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Assessing the Viability of Class Action Waivers in Arbitration Agreements: The Impact of *AT&T Mobility* and the Shadow of the NLRA

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Over the past decade or more, class action litigation has proliferated, particularly in the areas of consumer rights and employment. To help control exposure to class actions, businesses have increasingly used class action waivers in the arbitration agreements that they have presented to customers and employees. However, the enforceability of such waivers has been somewhat unpredictable, depending largely on the jurisdiction and the nature of the claims. The recent decision by the United States Supreme Court in *AT&T Mobility, LLC v. Concepcion*[1] has steadied the boat, renewing the business community's hope for enforcing class action waivers as a prominent weapon in the battles against consumer class actions and employment wage-and-hour class actions. While *AT&T Mobility* gives strong support for those hopes, the war is not over. Congress and state legislators are proposing laws to invalidate predispute agreements that prohibit class claims. And the National Labor Relations Board has jumped into the fray as it considers whether prohibiting class actions in arbitration agreements is an unfair labor practice under the National Labor Relations Act. The waters of class action waiver enforceability are less muddy but still require careful navigation.

Background

At the center of the dispute is the Federal Arbitration Act ("FAA"), which the Supreme Court has consistently supported since its enactment in 1925.[2] Under this law, agreements to arbitrate involving interstate commerce are "valid, irrevocable, and enforceable . . . save upon such grounds as exist at law or in equity for the revocation of any contract."[3] When there are doubts about the scope and enforceability of an arbitration agreement, the strong federal policy supporting arbitration directs courts to resolve such concerns in favor of arbitration.[4] Under section 2 of the FAA, an arbitration agreement is subject to generally applicable contract defenses (for example, unconscionability, fraud and duress). Moreover, the Supreme Court has interpreted that same section to invalidate any state law that specifically targets arbitration agreements, as opposed to all contracts in general.[5] The primary message of the Court has been that arbitration agreements must be treated in the same manner as other contracts.

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AT&T Mobility: The Supreme Court Finally Addresses Class Action Waivers

The Concepcions were California customers of AT&T Mobility, their cellular phone carrier. They objected to paying sales taxes charged for cell phones advertised as free and filed a lawsuit in federal court. Their case was consolidated with another case against AT&T, a class action that alleged false advertising in relation to those sales tax charges. AT&T moved to compel arbitration of the claims based on an arbitration provision in the service agreement that required all claims to be brought in the customer's individual capacity and not on a class basis. The federal district court, and then the Ninth Circuit Court of Appeals, denied the motion after concluding that the arbitration provision, with its class action waiver, was unconscionable under California law - the "*Discover Bank* rule."[6] In affirming the district court's decision, the Ninth Circuit held that the *Discover Bank* rule was not preempted by the FAA.

In a 5-4 decision, the United States Supreme Court reversed the Ninth Circuit after finding that the FAA did indeed preempt the California law announced in the *Discover Bank* decision by the California Supreme Court. The Court found that the California decision was effectively a prohibition on predispute arbitration agreements in consumer contracts, a decision that improperly frustrated the purpose of the FAA.

The Court rejected the claim that the *Discover Bank* rule constituted a "generally applicable" contract defense that is allowed by section 2 of the FAA to invalidate arbitration agreements. Instead, the court found that the rule used the defense of unconscionability in a manner that specifically targeted arbitration agreements. As the court observed, such "state law rules" conflict with the FAA's purpose of ensuring the enforcement of arbitration agreements according to their terms, in that those rules fail to place arbitration agreements on "equal footing" with other kinds of contracts.

Another important aspect of the Court's decision was its observation that requiring classwide arbitration would impede the fundamental aspects of arbitration, creating "a scheme inconsistent with the FAA."[7] In the Court's view, class wide arbitration would make the arbitration slower and more costly; require the parties to address the type of procedural formalities that arbitration is intended to minimize; and is poorly suited to the high stakes of class litigation because of the risk in arbitration that errors would go uncorrected without an appeals process. In response to the dissent's argument that class proceedings were critical to prevent small-dollar claims from "slipping through" the legal system, the majority opinion (1) focused on the importance of not requiring a procedure inconsistent with the FAA and (2) emphasized AT&T Mobility's consumer-friendly arbitration provisions, which would likely give customers a better chance of vindicating their rights in individual arbitration than in a class action.[8]

Reaction to *AT&T Mobility*

Attempts to limit or nullify *AT&T Mobility* began immediately. Within two weeks congressional bills were proposed to prohibit predispute agreements that require arbitration of a dispute involving employment, civil, or consumer rights.[9] For example, according to the official summary of one of the bills, it "declares that no predispute arbitration agreement shall be valid or enforceable if it requires arbitration of an employment, consumer, or civil rights dispute.[10]

State legislators also responded. For example, in Maryland, the House of Delegates proposed House Bill 729, which would have banned all class action waivers, regardless of the nature of the contract. However, after passing overwhelmingly in the House of Delegates, the bill failed on its third reading in the Maryland State Senate.

In California, within days after the *AT&T Mobility* ruling, the California Legislature introduced Assembly Bill 1062, which would make denials of petitions to compel arbitration non-appealable in state court (except when the arbitration would involve a collective bargaining agreement). Such a law would be another obstacle to enforcement of an arbitration agreement.

Litigants also have been quick to apply *AT&T Mobility* to pending cases. One such case is *Estrella v. Freedom Financial,*[11] in which a federal district court compelled arbitration and precluded class arbitration – even though the case had been pending for over two years. Before the *AT&T Mobility* decision, the parties had engaged in discovery and approved case management orders, and the court had certified the case as a class action. The defendant did not move to compel arbitration at the outset of the case, but did file such a motion shortly after *AT&T Mobility*, more than two years after the litigation began. The district court agreed with the defendant's argument that filing the motion before the U.S. Supreme Court's ruling would have been a futile act; accordingly, the defendant had not waived its right to compel arbitration. Because the arbitration agreement had a class action waiver that was deemed enforceable under *AT&T Mobility,* the class action in court instead became a handful of individual disputes before an arbitrator.

These Responses Beg the Question: Do We Really Know Yet the Force of *AT&T Mobility's* Impact?

Nearly six months after the decision, it is too early to declare with certainty what the impact will be. The case provides powerful support for including class action waivers in arbitration agreements in numerous contexts, including consumer rights and employment. Regarding the latter area, *AT&T Mobility* may be an especially powerful weapon for employers battling the ongoing onslaught of wage-and-hour class actions (and collective actions under the Fair Labor Standards Act). Although the arbitration agreement at issue was between a phone company and its customers, the U.S. Supreme Court's discussion in the *AT&T Mobility* case and holding was broadly worded, not specifically

confined to the context of consumer contracts. The Court unmistakably continued its support for arbitration and its disdain for state procedures and laws that are inconsistent with the FAA.

Nevertheless, challenges to *AT&T Mobility* and its applicability will be numerous. In addition to legislative response such as the bills mentioned above, state and federal courts will over the next several years surely have opportunities to address arguments that class action waivers are unenforceable notwithstanding the *AT&T Mobility* case. For example, before *AT&T Mobility,* some decisions, like *Discover Bank*, invalidated class action waivers as unconscionable because enforcing the waivers would not allow for full vindication of statutory rights. These courts have viewed class action waivers as waivers of substantive rights, not just procedural rights.[12] They have emphasized that, in the absence of a class action procedure, few, if any injured parties (especially where the damages are small) will choose to proceed with pursuing their individual claim. Particularly when individual claims are small, the absence of a mechanism for pursuing classwide relief would allow a company to avoid liability for wrongs committed against customers or employees. In such a scenario, the statutory rights of the customers or employees would not be vindicated.[13]

A Potential X Factor

Another potential challenge to the enforceability of class action waivers is the National Labor Relations Act ("NLRA"). In 2010, the NLRB General Counsel at the time, Ronald Meisberg, issued a memorandum to the Board's regional directors about how to address class action waivers in arbitration agreements. The memorandum stated that such waivers are valid and do not violate section 7, but that employees cannot be prevented from challenging the validity of the class action waivers, and the arbitration agreement must make clear that the employees will not be retaliated against for doing so. Now, though, the NLRB has a chance to weigh in officially on class action waivers. The National Labor Relations Board ("NLRB") will soon decide a case called *D.R. Horton, Inc.*, in which employees of a construction company seek unpaid overtime through classwide arbitration. The company triggered the class action waiver provision of the arbitration agreement that it had with the employees, a move that prompted the employees to file a NLRB complaint.[14] Under section 7 of the NLRA, all employees – even those not represented by a union – have the right to engage in "concerted activities for the purpose of collective bargaining or other mutual aid protection."[15] An administrative law judge determined that D.R. Horton did not violate the NLRA through its enforcement of a mandatory arbitration agreement that precluded pursuing classwide relief.[16]

Recently, the NLRB requested input from the public on the following question:

> Did [D.R. Horton] violate Section 8(a)(1) of the Act by maintaining and enforcing its Mutual Arbitration Agreement, under which employees are required, as a condition of employment, to agree to submit all employment disputes to individual arbitration, waiving all rights to a judicial forum, where the arbitration agreement further provides that arbitrators have no authority to consolidate claims or to fashion a proceeding as a class or collective action?

The outcome of the case will be closely watched, and it is certainly likely that the issue will make its way to the United States Supreme Court regardless of which way the NLRB rules. Only time will tell whether the Supreme Court's pro-FAA perspective will be as strong as it is now by the time it is considering the issues raised in *AT&T Mobility* in the context of the NLRA.

Going Forward

Until then, businesses interested in continuing or beginning the use of arbitration agreements should work with counsel and take the time to evaluate whether inclusion of a class action waiver is desirable in view of the risks and benefits. Arbitration agreements can no longer be "one size fits all" in nature. It will be critical for companies to balance the benefit of possibly preventing class actions against the risk of a potential charge of unfair labor practice. In addition, companies will need to keep in mind the likelihood of having to revise their agreements, or implement substantially different ones, as the law in this area continues to evolve.

In the course of deliberating these issues, a company may consider including certain provisions in its arbitration agreement for the purpose of increasing the chance of enforceability. Including in the arbitration agreement a statement of basis for coverage under the FAA will help keep the *AT&T Mobility* analysis in the discussion. If a class action waiver is desired, a company may also consider including an opt-out clause from the class action waiver. Another option is to include a provision that provides for an appeal of the arbitrator's decision to a second arbitrator. As *AT&T Mobility* teaches, making arbitration of individual claims favorable to individuals, within reason, should help in defending the enforceability of the class action waiver. Of course, a company that chooses to include a class action waiver must take care when considering an adverse employment action against an employee who has refused to sign an arbitration agreement with a class action waiver, or somehow challenges the validity of that waiver.

The *AT&T Mobility* decision is a promising development for employers and businesses that want to limit or avoid the exposure of class actions. But challenges will continue and the shadow of the NLRA remains.

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[1] 131 S. Ct. 1740, 2011 BL 110648 (2011).

[2] Federal Arbitration Act, 9 U.S.C. §§ 1-16 (2006).

[3] 9 U.S.C. § 2.

[4] *Moses H. Cone Mem'l Hosp. v. Mercury Constr. Corp.*, 460 U.S. 1, 24-25, (1983).

[5] *Perry v. Thomas*, 482 U.S. 483-84 (1987).

[6] In *Discover Bank v. Superior Court*, 36 Cal. 4th 148 (2005), the California Supreme Court struck down as unconscionable a class action waiver in a consumer contract. The critical issue addressed in the case was the idea that, without the availability of class actions, plaintiffs and their attorneys would be unlikely to pursue individual actions where claims involved small potential individual recoveries. In its ruling, the California Supreme Court held that when the class action waiver is found in a consumer contract of adhesion in a setting in which disputes between the contracting parties predictably involve small amounts of damages, and when it is alleged that the party with superior bargaining power has carried out a scheme to deliberately cheat large numbers of consumers out of individual sums of money, then . . . [class action waiver] becomes in practice the exemption of the [company] 'from responsibility for [its] own fraud, or willful injury to the person or property of another.' Under these circumstances, such waivers are unconscionable under California law and should not be enforced." 36 Cal. 4th at 162-63 (internal citations omitted).

[7] 131 S. Ct. at 1753.

[8] *Id.*

[9] Representative Henry Johnson (D-Georgia) sponsored H.R. 1873, while Senator Al Franken (D-Minnesota) sponsored S. 987. Each bill was titled "Arbitration Fairness Act of 2011."

[10] No. C09-03156 SI, H.R. 1873, Official Summary.

[11] 2011 BL 175367 (N.D. Cal. July 5, 2011).

[12] *See Kristian v. Comcast Corp.*, 446 F.3d 25 (1st Cir. 2006); *Gentry v. Superior Court*, 165 P.3d 556, 2007 BL 91713 (Cal.2007). *Cf. Johnson v. West Suburban Bank*, 225 F.3d 366, 378 (3d Cir. 2000) (viewing class action waiver as affecting procedural rights).

[13] *See generally* Diana M. Link & Richard A. Bales, W*aiving Rights Goodbye: Class Action Waivers in Arbitration Agreements After* Stolt-Nielsen v. AnimalFeeds International, 11 Pepperdine Disp. Resol. L.J. 296-300 (2011).

[14] *D.R. Horton, Inc. v. Cuda*, N.L.R.B. No. 12-CA-25764 (2011).

[15] 29 U.S.C. § 157 (2011).

[16] Section 8(a)(1) of the NLRA makes it an unfair labor practice for an employer to interfere with, restrain, or coerce employees in their exercise of their rights under section 7 of the Act. 29 U.S.C. § 158(a)(1) (2011).