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Class Action Exposure Post-Concepcion

Law360, New York (May 27, 2011) -- It was the class action shot heard 'round the world. On April 27, U.S. Supreme Court Justice Antonin Scalia, writing for the majority, effectively vitiated a consumer's right to bring class action lawsuits by holding that class action waivers in arbitration agreements are enforceable, and contrary state laws are preempted by the Federal Arbitration Act (FAA). But does this decision really end class action litigation as we know it? In short, no.

Even in light of this landmark decision, areas of exposure still remain for businesses. You can be sure that, as you read this article, companies across the nation are adding class waivers to many of their agreements. But even with a waiver, companies still must be aware that there are certain types of conduct that may remain vulnerable to class action lawsuits.

AT&T Mobility LLC v. Concepcion

To fully understand the decision in Concepcion,[1] we must first look at an earlier California Supreme Court decision called Discover Bank v. Superior Court.[2] In that case, the court held that class waivers were unconscionable in the context of adhesion contracts where disputes between the parties were likely to involve small amounts in damages, and the party with inferior bargaining power alleged that the company had a scheme to defraud its customers.[3] The court also held that this rule was not preempted by the FAA.[4] But the Supreme Court disagreed.

In Concepcion, the Supreme Court held that California's Discover Bank rule is preempted by the FAA because "it 'stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress.'"[5]

The Concepcion claim arose in 2002 when Vincent and Liza Concepcion entered into a contract for cellular telephone service from AT&T Mobility LLC (AT&T).[6] Upon entering into the contract, the Concepcions believed that they were entitled to free cellular phones.[7] The Concepcions did receive free phones from AT&T, but were charged $30.22 in sales tax.[8] After the Concepcions filed suit, AT&T moved to compel arbitration.[9] The Concepcions opposed the arbitration, contending that the arbitration agreement was unconscionable because it contained a class waiver.[10]

Notably, the arbitration provision at issue in this case was very consumer-friendly. The process required customers to initiate a dispute by filing a one-page Notice of Dispute form, which was available online. AT&T could then decide whether or not to settle with the customer.[11 If AT&T chose not to settle, the case would proceed to arbitration.[12]

The terms of the arbitration itself also favored the customer: 1) AT&T agreed to pay all costs of nonfrivolous claims; 2) the arbitration would take place in the customer's county; 3) the arbitration could be conducted in person, by telephone or based only on the papers; 4) the customer could bring the case in small claims court in lieu of arbitration; 5) the arbitrator could award any type of relief; 6) AT&T agreed not to seek attorneys' fees; and 7) if the customer received an award greater than AT&T's last offer to the customer, AT&T would pay a $7,500 minimum recovery and twice the amount of the customer's attorneys' fees.[13]

After considering this arbitration provision and the text of the FAA, the Supreme Court held that a class waiver does not by itself make an arbitration provision unconscionable because "[r]equiring the availability of classwide arbitration interferes with fundamental attributes of arbitration and thus creates a scheme inconsistent with the FAA."[14]

Areas of Exposure in Light of the Broad Decision in Concepcion

Although the practical effect of Concepcion will likely be a significant decline in the number of class actions filed, companies should not simply rest on their laurels. Companies still face exposure to class actions in various types of interactions with their customers. The following are examples of transactions where companies are still exposed to the risk of class action litigation.

1) The Arbitration Provision is Found Unconscionable, or is Obtained as a Contract Term Through Fraud or Duress

In Concepcion, the majority took pains to note that AT&T's arbitration provision was extremely favorable to the customer. But if a given arbitration agreement is unconscionable, or was agreed upon based on fraud or duress, the arbitration clause, and consequently, the class action waiver in that contract, may still be invalidated.

Section 2 of the FAA states that arbitration agreements may be declared invalid "upon such grounds as exist at law or in equity for the revocation of any contract."[15] The court noted that such defenses include fraud, duress or unconscionability.[16] The court in Concepcion focused on unconscionability, because the Discover Bank rule specifically held that class waivers were unconscionable.

Unconscionability "has generally been recognized to include an absence of meaningful choice on the part of one of the parties together with contract terms which are unreasonably favorable to the other party. Phrased another way, unconscionability has both a 'procedural' and a 'substantive' element."[17] The procedural element focuses on oppression or surprise due to unequal bargaining power, and the substantive element focuses on overly harsh or one-sided results.[18]

To ensure that the class waiver provision in an agreement to arbitrate would survive under Concepcion, companies should, to the extent possible, ensure that their arbitration provisions would not encourage a legitimate challenge that the arbitration clause is procedurally or substantively unconscionable.

It is also important that arbitration provisions not be included in a contract as a result of fraud or duress. Companies should utilize fair contractual bargaining techniques with customers to ensure that the company's arbitration provision will not be nullified, because such nullification may lead to class action exposure.

An arbitration provision that is 1) deemed to be unconscionable; 2) determined to have been included in the contract as a result of fraud or duress; or 3) is susceptible to generally applicable contract defenses, may still expose companies to the risk of class action litigation. To protect against this risk, companies should review their arbitration provisions and consider these three issues when drafting new arbitration provisions.

2) Noncontractual Class Action Lawsuits

It goes without saying, that to have a class action waiver in an arbitration provision, you must have some kind of written agreement. But many business transactions are not based on contract. For example, litigation regarding mass torts is not contractually based. Also, a consumer does not typically agree to an arbitration provision when shopping in a brick and mortar store. Thus, it stands to reason that some transactions may still be vulnerable to class action exposure.

This is not to say that corporations will not try to construe the offending claims as contractually based in order to avoid class action liability. It is feasible to imagine, for example, that some brick and mortar stores may argue that all customers agree to their terms and conditions of sale simply by entering the store. If the terms and conditions contain a class waiver in the arbitration clause, the company could argue against class liability.

Barring such creative arguments, companies who face litigation not based on a contractual relationship may still be exposed to class action risk.

3) Contractual Cases Where There is No Privity of Contract

Privity of contract is the "relationship between the parties to a contract, allowing them to sue each other but preventing a third party from doing so."[19] Privity of contract "between the plaintiff and defendant is ordinarily essential to recovery in actions for breach of warranty."[20] But there is "no privity [of contract] between the original seller and a subsequent purchaser who is in no way a party to the original sale."[21] The privity of contract requirement is subject to various exceptions.

If privity of contract is required in a given lawsuit, even if a company included a class waiver in an arbitration clause, that class waiver would likely not be enforceable against third parties. Thus, even if the company sought to protect itself against class exposure, such protection may not be foolproof if the contracting party entered into an agreement with a subsequent purchaser.

4) Public Policy and the Broughton/Cruz Doctrine

The California Supreme Court has held that claims for injunctive relief designed to benefit the public are not subject to arbitration. In Broughton, the court held that an action for injunction in a malpractice suit brought under the Consumer Legal Remedies Act is not amenable to arbitration.[22]

Similarly, in Cruz, the court said that "injunctive relief designed to benefit the public present[s] a narrow exception to the rule that the FAA requires state courts to honor arbitration agreements."[23] In that case, the court held that claims for injunctive relief under the unfair competition law was also nonarbitrable.[24]

Although these cases present a very narrow exception, companies should be mindful that, even with an arbitration provision, an argument might still be made that the class waiver violates public policy based on the Broughton/Cruz doctrine. However, it is an open issue whether the Broughton/Cruz doctrine is still valid law under Concepcion.

Proposed Legislative Response to Concepcion

Lawmakers have not failed to take notice of this game-changing decision by the Supreme Court. The very day that this decision was handed down by the Supreme Court, Sens. Al Franken and Richard Blumenthal, and Rep. Hank Johnson, said that they planned to introduce legislation to protect consumers against the effects of the Concepcion decision.[25]

The bill, called the Arbitration Fairness Act, would, in the words of Franken, "help rectify the court's most recent wrong by restoring consumer rights. Consumers play an important role in holding corporations accountable, and this legislation will ensure that consumers in Minnesota and nationwide can continue to play this crucial role."[26] The Arbitration Fairness Act seeks to protect consumers by "eliminat[ing] forced arbitration clauses in employment, consumer and civil rights cases, and would allow consumers and workers to choose arbitration after a dispute occurred."[27]

What Should a Company do in Light of These Issues?

Given the pending legislation, the vast implications raised by Concepcion have yet to be fully determined. Businesses should keep apprised of developments on this issue in order to fully protect themselves from class action exposure. Businesses should take care to review their consumer contracts and consider whether a class action waiver and arbitration clause are appropriate for inclusion.

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[1] AT&T Mobility LLC v. Concepcion, No. 09-893, 2011 U.S. LEXIS 3367, at *1 (U.S. Apr. 27, 2011).

[2] Discover Bank v. Superior Court, 36 Cal. 4th 148 (Cal. 2005).

[3] Id. at 162-163.

[4] Id. at 166.

[5] Concepcion, 2011 U.S. LEXIS 3367, at *33.

[6] Id. at *5.

[7] Id. at *7.

[8] Id. at *7

[9] Id. at *7-8.

[10] Id. at *8.

[11] Id. at *6.

[12] Id. at *6.

[13] Id. at *6-7.

[14] Id. at *18.

[15] 9 U.S.C.S. § 2 (2011).

[16] Concepcion, 2011 U.S. LEXIS 3367, at *11.

[17] A & M Produce Co. v. FMC Corp., 135 Cal. App. 3d 473, 486 (Cal. App. 4th Dist. 1982).

[18] Concepcion, 2011 U.S. LEXIS 3367, at *12.

[19] Blacks Law Dictionary 1237 (8th ed. 1999).

[20] 4 Witkin Sum. Cal. Law Sales § 97.

[21] Blanco v. Baxter Healthcare Corp., 158 Cal. App. 4th 1039, 1059 (Cal. App. 4th Dist. 2008).

[22] Broughton v. Cigna Healthplans, 21 Cal. 4th 1066, 1083 (Cal. 1999).

[23] Cruz v. PacifiCare Health Systems, Inc., 30 Cal. 4th 303, 312 (Cal. 2003).

[24] Id. at 316.

[25] Sens. Franken, Blumenthal, Rep. Hank Johnson Announce Legislation Giving Consumers More Power in the Courts against Corporations, (May 1, 2011, 2:40 p.m.),http://blumenthal.senate.gov/press/release/?id=0c87cc34-f6b8-4fdf-a93c-0df05399e729.

[26] Id.

[27] Id.