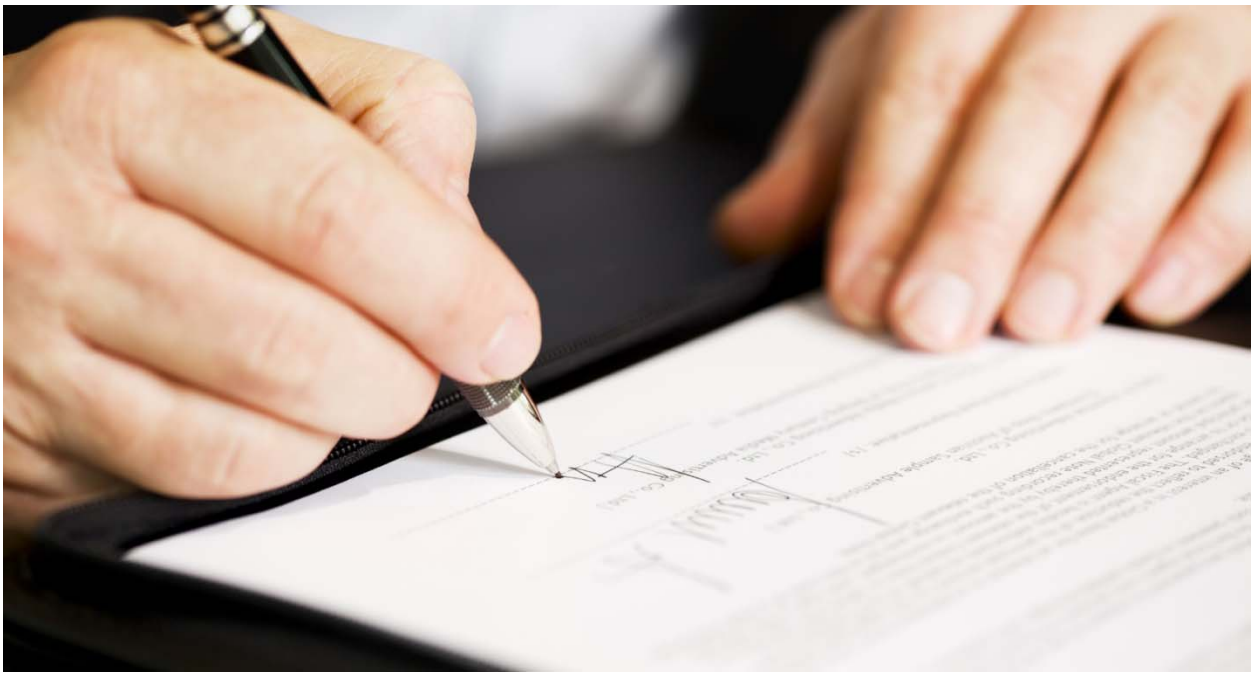

Developments in Litigation Since the U.S. Supreme Court Validated Class Action Waivers in Consumer Contracts

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In 2011, the U.S. Supreme Court held in *AT&T Mobility LLC v. Concepcion* that the Federal Arbitration Act ("FAA"), 9 U.S.C. § 2, which "makes agreements to arbitrate 'valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract,'" preempted a state law[i] that invalidated a class action waiver in a mandatory, pre-dispute arbitration agreement.[ii] The state law in question was a common law rule, adopted by California courts, that voided class action waivers in any contract—whether imbedded in an arbitration clause or otherwise—whenever the following factors are present: (1) a consumer contract of adhesion; (2) predictably small damages; and (3) an allegation that the defendant engaged in a scheme to cheat consumers.[iii] Casting a fairly expansive, preemptive net, the Court held that a state rule that interferes with the objectives of the FAA, i.e., to provide "streamlined proceedings and expeditious results," is preempted by federal law.[iv] Because class, rather than individual, arbitration would interfere with the FAA due to its delays, procedural hurdles, and involvement of higher stakes, it is "inconsistent with the FAA."[v]

Although *Concepcion* forbids the compulsion of class arbitration, the Court recognized the FAA's savings clause, which permits arbitration clauses to be invalidated by "'generally applicable contract defenses, such as fraud, duress, or unconscionability,' but not by defenses that apply only to arbitration or that derive their meaning from the fact that an agreement to arbitrate is at issue."[vi] In other words, a generally applicable contract defense should not "disproportionate[ly] impact … arbitration agreements."[vii] The Court stated, however, "Of course States remain free to take steps addressing the concerns that attend contracts of adhesion—for example, requiring class-action-waiver provisions in adhesive arbitration agreements to be highlighted."[viii]

Two years later, in *American Express Co. v. Italian Colors Restaurant*, the Court held that an arbitration clause could not be invalidated on the grounds that the unavailability of the class

mechanism "prevent[ed] the 'effective vindication' of a federal statutory right," i.e., seeking damages for an antitrust violation.[ix] The Court stated, "[T]he fact that it is not worth the expense involved in *proving* a statutory remedy does not constitute the elimination of the *right to pursue* that remedy."[x]

The impact of *Concepcion* has been profound. First, recognizing the high court's hostility toward class action-oriented policy arguments against enforcement of arbitration clauses, litigants and courts have largely abandoned them. Courts have altered their analyses and, for the most part, significantly narrowed the circumstances under which they consider invalidation arguments. Second, the proliferation of arbitration clauses in employment and consumer contracts, both leading up to and following the *Concepcion* decision, has led to legislative and regulatory proposals, and to executive action, to shorten the FAA's preemptive reach. Third, lawyers seasoned in complex litigation have gravitated toward filing class cases where there is no arbitration clause at issue.

Post-*Concepcion* Arbitration Decisions of Interest to Class Litigants

Since *Concepcion*, courts have almost unflaggingly compelled arbitration in cases where arbitration is challenged on the policy grounds that deprivation of class procedures would produce and unjust result. The most notable exception was the lower appellate court in *Italian Colors*, whose disposition the Supreme Court ultimately reversed, as noted above. Several courts have refused to compel arbitration on grounds unrelated to any class action posture, such as the failure of the defendant to sign an agreement, or through waiver of the right to arbitrate based on pre-arbitration litigation conduct. These cases fall beyond the current discourse, however, because none of these decisions is tethered to class action procedure, nor do they tend to pave a particular path promising to ease a class action's journey in court. However, there have been several notable decisions in the last two years addressing arbitration clauses on grounds applicable to both individual and class litigation, mainly due to their treatment of standardized contracts of adhesion.

Keeping in mind that *Concepcion* expressly carved out contract formation and unconscionability defenses as candidates to defeat arbitration—as long as they do not disproportionally disfavor arbitration over other types of contract provisions—several decisions have explored non-class-action-based contract defenses, albeit in the context of purported class actions. In the lead are cases applying California law on the issue of the unconscionability of certain arbitration provisions. Avoiding class action waiver provisions entirely, a number of opinions have analyzed defendants' arbitration clauses in standardized contracts, both in terms of procedural unconscionability, which measures the level of oppression or surprise at the time a contract is formed, and substantive unconscionability, where a contract is unjustifiably one-sided and shocks the conscience.[xi]

Procedural Unconscionability (Contract Formation Defenses)

Several such cases held that where an agreement to arbitrate was a condition of employment or was otherwise offered on a take-it-or-leave-it basis, the arbitration clause was procedurally unconscionable.[xii] Courts also considered arbitration clauses procedurally unconscionable where the terms of arbitration were not disclosed at the time of the agreement,[xiii] and where the defendant had the ability unilaterally to modify the agreement.[xiv] One court held that the availability of competing market services does not overcome the procedural unconscionability of defendant's contract.[xv] The same court also held that the arbitration clause failed to disclose its terms clearly where the provision appeared on the sixteenth page of a prolix, 20-page contract, and although the table of contents highlighted the arbitration provision, such efforts were diminished by the defendants' repeated modification of the agreement 35 times over 10 years without notice.[xvi]

Substantive Unconscionability (Contract Enforceability Defenses)

Those same decisions analyzed whether the subject clauses were also substantively unconscionable. For instance, where an arbitrator selection provision favored an employer, who would essentially be guaranteed to be able to select the arbitrator or control arbitrator candidates, courts considered the clause substantively unconscionable.[xvii] Also, plaintiffs

demonstrated substantive unconscionability where the arbitration clause imposed a significantly truncated limitations period within which to bring a claim.[xviii] Courts have held that an arbitration clause requiring that an employee or consumer pay substantial arbitration costs is substantively unconscionable.[xix] And in *Merkin*, the court held that an arbitration clause is substantively unconscionable where it lacked "mutuality" because the contract exempts from arbitration types of disputes that would naturally be brought by the defendant and not a plaintiff.[xx]

The Sliding Scale of Unconscionability

These post-*Concepcion* cases demonstrate the deftness with which courts can wield a litany of non-class-specific contract formation and enforcement defenses. However, it is unclear whether any single defense discussed above, standing alone, would suffice to void an arbitration clause. In each case discussed above, the courts did not rely on a single transgression, but instead presented a parade of unconscionable provisions that worked in concert to invalidate the whole.

There have been notable exceptions. The Supreme Court of New Jersey recently held that the absence of any language in an arbitration provision that the party is waiving her statutory right to seek relief in a court of law renders the provision unenforceable.[xxi] The Supreme Court of California held that an arbitration clause waiving a collective or representative action under the private attorney general act is void.[xxii] At least one court has held that the single issue of whether an arbitration agreement requires an unconscionable up-front fee to initiate a dispute sufficed to void an arbitration clause.[xxiii] In addition, several courts have analyzed the single issue of whether lack of mutuality of the obligation to arbitrate alone can void an arbitration agreement.[xxiv]

One thing is clear, though. Before *Concepcion*, many courts paid mere lip service to arguments that a contract of adhesion is procedurally unconscionable, knowing that the meat of the issue was whether a class action waiver was substantively unconscionable. Now, however, the leading decisions have delved deeply into the minutia of bygone contract defenses to wrest policy arguments from dusty texts. As the non-class-oriented grounds of these opinions make clear, the decisions are not only fair game, they represent the inescapable outcropping of state law policy expressly preserved by the FAA, bounded by the limitations suddenly articulated in *Concepcion*.

Non-Class-Related Unconscionability Law Not Preemption by FAA

Relating as they do generally to standardized contracts of adhesion, many procedural unconscionability arguments clearly do not derive their meaning from the fact that an agreement to arbitrate is at issue. Those grounds for voiding an arbitration provision appear to fall well outside the compass of preemption's bending sickle. Many substantive unconscionability arguments, on the other hand, at least cross the threshold of arbitration's sanctum. For instance, the unconscionability of the arbitrator selection provision and arbitration fee provision in *Chavarria* certainly derived their meaning from the arbitration clause—and not from generally applicable contract principles.

Courts have held in such circumstances that FAA preemption has its limits, even in the post-*Concepcion* world. In *Chavarria*, the court of appeals freely admitted that its finding of substantive unconscionability disproportionally impacted arbitration. However, the court held, the unconscionability finding "does not disfavor arbitration; it provides that the arbitration process must be fair," because the filing fees were "'so high as to make access to the forum impracticable.'"[xxv] Similarly, in *Jackson v. Payday Financial, LLC*, the U.S. Court of Appeals for the Seventh Circuit invalidated an arbitration clause where the body selected (a Native American Tribe) had no arbitration procedures and no arbitrators.[xxvi] The court held that a state law invalidating a forum selection clause that imposed difficulties and inconveniences, depriving the plaintiff of being heard, was not preempted by the FAA because invalidating an arbitral "process that is a sham from stem to stern" hardly frustrates the FAA.[xxvii]

Arbitration-specific state laws requiring the opportunity for fair dispute resolution and reasonable access to a true forum, therefore, are not preempted because they do not frustrate the FAA's purposes. Although class action procedures were argued to fit this mold, in that they supply the only realistic means for redress, the Supreme Court in *Concepcion* specifically held that individual dispute resolution is an *essential feature* of

arbitration. But fair arbitration is an essential feature of arbitration as well, at least according to the Seventh and Ninth Circuit Courts, and state laws requiring fair arbitration have a chance of surviving as long as they steer clear of invalidating class action waivers.

Legislative and Executive Response to Mandatory Arbitration in Non-Commercial Transactions

Despite the recognition within the legal community of just how significantly arbitration clauses have foreclosed collective recourse by employees and consumers, their meaning remains fairly obscure to the public at large. The trend and its impact have, however, garnered the attention of some lawmakers, and even the President.

On July 31, 2014, President Obama signed an executive order requiring large government contractors to waive pre-dispute, binding arbitration of civil rights and sexual harassment disputes with their workers.[xxviii] Progressive online magazine Slate.com reported that the order went "virtually ignored," but quoted consumer lawyer Paul Bland as saying it "will result in millions of employees having their rights restored to them."[xxix] It is not apparent why companies were required to abandon pre-dispute arbitration clauses only with regard to civil rights and sexual harassment disputes.

In 2010, Congress passed the Dodd-Frank Wall Street Reform and Consumer Protection Act. The law created the Consumer Financial Protection Bureau,[xxx] and gives the CFPB authority to ban pre-dispute, mandatory arbitration clauses in consumer financial services contracts, "if the Bureau finds that such a prohibition … is in the public interest and for the protection of consumers."[xxxi]

Antecedent to adopting such a rule, however, the CFPB is required to conduct a study and report to Congress regarding the use of arbitration agreements in consumer financial products or services,[xxxii] and any rule curtailing pre-dispute arbitration agreements must be based on findings in the study.[xxxiii] On December 12, 2013, the CPFB released its 168-page preliminary report.[xxxiv] The study found that arbitration clauses proliferated among large institutions, nearly all clauses banned class actions, relatively few arbitrations were initiated by consumers, consumers do not file arbitrations or small-claims court actions for small-dollar disputes, and consumers do not choose arbitration over class action settlements.[xxxv] The CFPB also noted its plans to supplement its preliminary data and findings with other "phases of work that are underway."[xxxvi] Apparently, chief among them is a consumer survey to assess awareness of arbitration clauses and expectations about dispute resolution.[xxxvii]

The final CFPB study, a prerequisite to rulemaking, is anticipated to be completed in 2015.

Finally, various versions of a bill referred to as the Arbitration Fairness Act has been introduced over the years. The most recent bill made its way to Congress in 2013, when Senator Al Franken sponsored S. 878, the Arbitration Fairness Act of 2013, in the U.S. Senate. S. 878 would have invalidated predispute arbitration agreements in employment, consumer, antitrust, and civil rights disputes. The bill died after being referred to the Judiciary Committee.

New Litigation Directions in the U.S. Resulting from *Concepcion*

The increased use of arbitration clauses in consumer and employee standardized contracts, combined with their burgeoning validation by the judiciary, may have resulted in class action filings in newer or under-represented sectors—previously neglected or under-served—in which products or services are offered without a written contract. As the CFPB preliminary report shows, tens of millions of Americans are currently subject to pre-dispute, binding arbitration provisions in their credit card and banking terms of service. Consumer financial service disputes once represented a large chunk of class action filings, as did cases against cellular service providers. Trends now show that class action growth areas include data privacy violations and deceptive labeling cases, particularly with regard to food labeling.

One survey showed that the number of **privacy violation** cases has grown.[xxxviii] These cases include allegations that defendants mishandled or improperly collected plaintiffs' private, personal information or sent them SPAM in violation of the Telephone Consumer Protection Act ("TCPA").[xxxix] Another study confirmed that telemarketing was the most common legal theory employed among privacy and security class action cases.[xl]

Class action researcher Carlton Fields recently reported, "In 2013, corporate counsel expect an onslaught of new consumer fraud class actions related to **data security**, wireless and other untested technologies, and **food safety and labeling**."[xli] The American Bar Association asserted in 2012 that "the number of consumer class actions challenging health and nutrition marketing claims made in relation to food and drinks has expanded dramatically."[xlii] The bar group also attributed the expansion, at least in part, to arbitration proliferation:

> [A] likely contributing factor of the growth in health and benefit claims [in food labeling cases] is the current environment of traditional class-action cases. Traditional claims have become more difficult to pursue. For example, the pleadings standards in securities class actions have been heightened, and, after *AT&T Mobility v. Concepcion*, the ability to bring class actions over sales of products involving a consumer contract has been limited. This may have curtailed claims against sellers of financial products, consumer credit, or cellular services.[xliii]

This list of trends is not exhaustive. Interest by the class action bar, post-*Concepcion*, has grown in antitrust cases, many of which do not involve arbitration clauses, and in partnerships with public entities not subject to such provisions. Nor can the connection between these growth areas and arbitration clauses be exclusively established, as many factors contribute to growth, such as an amendment to the TCPA making it easier to seek relief, or the spate of large scale, credit card security breaches at major retail chains. However, from a practitioner's perspective, the link is clear: by stripping courts of their ability to employ class action procedures in large, consumer-oriented sectors, *Concepcion* has had a dramatic effect on the ability of consumers and employees to effectively vindicate their rights, and has caused the class action bar to begin serving a nascent variety of consumer dispute.

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NOTES

[i] The United States Constitution's Supremacy Clause, U.S. Const., Art. VI, cl. 2, "invalidates state laws that 'interfere with, or are contrary to,' federal law." *Hillsborough County, Fla. v. Automated Med. Labs., Inc.*, 471 U.S. 707, 712 (1985) (quoting *Gibbons v. Odgen*, 22 U.S. (9 Wheat.) 1, 211 (1824)). Federal law is thus said to "preempt," or supersede, state law when Congress, acting within its constitutional authority, expressly says it does, or when state law makes compliance with federal law impossible. *Id.* at 713.

[ii] *AT&T Mobility LLC v. Concepcion*, 131 S. Ct. 1740, 1748, 1753 (2011).

[iii] *Id.* at 131 S. Ct. at 1746.

[iv] *Id.* at 1749.

[v] *Id.* at 1750-51.

[vi] *Concepcion*, 131 S. Ct. at 1746 (quoting *Doctor's Assoc., Inc.*, 517 U.S. 681, 687 (1996)).

[vii] *Id.* at 1747.

[viii] *Id.* at 1750 n.6.

[ix] *Am. Express Co. v. Italian Colors Rest.*, 133 S. Ct. 2304, 2310-11 (2013).

[x] *Id.* (emphasis in original).
[xi] *Chavarria v. Ralphs Grocery Co.*, 733 F.3d 916, 922-25 (9th Cir. 2013).
[xii] *Id.* at 922-23; *Zaborowski v. MHN Gov't Servs., Inc.*, --- Fed. App'x ----, No. 13-15671, 2014 WL 7174222, *1 (9th Cir. Dec. 17, 2014); *Elite Logistics Corp. v. Hanjin Shipping Co., Ltd.*, --- Fed. App'x. ----, No. 12-56238, 2014 WL 4654383, *1 (9th Cir. Sept. 19, 2014); *Merkin v. Vonage Am. Inc.*, No. 2:13-cv-08026, 2014 WL 457942, *6 (C.D. Cal., Feb. 3, 2014).
[xiii] *Chavarria*, 733 F.3d at 923.
[xiv] *Merkin*, 2014 WL 457942 at *7.
[xv] *Id.*
[xvi] *Id.* at *8-9.
[xvii] *Chavarria*, 733 F.3d at 924-25; *Zaborowski*, 2014 WL 7174222 at *1.
[xviii] *See Zaborowski*, 2014 WL 7174222 at *1 (6 month limitations period was too short where California's statute of limitations for underlying dispute was 4 years); *Elite Logistics Corp.*, 2014 WL 4654383 at *2 (30-day limitations period was too short).
[xix] *See Chavarria*, 733 F.3d at 925-26 (9th Cir. 2013) ($3,500-$7,000 per day unconscionable); *Zaborowski*, 2014 WL 7174222 at *1-2 (provisions shifting costs to prevailing party and requiring employee to pay $2,600 filing fee unconscionable).
[xx] 2014 WL 457942 at *10.
[xxi] *Atalese v. U.S. Legal Servs. Group, L.P.*, 99 A.3d 306 (N.J. 2014).
[xxii] *See Iskanian v. CLS Transp. Los Angeles, LLC*, 327 P.3d 129 (Cal. 2014) (holding PAGA representative action is distinguishable from a "class action" and is thus not preempted by the FAA, where the statute defines the claim as belonging to the State of California and merely assigns the right to bring the claim to individuals harmed by a violation of the Labor Code), *cert. denied*, *CLS Transp. Los Angeles v. Iskanian*, --- S. Ct. ----, No. 14-341, 2015 WL 231976 (Jan. 20, 2015).
[xxiii] *See Roldan v. Callahan & Blaine*, 219 Cal. App. 4th 87 (2013) (holding that defendant could either pay indigent plaintiff's up front arbitration fees or waive its right to compel arbitration).
[xxiv] *Compare Dalton v. Santander Consumer USA, Inc.*, --- P.3d ----, No. 33,136, 2014 WL 743867 (N.M. Dec. 30, 2014) (holding that language of mutuality of obligation to arbitrate was illusory where plaintiffs' most likely claims required arbitration, whereas defendant's most likely remedies, such as "repossession" of the subject vehicle, were exempted from arbitration, making arbitration clause substantively unconscionable, and that state requirement of mutuality is not preempted by FAA), *with THI of New Mexico at Hobbs Center, LLC v. Patton*, 741 F.3d 1162, 1168-69 (10th Cir. 2014) (state law rule requiring mutuality of obligation to arbitrate amounts to the view that arbitration is inferior to court proceedings, in violation of *Gilmer v. Interstate/Johnson Lane Corp.*, 500 U.S. 20, 34 n.5 (1991)).
[xxv] 733 F.3d at 927 (quoting *Italian Colors Rest.*, 133 S. Ct. at 2310-11).
[xxvi] *Jackson v. Payday Financial, LLC*, 764 F.3d 765 (7th Cir. 2014).
[xxvii] *Id.* at 779.
[xxviii] 79 Fed. Reg. 45314 (Aug. 5, 2014) (section 6).
[xxix] Emily Bazelon, *Obama Is on a Pro-Labor Roll*, Slate, Aug. 7, 2014, available at http://www.slate.com/articles/news_and_politics/jurisprudence/2014/08/obama_executive_order_on_mandatory_arbitration_huge_news_for_workers_rights.single.html.
[xxx] 12 U.S.C. § 5491.
[xxxi] *Id.* at § 5518(b).
[xxxii] *Id.* at § 5518(a).
[xxxiii] *Id.* at § 5518(b).
[xxxiv] Consumer Financial Protection Bureau, *Arbitration Study Preliminary Results*, Dec. 2013, available at http://files.consumerfinance.gov/f/201312_cfpb_arbitration-study-preliminary-results.pdf.
[xxxv] *Id.* at 12-15.
[xxxvi] *Id.* at 129.
[xxxvii] *Id.*

[xxxviii] NERA Economic Consulting, *Consumer Class Action Settlements: 2010 – 2013, Settlements Increasing, With a Focus on Privacy*, July 22, 2014, available at http://www.nera.com/content/dam/nera/publications/archive2/PUB_Consumer_Class_Action_Settlements_0614.pdf.
[xxxix] *Id.* at 18.
[xl] Shahin Rothermel & David Zetoony, *Shifting Trends: Privacy & Security Class Action Litigation*, June 2014, available at http://www.bryancave.com/files/Publication/da99a2d1-9148-41a3-85d2-863be2ec5953/Presentation/PublicationAttachment/b2809896-d367-4aeb-ab4a-94e159cdbfc3/DC01DOCS-%23421722-v2-Data_Litigation_Report_Q1_2014.pdf.
[xli] Carlton Fields, *The 2013 Carlton Fields Class Action Survey*, 2013, available at http://online.wsj.com/public/resources/documents/carlton.pdf.
[xlii] David T. Biderman and Joren S. Bass, *Trends in Food Labeling and Nutrition Class Actions*, American Bar Association Section of Litigation, Apr. 30, 2012, available at http://apps.americanbar.org/litigation/committees/classactions/articles/spring2012-0412-trends-food-labeling-nutrition-class-actions.html.
[xliii] *Id*.