

IS THE SUPREME COURT READY TO VALIDATE CLASS ACTION WAIVERS?

PERSPECTIVE

By Brian Kabateck and Evan Zucker

Promoted by consumer services providers - and in fields as diverse as consumer banking and mobile phone services - more and more contracts are including arbitration provisions. This is not new. But contracts now often include, within the arbitration provision, a waiver of a consumer's right to bring a claim as a representative of a class action. California and the 9th U.S. Circuit Court of Appeals have been leaders in holding that these class action waivers are often unconscionable and unenforceable.

The argument that class action waivers are unenforceable was made popular in *California by Discover Bank v. Sup.Ct.* (2005) 36 Cal.4th 148, and later expanded by *Shroyer v. New Cingular Wireless Services Inc.*, 498 F.3d 976 (9th Cir. 2007). This line of cases was recently upheld and even strengthened further by the decision in *Laster v. AT&T Mobility LLC ("Concepcion")* 584 F.3d 849 (9th Cir. 2009). In that case, which involved a contract for cell phone service, AT&T advertised free phones when a consumer signed up for a cellular phone service contract, but the company still charged consumers tax on the full retail price of the phone. The plaintiff in the case argued this practice was fraudulent because the phone is not therefore "free" as advertised. Within AT&T's contract was an arbitration provision and a class action waiver, put in place so consumers could only arbitrate individual claims.

In an apparent attempt to craft a class action waiver that was designed to survive an unconscionability argument, AT&T inserted a number of provisions to make individual arbitration more fair and appealing to consumers. Among others, AT&T's contract clause provided the following pro-consumer concessions: a payment of \$7,500 (the amount of the maximum claim that could be brought in small claims court) if the arbitrator awarded the consumer more than AT&T's final written offer prior to arbitration; AT&T offered payment of double attorneys' fees on claims that receive the \$7,500 payment; AT&T promised to pay full arbitration costs and fees and stipulated that they would not seek attorneys fees if they prevail on a non-frivolous claim, and they made available the full set of remedies including punitive damages. Despite AT&T's effort to draft a class action waiver that was not unconscionable, the 9th Circuit was not swayed and still found the clause unenforceable on unconscionability grounds.

Although the risks associated with bringing an individual claim for very small losses have been largely alleviated by AT&T's contract provision in *Concepcion*, the increased upside is illusory in practice. Plaintiffs are purportedly motivated by the possibility of a \$7,500 award and double attorneys' fees if they obtain an arbitrator's ruling in excess of the last written offer prior to arbitration by AT&T. However, game theory here dictates that, in practice, no more than one plaintiff would ever receive this windfall payment on any class of claims. Take for example the *Concepcion* case, where the consumer's claim was for the amount charged for tax on a phone advertised as free: \$30.22. When presented with an arbitration demand, AT&T is likely to make routine offers to settle for nothing. Once the first of this type of claim is decided by an arbitrator to be valid, the first decision will net the plaintiff the \$30.22 he was defrauded out of,

plus \$7,500 and double attorneys' fees. But, every subsequent claim will garner a written offer of \$30.22, the amount of the fraudulent overcharge, thereby erasing the incentives for a plaintiff or any attorney representing plaintiffs to bring an individual claim. Perhaps this calculus was part of the reason the 9th Circuit said, "[t]he *applicable* rule focuses on whether damages are predictably small, and in the end, the premium payment provision does not transform a \$30.22 case into a predictable \$7,500 case."

However, the Supreme Court's willingness to review this case raises questions about California's position. If the AT&T case is upheld, it will serve as an indication that the courts are unwilling to consider anything that curtails a consumer's full rights to pursue a class action, especially in contracts that are not negotiable by the consumer, whether or not they concern essential services. Although contract drafters can get more and more creative, AT&T's efforts to draft an acceptable waiver provision likely took that effort to the limit and the court still only gave minimal consideration their efforts. Instead, the 9th Circuit applied the *Shroyer* case in a very straightforward manner without delving into the details or the practical operation of AT&T's contract clause.

On the other hand, if the court were to overturn this decision, they have two avenues to do so. First, and most heavily briefed, they could rule that the Federal Arbitration Act or FAA preempts state laws purporting to limit an arbitration clause such as unconscionability. AT&T's petition for review to the Supreme Court makes this argument at length. But because the FAA explicitly allows contract defenses of general applicability, this argument has been rejected by a number of courts in the past. If inclined to reverse this decision, the second avenue for challenge would be for the Supreme Court to outline a test to determine if the substance of the specific class action waiver at issue is consistent with the goals of the courts, such as those providing litigants with a reasonable venue and procedure to protect their rights.

There is also another important purpose for the class action mechanism. It not only allows consumers an efficient way to redress small but widespread losses, but it also acts as a deterrent for fraudulent or harmful practices by large corporations and other potential wrongdoers. California courts have been mostly critical of attempts to draft class action waivers, likely because they do not address both purposes that the class action mechanism accomplishes. The Supreme Court might not take the same view.

In April of 2010, the Supreme Court said, in *Stolt-Nielsen S.A. v. AnimalFeeds International Corp.* 130 S.Ct. 1758 (2010), that an arbitration provision, which was silent on class arbitration, in the context of a maritime dispute, could not force the parties to participate in class arbitration. The court relied on the fact that arbitration is a matter of consent, not coercion.

While the court did not discuss either FAA preemption or the unconscionability analysis of class action waivers, this decision could indicate a trend that the class action mechanism is increasingly afforded less protection than it has had historically.

If the court, either on preemption grounds or the unconscionability standard, issues a decision upholding class action waivers, which are drafted to give individual consumers enough incentive to pursue a claim, that decision would fundamentally change the way contracts are written and consumers pursue claims. The purpose of a class action is to allow consumers who have been cheated in some small but uniform way to recover for their loss.

Another result of the class action mechanism is to lessen the burden on the court system by allowing for the adjudication of hundreds or maybe even millions of small claims to be decided in a single action. The FAA explains that the proliferation of arbitration is intended to have a

similar purpose. A move to greater reliance on arbitration to settle consumer disputes was intended to lessen the burden on the court system by allowing parties to agree on an out of court forum in which to vindicate rights before a neutral third party.

This presents an unusual situation for the courts. If the Supreme Court were to uphold contract provisions that include class action waivers, then the court is acknowledging that where violations occur, each harmed member would be adequately motivated to bring an individual claim either in court or directly in arbitration. The subsequent flood of claims would run in opposition to the stated purpose of both the class action mechanism and the arbitration mechanism because both were intended to reduce the number of claims and efficiently handling identical issues, not increase them by creating hundreds (or perhaps millions) of individual claims. On the other hand, if the court's decision is based on FAA preemption, the court would be forced to read into the intent of the act and suggest that it is designed to limit class action lawsuits. That is a proposition found nowhere in the Federal Arbitration Act.

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