d Cir. 2010), *vacated and remanded by* No. 10-551, 2011 U.S. LEXIS 3411 (holding class arbitration waiver invalid under New Jersey law); *Brewer v. Missouri Title Loans, Inc.*, 323 S.W.3d 18 (Mo. 2010), *vacated and remanded by* No. 10-1027, 2011 US LEXIS 3378 (2011) (referring case to class action in court on finding that class action waiver was unconscionable and class arbitration impermissible due to *Stolt-Nielsen*).

35. While the current Congress may act on the issue, it is likely that the *AT&T* decision will lead to renewed efforts in Congress to enact a version of the Arbitration Fairness Act or other legislation restricting arbitration in consumer adhesion contracts. Indeed, Senators Franken (Minnesota), Blumenthal (Connecticut) and Representative Hank Johnson (Georgia) reintroduced the Arbitration Fairness Act legislation on May 17, 2011 (H.R. 1873, S. 987) and issued a press release stating that the reintroduction of the legislation was in direct response to the *AT&T* decision.
36. 2011 U.S. App. LEXIS 13633 (2d Cir. 2011).
37. *Jock*, 2011 U.S. App. LEXIS at *2-*3.
38. *Jock*, 2011 U.S. App. LEXIS at *3-*4.
39. *Jock*, 2011 U.S. App. LEXIS at *4-*5.
40. *Id.*
41. *Jock*, 2011 U.S. App. LEXIS at *5-*6.
42. *Jock*, 2011 U.S. App. LEXIS at *6.
43. *Jock*, 2011 U.S. App. LEXIS at *7.
44. *Jock*, 2011 U.S. App. LEXIS at *7-*8.
45. *Jock*, 2011 U.S. App. LEXIS at *8-*9.
46. *Jock*, 2011 U.S. App. LEXIS at *9.
47. *Jock*, 2011 U.S. App. LEXIS at *10.
48. *Jock*, 2011 U.S. App. LEXIS at *11-*12.
49. *Jock*, 2011 U.S. App. LEXIS at *12.
50. *Jock*, 2011 U.S. App. LEXIS at *14-*20.
51. *Jock*, 2011 U.S. App. LEXIS at *15.
52. *Jock*, 2011 U.S. App. LEXIS at *17.
53. *Jock*, 2011 U.S. App. LEXIS at *14-*15.
54. *Jock*, 2011 U.S. App. LEXIS at *30.
55. *Jock*, 2011 U.S. App. LEXIS at *20-*33.
56. *Jock*, 2011 U.S. App. LEXIS at *27-*28.
57. *Jock*, 2011 U.S. App. LEXIS at *29.
58. *Jock*, 2011 U.S. App. LEXIS at *29-*30.
59. *Jock*, 2011 U.S. App. LEXIS at *36.
60. *Jock*, 2011 U.S. App. LEXIS at *36-37. The Second Circuit dismissed the employer's arguments that the arbitrator got it backwards by finding that the agreement did not prohibit class arbitration rather than that it authorized it, finding the relevant question to be a determination under state law and contract interpretation of the parties' intent. *Jock*, 2011 U.S. App. LEXIS at *33-*35.
61. The Supreme Court does not answer in *Stolt-Nielsen* the question of why the parties' agreement to submit the class arbitration issue to the arbitrators did not itself act as a separate agreement providing the arbitrators with the authority to decide the class arbitration question.
62. 615 F.3d 1204 (9th Cir. 2010), *cert. granted*, 2011 U.S. LEXIS 3404 (2011). Morrison & Foerster, with which the author is Of Counsel, was co-counsel on the petition for certiorari and represents one of the petitioners in the case.
63. 15 U.S.C. §§ 1679 *et seq*.
64. The Supreme Court had also granted certiorari in an additional arbitration case, *Citibank v. Stok & Assoc.*, 387 Fed. Appx. 921 (11th Cir. 2010), *cert. granted*, 131 S. Ct. 1556 (2011), *cert dismissed*, 2011 U.S. LEXIS 4179 (2011). This case, which raised the issue of whether a party who chooses litigation waives the right to demand arbitration, or whether the party still retains that right absent prejudice to the other party, was dismissed after the parties settled the matter.

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