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U.S. SUPREME COURT MAKES IN OFFICIAL—THUMBS
UP ON MANDATORY ARBITRATION/THUMBS DOWN
ON CLASS ARBITRATION (*AT&T MOBILE, LLC v.*
CONCEPCION)

by

J.L. Yranski Nasuti, J.D., LL.M.*

In 1925, Congress passed the Federal Arbitration Act (FAA)¹ in order to overcome judicial hostility to arbitration proceedings. Today the U.S. Supreme Court no longer bears animosity to this particular form of alternative dispute resolution. On the contrary, the majority of the current Court “rigorously enforces” mandatory arbitration agreements whether they have been negotiated at arms length between merchants or have been presented to employees and consumers in standard form contracts. In the recent case of *AT&T Mobile, LLC v. Concepcion (AT&T Mobile)*,² the Court once again upheld a mandatory arbitration clause—but a mandatory arbitration that also contained an anti-class action provision—on the grounds that the savings clause of the FAA preempts the application of a state law regarding unconscionable contracts.

I. BACKGROUND

In February 2002, Vincent and Liza Concepcion did what many people do everyday—they entered into a wireless service agreement. The provider of services in their case was Cingular Wireless (which was subsequently acquired by AT&T in 2005 and renamed AT&T Mobility LCC in 2007). The agreement,

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which was executed at the provider’s retail store in Carlsbad, California, was a common “bundled” transaction in which each of the Concepcions received a “free” cell phone in exchange for agreeing to a two year service contract. The provider subsequently charged the Concepcions \$30.22—for sales tax based on the full retail value of the “free” phones.³

The original agreement between the Concepcions and Cingular was a standard form contract that included a single page statement of “Terms and Conditions.” Among the terms was a mandatory arbitration clause that also prohibited class actions. The arbitration clause was located near the bottom of the page in a paragraph that also stated the provider’s limited liability under the plan. The word “ARBITRATION,” which was capitalized and in bold, was followed by a sentence instructing the consumer to “read this paragraph carefully.”⁴ The paragraph went on to state that the parties would “negotiate in good faith to settle any dispute or claim arising from or relating to this Agreement” . . . and if the parties “do not reach an agreement within 30 days, instead of suing in court,” the parties “agree to arbitrate any and all disputes and claims arising out of this Agreement.”⁵ A subsequent provision stated that the parties “agree that no Arbitrator has the authority to (1) award relief in excess of what this agreement provides; (2) award punitive damages or any other damages not measured by the prevailing party’s actual damages; or (3) order consolidation or class arbitration.”⁶ The only exception to the mandatory arbitration rule was if either party elected to file a complaint in small claims court.⁷

The Concepcions renewed their wireless agreements with Cingular (and its successor, AT&T) on a number of occasions. With each of the subsequent contracts, the Concepcions were given a current statement of the “Terms of Service.” All of those statements included a “change-in-terms” clause that

allowed the provider to unilaterally amend the terms and conditions of the agreement at any time so long as the provider notified the customers of the changes either in their monthly bills or separately.⁸ In December 2006, two months after the Concepcions had renewed their wireless contract, AT&T notified its customers that it had exercised its right under the “change-in-terms” clause to revise the agreement’s arbitration policy. The amended arbitration provisions were much more explicit and, AT&T would subsequently argue, much more favorable to the consumer.

The revised agreement still required disputes to be resolved in either small claims court or through individual (but not class-wide) arbitration hearings. In addition it introduced six significant changes. The first was the establishment of a new premium payment term requiring the provider to pay the customer \$7,500 in the event that the arbitrator’s actual award was less than \$7,500 but greater than the provider’s last written settlement offer prior to selection of the arbitrator.⁹ The second was AT&T’s promise to pay double the amount of customer’s attorney fees and reimburse any of the attorney’s reasonable expenses accrued while investigating, preparing, and pursuing the client’s claim in arbitration—but only if the arbitrator awarded the customer more than the provider’s last written settlement offer.¹⁰ The third prohibited the provider from seeking attorneys’ fees and expenses—even if it prevailed in arbitration and even if it had the right to do so under the law.¹¹ The fourth allowed punitive damages to be awarded to the extent allowed in court.¹² The fifth provided that the customer had the exclusive option of deciding whether the arbitration would be conducted in person, by telephone, or based solely on submission of documents—so long as the claim was for \$10,000 or less.¹³ Finally, it specified that arbitration would take place in the county of the customer’s billing address.¹⁴

II. PREVIOUS LITIGATION IN CALIFORNIA

The Concepcions were not the only dissatisfied California consumers to have entered into similar wireless service agreements with their cell phone providers. In late 2004 and early 2005, Elizabeth Voorhies accepted a bundled transaction with Cingular (through its agent Go Wireless) and Jennifer Laster accepted one with T-Mobile. Each was given a “free phone” and then charged for the sales tax on its full retail value. In May 2005, Voorhies, Laster, and an additional plaintiff, Andrew Thompson, filed complaints against their providers in the California Superior Court.¹⁵ While Thompson’s case was dismissed without prejudice, the other two were removed to the U.S. District Court for the Southern District of California under the Federal Class Action Fairness Act of 2005 (CAFA).¹⁶ In August 2005, Voorhies and Laster filed an amended complaint on behalf of themselves and all other consumers who had entered into similar bundled transactions, received free phones, and been charged for the sales tax.¹⁷ The complaint alleged that the providers had engaged in violations of California’s False Advertising Law (FAL),¹⁸ the Unfair Competition Law (UCL),¹⁹ and the Consumer Legal Remedies Act (CLRA).²⁰ The providers responded by filing motions to compel arbitration and to dismiss the amended complaint pursuant to §12(b)(6) of the Federal Rules of Civil Procedure. The Court denied the motion to compel arbitration on the grounds that the arbitration agreements were both procedurally and substantively unconscionable under California contract law. The motion to dismiss the amended complaint was granted without prejudice since the plaintiffs, in their UCL and FAL claims, had failed to allege reliance on the providers’ misrepresentations when making their decisions to accept the cell phones. The CLRA claim, on the other hand, was dismissed with prejudice for

failure to comply with statutory notice requirements set forth in California Code § 1782.²¹

In December 2005, AT&T and T-Mobile (who were later joined by the other defendants) appealed the Court's denial of their motion to compel arbitration and moved to stay the proceedings pending the outcome of the appeal. The plaintiffs then filed a second amended complaint—to which the defendants responded by filing an instant motion to dismiss. The Court denied the defendants' motions to compel arbitration and to dismiss the second complaint but granted their motion to stay the proceedings pending the appeal.²²

The Concepcions filed their own lawsuit against AT&T in the U.S. District Court for the Southern District of California in March 2006. Their complaint alleged that AT&T's practice of charging sales taxes for phones that were advertised as "free" constituted fraud. The following September, the U.S. District Court consolidated the Concepcions' case with the *Laster* putative class action lawsuit.²³

In August 2007, before the U.S. Court of Appeals for the Ninth Circuit had ruled on the lower court's denial of the defendants' motion to compel arbitration in the *Laster* case, it released its decision in the case of *Shroyer v. New Cingular Wireless*.²⁴ The issue in *Shroyer* was whether the binding arbitration clause and class arbitration waiver in Cingular's standard service contract were enforceable. The three judge panel concluded that, under California law, the provisions were both unconscionable and unenforceable. The appellate court also ruled that the FAA did not preempt the state law relating to unconscionable contracts.²⁵ Since the class arbitration waiver at issue in the *Shroyer* case was substantially identical to the one at issue in *Laster*, the Court of Appeals asked the parties in *Laster* to submit letter briefs discussing the effect of

the *Shroyer* decision on their pending appeal.²⁶ At that point, all of the defendants except T-Mobile agreed to voluntarily dismiss their appeals. After the Circuit Court affirmed the lower court's decision to deny T-Mobile's motion to dismiss, T-Mobile filed an unsuccessful writ of certiorari with the U.S. Supreme Court. In the meantime, the District Court lifted the stay that had been placed on the *Laster* case while the appeal had been pending.²⁷

III. IMPACT OF *SHROYER* ON *AT&T MOBILE*

In March 2008, AT&T filed a motion to compel the Concepcions to submit their dispute to the mandatory individual arbitration procedure that was outlined in AT&T's revised wireless agreement of December 2006.²⁸ According to AT&T, the class arbitration waiver in the amended agreement was not only "substantially distinct" from the waiver considered in the *Shroyer* case but it also provided a sufficient substitute for any class action relief that its customers had waived. The Concepcions responded with two arguments. The first was that the terms of the 2006 revised arbitration provision were inapplicable since the amendments had only been added after the Concepcions had filed their lawsuit. The second was that even if the revised terms relating to arbitration and class actions were applicable they were still unconscionable and, therefore, unenforceable under California law. While the District Court ruled that federal and California law both allowed AT&T to base its claim on the revised terms,²⁹ it denied AT&T's motion to compel arbitration on the grounds that California contract law did not allow an unconscionable contract provision to be enforced.³⁰ It concluded instead that although the AT&T consumer agreement was only marginally a contract of adhesion³¹ and even though the premium damage clause provided an incentive for consumers to pursue small claims in arbitration,³² the arbitration provision did not

sufficiently deter AT&T from retaining the benefits of its wrongful conduct and continuing that conduct with impunity.³³

AT&T presented three main arguments when it filed its appeal with the U.S. Court of Appeals. The first was that the decision in *Shroyer* was inapplicable since AT&T's amended premium payment provision did not have the practical effect of rendering AT&T immune from individual claims. The second was that the amended arbitration clause was neither unconscionable nor unenforceable. The third was that the FAA preempted California's unconscionability law.³⁴ A three judge panel unanimously rejected each claim and affirmed the lower court's decision.

The Ninth Circuit's de nova review of the motion to compel arbitration began by reaffirming the holding of the California Supreme Court in *Discover Bank v. Superior Court*.³⁵ In that case, the state court had ruled that a class action waiver in a mandatory arbitration provision was unconscionable if it was part of a consumer adhesion contract "in which disputes between the contracting parties predictably involve small amounts of damages, and when it is alleged that the party with the superior bargaining power has carried out a scheme to deliberately cheat large numbers of consumers out of individually small sums of money."³⁶ The Court of Appeals held that, under state law, AT&T's premium payment provision did not negate the unconscionability of the class action waiver. Although it was true that the provision would penalize AT&T if it low-balled an offer, it still did nothing to provide incentives to individual customers to pursue small claims.³⁷ The Court concluded that the FAA did not preempt California's unconscionability law since the state law did not stand "as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress."³⁸ California law did not undermine the FAA's purpose of placing

arbitration agreements on the same footing as any other contract since class arbitration waivers in adhesion contracts and class action waivers in other contracts would both be voided if found to be unconscionable.³⁹ As to the second purpose of the FAA, the promotion of efficient and expeditious resolution of claims, the Court reaffirmed its previous holding in *Shroyer* in which it concluded that when large numbers of consumers sought compensation based on similar claims, a class arbitration proceeding was actually simpler, cheaper, and faster for the consumers as well as the defendant company.⁴⁰

IV. *AT&T MOBILE* AND THE U.S. SUPREME COURT

Business and consumer groups both knew that a great deal was at stake when the U.S. Supreme Court granted the writ of certiorari to hear the case (now under the heading of *AT&T Mobility LLC v. Concepcion et ux.*) Yet even after oral arguments had concluded, it was still unclear where the nine justices stood on the three most compelling issues—whether there was any reason in this particular case for not continuing the general policy of favoring arbitration agreements, whether there was a specific justification for allowing class action waivers in consumer arbitration agreements, and whether the FAA preempted the California law on unconscionability. It was not until April 27, 2011, when Justice Antonin Scalia began to deliver the decision of the Court that it became evident that consumers who entered into standard form contracts containing mandatory arbitration agreements and class action waivers had lost in a very big way.

The U.S. Supreme Court, in a 5-4, decision reversed the Ninth Circuit's judgment and remanded the case. Justice Scalia's opinion was joined by Chief Justice Roberts and Justices Anthony Kennedy, and Samuel Alito. Justice Clarence Thomas delivered a concurring opinion and Justice Stephen

Breyer issued a dissenting opinion that was joined by Justices Ruth Bader Ginsburg, Sonya Sotomayor, and Elena Kagan. The focus of all three opinions was the interpretation of §2 of the FAA—which the Court, in an earlier decision, had characterized as “the primary substantive provision of the Act.”⁴¹ Section 2 states that: “A written provision in any maritime transaction or a contract evidencing a transaction involving commerce to settle by arbitration a controversy thereafter arising out of such contract or transaction . . . shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract.”⁴² It was the interpretation of the second part of this section—the savings clause—on which the justices disagree.

A. Majority Opinion

According to Scalia, the primary issue before the Court was “whether the FAA prohibits States from conditioning the enforceability of certain arbitration agreements on the availability of classwide arbitration procedures.”⁴³ To resolve that issue it was necessary to determine whether California’s rule regarding unconscionability (as articulated in the *Discover Bank* case) was covered by the FAA’s savings clause. Scalia began his analysis of that issue only after reaffirming the Court’s previous holdings that Section 2 of the FAA reflects a “liberal federal policy favoring arbitration”⁴⁴ and the “fundamental principle that arbitration is a matter of contract.”⁴⁵ As a consequence, arbitration agreements were on equal footing with any other contracts and should be enforced according to their terms—unless, under the terms of the savings clause, they were found to be unenforceable “upon such grounds that exist at law or in equity for the revocation of any contract.” It was at this point, that Scalia delivered a decision that greatly limited the scope of the savings clause especially with regard to consumer arbitration agreements.

Scalia acknowledged that the FAA’s savings clause allowed an arbitration agreement to be invalidated by “generally applicable contract defenses, such as fraud, duress, or unconscionability” but not by defenses that apply only to arbitration or derive their meaning from the fact that an agreement to arbitrate is at issue.”⁴⁶ He then addressed the validity of the *Discover Bank* holding that classified collective arbitration waivers as unconscionable only when they were included in consumer contracts. Under California statutory law, a court may either refuse to enforce any contract that was “unconscionable at the time it was made” or “limit the application of any unconscionable clause.”⁴⁷ In the *Discover Bank* case, the California Supreme Court found that a class action waiver in a consumer adhesion contract typically applied to disputes that involved small sums of money and a party with superior bargaining power who included the waiver in the contract in order to cheat large numbers of consumers out of individually small sums of money. The waiver was unconscionable because it exempted the non-consumer party to the contract from its own fraud or willful injury to the consumer party.

Scalia presented two alternative possibilities for deciding the outcome of the case. If California’s unconscionability doctrine and policy against exculpation were grounds “that exist at law or equity for the revocation of a contract,” then they were applicable under the FAA’s savings clause. On the other hand, if it turned out that these generally applicable doctrines had been used to disfavor arbitration, they were preempted by the FAA.⁴⁸ Scalia chose the second theory to rule against consumers and in favor of business. He hypothesized that a state could not target consumer arbitration agreements as unconscionable or unenforceable simply because they deprived the consumer of judicially monitored discovery or did not abide by the Federal Rules of Evidence or did not

allow for a trial by jury. Such actions would clearly be seen as obstacles to the accomplishment of the stated purposes of the FAA. Similarly, if the “overarching purpose” of the FAA was “to ensure the enforcement of arbitration agreements according to their terms so as to facilitate streamlined proceedings,”⁴⁹ then “requiring the availability of classwide arbitration interfere[d] with fundamental attributes of arbitration and thus create[d] a scheme inconsistent with the FAA.”⁵⁰

Scalia referred to §§2, 3, and 4 of the FAA to support his position that the principal purpose of the FAA was to ensure that private arbitration agreements were enforced according to their terms. Section 2 stated that, subject to the savings clause, arbitration agreements were “valid, irrevocable, and enforceable.” Section 3 required litigation of arbitral claims to be stayed pending arbitration of those claims “in accordance with the terms of the agreement.” Finally, §4 instructed courts to compel arbitration “in accordance with the terms of the agreement” so long as the “making of the arbitration agreement or the failure . . . to perform the same” was not at issue. Scalia reasoned that parties to an arbitration agreement may specify the issues to be arbitrated,⁵¹ select the rules of arbitration,⁵² and limit with whom a party may arbitrate its dispute.⁵³ This ability to design particular arbitration processes according to the needs of different kinds of disputes reduced the cost at the same time that it increased the speed of dispute resolution.

In his dissenting opinion, Breyer quoted the case of *Dean Witter Reynolds Inc. v. Byrd*⁵⁴ in which the Supreme Court “reject[ed] the suggestion that the overriding goal of the Arbitration Act was to promote the expeditious resolution of claims.” Scalia claimed that the dissent’s use of that particular quote was misleading. Although it was true that the Court in *Dean Witter* stated that the purpose of the FAA was to “ensure judicial enforcement of privately made agreements to

arbitrate,”⁵⁵ it also pointed out that “this is not to say that Congress was blind to the potential benefit of the legislation for expedited resolution of disputes.”⁵⁶

In the present case, Scalia found no conflict between the two goals of the FAA—the enforcement of private agreements and the encouragement of efficient and speedy dispute resolution—in enforcing the terms of the AT&T arbitration clause. He did, however, see a conflict between the FAA’s promotion of arbitration and California’s *Discover Bank* rule. The *Discover Bank* rule interfered with arbitration the same way a state law rule that required the parties to exhaust administrative remedies before proceeding to arbitration frustrated the objective of the FAA.⁵⁷ Although the California rule did not require class-wide arbitration in all consumer contract cases, it did have the same practical result. The application of the rule was limited to adhesion contracts where the damages were predictably small and the consumer alleged a scheme to cheat consumers. Scalia, however, noted that most consumer contracts were adhesion contracts, that the idea of a small claim was very relative, and that all the consumer had to do was allege a scheme to cheat. As a result, most consumers would have the option to resolve their disputes through bilateral arbitration or through class arbitration. Given that option, Scalia speculated that a consumer would have difficulty finding a lawyer who would be willing to handle an individual arbitration claim when the possibility of a class action existed. Businesses, on the other hand, would have less incentive to use arbitration for individual claims when faced with exposure to the inevitable class arbitration.

In order to illustrate the problems arising from class arbitration, Scalia referred to the recent case of *Stolt-Nielsen v. AnimalFeeds Int’l. Corp.*⁵⁸ in which the Supreme Court held that an arbitration panel had exceeded its authority under the

FAA when it imposed class procedures that arose from policy judgments and not from the terms of the arbitration agreement or the interpretative principals of contract law. The basis for the decision was the Court's conclusion that the "changes brought about by the shift from bilateral arbitration to class-action arbitration" were "fundamental."⁵⁹ In class actions parties may be absent, additional and different procedures may be needed, there is the potential for a loss of confidentiality, and, it is likely that there will not be many arbitrators knowledgeable in the procedural aspects of class certification.

Scalia then focused on the three problematic differences between bilateral arbitration and class action arbitration. The first was the loss of the primary advantage of arbitration—its informality. In bilateral arbitration, the parties "forgo procedural rigor and appellate review" in exchange for "lower costs, greater efficiency and speed, and the ability to choose expert adjudicators to resolve specialized disputes."⁶⁰ In class action arbitration, the arbitrators must certify the class and determine how discovery for the class will be conducted before they can even begin to consider the merits of the claims. Scalia cited a study by the American Arbitration Association (AAA) reporting that, on the average, it took six months to resolve an individual consumer arbitration claim on the merits (four months if the arbitration was conducted by documents only.)⁶¹ Of the 283 class arbitration cases opened as of September 2009, 121 remained active, 162 had been settled, withdrawn, or dismissed, and not a single one had resulted in a final award on the merits. The median time from filing to settlement, withdrawal or dismissal of class arbitration cases that were no longer active was 583 days.⁶²

The second difference between bilateral and class action arbitration cases was that class arbitration required procedural formality similar to that found in the Federal Rules of Civil

Procedure in order to protect the interests of all members of the class.⁶³ Scalia noted that many procedural problems facing arbitrators in class action cases had certainly not been anticipated by the drafters of the FAA since class actions had not even been available at the time the statute was enacted.

The final difference, which seemed to be particularly important to Scalia, was the fact that class arbitration greatly increased the risks to defendants. The defendants were aware that it was inevitable that errors might occur in informal arbitration procedures which could not be corrected through an appeal process. But, it was an infrequent cost that they were willing to pay in exchange for not having to incur the expenses of going to court. That cost-benefit analysis changed, however, when the inevitable error no longer involved a relatively small individual claim but claims of a sizeable class of plaintiffs. In those instances, even the chance of an error might pressure a defendant into settling claims which, on the merits, might have been questionable. An important issue in a class action case involves the certification of the class. Under the FAA, the only time that a court may vacate an arbitral award was if it "was procured by corruption, fraud, or undue means"; "the arbitrators were guilty of misconduct in refusing to postpone the hearing . . . or in refusing to hear evidence pertinent and material to the controversy[,] or of any other misbehavior by which the rights of any party have been prejudiced"; or if the "arbitrators exceeded their powers, or so imperfectly executed them that a mutual, final, and definite award . . . was not made."⁶⁴ While certification decisions were reviewable, under the FAA review was limited to the misconduct of the arbitrators and not on an error in applying the law. Under the circumstances, Scalia doubted whether a defendant would agree to class arbitration with no means of review or whether Congress would want state courts to place the defendant in such a position.

Scalia acknowledged that many of the small dollar claims that individual consumers had against AT&T would never be pursued without the benefit of a class action option. That result by itself, however, did not justify allowing a state to require a “procedure that is inconsistent with the FAA, even if it is desirable for unrelated reasons.”⁶⁵ The only thing that mattered was the fact that California’s rule on unconscionability “stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress.”⁶⁶

B. Concurring Opinion

Justice Thomas’ concurring opinion focused on the issue of whether the *Discover Bank* rule was, under the savings clause of the FAA, a “groun[d] . . . for the revocation of any contract.” Thomas’ textual reading of §2 limited a court’s ability to revoke an arbitration agreement only on the basis of an illegally (such as fraud or duress) in the formation of the agreement.⁶⁷ The fact that a particular state law defense applied “to any contract” was not by itself sufficient to revoke the arbitration agreement if that defense represented nothing more than a state’s public policy against arbitration. It was significant to Thomas that while §2 states that arbitration provisions in contracts are “valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract,” it “does not parallel the words “valid, irrevocable, and enforceable” by referencing the grounds as exist for the “invalidation, revocation, or nonenforcement” of any contract.”⁶⁸ The omission allowed him to conclude that the exception in the savings clause did not apply to any contract defense but only to a subset of those defenses. Although Thomas acknowledged that courts have referred to the concepts of revocability, validity, and enforceability interchangeably, he found it significant that

Congress only chose to include the concept of revocability in the savings clause.

To understand the meaning of the savings clause, Thomas turned to §4 of the FAA (which specified that if a court was satisfied that the making of the agreement for arbitration or the failure to comply was not an issue, it must order arbitration according to the terms of the agreement.) He concluded that if §2 was read harmoniously with §4 then the only grounds for revoking an arbitration agreement under §2 would be those relating to the making of the agreement—and not other defenses—such as public policy—that were unrelated to the making of the agreement.⁶⁹

Under the *Discover Bank* rule, the class action waiver in a consumer contract of adhesion was unconscionable because it was unlawfully exculpatory—and contrary to public policy. But, the *Discover Bank* rule did not concern itself with the making of the arbitration agreement. There was no claim of fraud, duress, or delusion on the part of the consumer.⁷⁰ It was the terms, conditions, and practices contained in the arbitration agreement that the California court held to undermine public policy. And, that public policy reason was an unacceptable ground for refusing to enforce an arbitration agreement since it had nothing to do with whether the contract was properly made.

C. Dissenting Opinion

Justice Breyer’s dissenting opinion reveals a frustration with the majority’s interpretation of the savings clause of the FAA. According to the minority opinion, “grounds as exist at law or in equity for the revocation of any contract” would surely include the *Discover Bank* rule. In the *Discover Bank* case, the California court, interpreting §§ 1668 and 1670.5(a) of the

California Civil Code, concluded that a class action waiver in a consumer contract was exculpatory and unconscionable when: 1. the consumer contract was an adhesion contract, 2. the disputes between the parties were predictably for small amounts of damages, and 3. it was alleged that the party with the superior bargaining power had carried out a scheme of deliberately cheating large numbers of consumers out of individually small sums of money.

The *Discover Bank* rule did not invalidate all class action waivers in consumer contracts—only those which offended the more general principle of unconscionability. That principle did not target arbitration agreements since it applied equally to class action litigation waivers as well as class action arbitration waivers. It was, under the terms of the savings clause, a valid ground on which to refuse to enforce an arbitration agreement that exists “for the revocation of *any* contract.” (Emphasis added.)⁷¹

Breyer found no inconsistency between the *Discover Bank* rule and the basic purpose behind the FAA. Although the House Report in support of the original bill emphasized the costliness and delays of litigation, the expeditious resolution of claims through arbitration was not Congress’ overriding goal in enacting the FAA. The purpose of the FAA was to ensure the judicial enforcement of arbitration agreements in commercial contracts and admiralty contracts by placing them “upon the same footing as other contracts.”⁷²

The minority opinion was critical of the majority’s claim that the *Discover Bank* rule was an obstacle to the objective of the FAA since it would increase the complexity of arbitration procedures and discourage parties from entering into arbitration agreements.⁷³ While the California rule might, in some instances, invalidate an unconscionable anti-class

arbitration contract term, it did not follow that that would increase the complexity of the arbitration procedures. Breyer also rejected the suggestion that applying the *Discover Bank* rule was just as unacceptable as requiring arbitration agreements to provide for the ultimate disposition by a jury, a judicially monitored discovery, and the use of the Federal Rules of Evidence.⁷⁴ Class action arbitration was consistent with arbitration and was well known in California and elsewhere. Even the American Arbitration Association had characterized class arbitration as “a fair, balanced, and efficient means of resolving class disputes.”⁷⁵

Breyer challenged the majority’s assumption that individual, rather than class, arbitration, was a fundamental attribution of arbitration. He found no basis for such a claim in the legislative history. While it was true that at the time the FAA was enacted, arbitration procedures had not yet been fully developed,⁷⁶ there was evidence to suggest that as Congress was considering the legislation it thought of arbitration primarily in the context of merchants who “sought to resolve disputes of fact, not law, under customs of their industries, where the parties possessed roughly equivalent bargaining power.”⁷⁷ This would suggest that a compelling Congressional concern had been that the bargaining power be roughly equivalent in the arbitration process. If that were the case, consumer class arbitration, which helps to level the playing field with merchants, would be consistent with that objective.⁷⁸

The minority opinion also rejected the claim that the incentives to include a mandatory arbitration clauses in contracts would disappear if potential defendants knew that the result might be complex class arbitration. On the issue of incentives, Breyer argued that the relevant comparison was not between bilateral arbitration and class action arbitration but

between class arbitration and judicial class actions.⁷⁹ In such a comparison, parties would not necessarily be discouraged from including mandatory arbitration clauses in contracts. One incentive for agreeing to arbitration is that it saves time. While class arbitration may be more time consuming than bilateral arbitration, it is still less time consuming than the average class action litigation. Similarly, if speed in resolving a dispute is an objective of the FAA, AAA statistics have suggested that “a single class proceeding is surely more efficient than thousands of separate proceedings for identical claims.”⁸⁰ The dissent found no empirical support for the majority’s claim that there is a disincentive for parties to submit high stack claims to arbitration.⁸¹ It also pointed out that even though contract defenses might “slow down the dispute resolution process,” that was something that federal arbitration law treated as a state law matter—unless the defense was being used to disfavor arbitration.⁸²

Scalia had highlighted the practical disadvantages of class arbitration—it greatly increased the risks to the defendants and might pressure defendants into settling questionable claims rather than face the chance of a devastating loss. Breyer, on the other hand, emphasized the countervailing advantages of class arbitration. The first was that without the possibility of a consolidated arbitration, many small dollar claimants would simply abandon their claims. The second was that tenacious parties, such as the *Concepcions*, would have difficulty finding attorneys to represent them in proceedings involving small claims and even smaller fees. As Breyer noted, “The *realistic* alternative to a class action is not 17 million individual suits, but zero individual suits, as only a lunatic or fanatic sues for \$30.”⁸³

In his review of U.S. Supreme Court cases, Breyer found no “meaningful” support for many of the majority’s legal

conclusions. Instead he found precedents that authorized complex arbitration procedures,⁸⁴ upheld nondiscriminatory state laws that slowed down the proceedings,⁸⁵ and refused to strike down a state statute that treated arbitration on par with judicial and administrative proceedings.⁸⁶ Other cases reaffirmed that the basic objective of the FAA was to treat arbitration agreements “like all other contracts”⁸⁷ and not to immunize them from judicial challenges in a way that elevated the arbitration agreement above other forms of contracts.⁸⁸

The dissenting opinion concluded with a brief discussion of a basic premise of federalism—“that Congress does not cavalierly pre-empt state-law causes of action.”⁸⁹ Breyer noted that the savings clause of the FAA clearly recognized that the states had a role of determining if there were grounds at law or in equity for revoking a particular arbitration contract. Consequently, the Court failed to honor federalist principles when it ignored the specific language of the savings clause and struck down the California law.

IV. CONCLUSION

The *AT&T Mobility v. Concepcion* case may very well become a milestone case not because of the legal reasoning that the Supreme Court used to interpret the savings clause or because of its predictable reaffirmation of the arbitration process. On the contrary, it may be remembered as the case that not only changed the future of consumer class action arbitration but also the future of consumer class action litigation in the United States.

Soon after the Supreme Court heard oral arguments in the *AT&T Mobility* case, the *Wall Street Journal* and the *New York Times* presented the public with two views of what was at stake. The editors of *The Wall Street Journal*, referring to the

case as “the \$30 bonanza,” conjured up a fantasy dream for business . . . “[i]magine if class action lawsuits become a historical curiosity like spiked hair and platform shoes. While we would never underestimate the resilience of trial lawyers, a case heard by the Supreme Court . . . could put a damper on the class action bonanza.”⁹⁰ The *New York Times*, on the other hand, referred to the *AT&T Mobility* case as the “latest in the arbitration war—a battle over whether the United States will increasingly have a privatized system of justice that bars people from enforcing rights in court and, if so, what will be considered fair in that system. It would be grossly unfair for the court to let the corporation get away with what it wants to in *AT&T Mobility v. Concepcion*—a case that involves a small amount of money and a huge principle.”⁹¹ In the end the \$30 bonanza was not a windfall for trial lawyers and consumers—but a gigantic bonanza for business. In this case the winners did take all.

The majority opinion focused on what would happen if the class action arbitration clause was invalidated. Businesses would have less incentive to include arbitration clauses in adhesion contracts. A few losses to individual claimants were one thing—but a single loss to a larger class of consumers was perhaps too risky. Under those circumstances, businesses might find the litigation process preferable to the arbitration process (with its limited discovery possibilities, flexible rules of evidence, and limited possibility of review). What the Court chose not to consider was what business would do if the provision prohibiting class actions was upheld. One consequence of the Supreme Court’s decision in *Circuit City Stores, Inc. v. Adams*⁹² was the increased use of mandatory arbitration clauses in employment contracts. After the *AT&T Mobility* decision, it would not be far-fetched to anticipate two strategic moves by business. The first would be to amend employment application forms and contracts to include class

action waivers as well as mandatory arbitration clauses. The second would be to redraft all types of consumer sales contracts to include mandatory arbitration clauses with class action waivers. The end result might not only be the demise of class action arbitration but also individual and class action litigation for cases involving claims by consumers and employees.

Although things do appear bleak for employees and consumers seeking to invalidate mandatory arbitration with anti-class action clauses, there is still the possibility of change. Soon after the Supreme Court issued its decision in *AT&T Mobility*, Representative Henry Johnson (D-GA) and Senator Al Franken (D-MN) introduced a bill in Congress that was intended to invalidate a number of the Court’s recent decisions involving arbitration. The Arbitration Fairness Act of 2011⁹³ would prohibit employers and businesses from including pre-dispute mandatory arbitration clauses in employment and consumer contracts where the subsequent conflicts involve statutorily protected civil rights. The likelihood that the current Congress will pass the bill is quite slim. There is also the possibility that the U.S. Supreme Court itself might revisit its current policy in favor of mandatory consumer arbitration clauses when it decides the case of *CompCredit Corp., et al. v. Greenwood, et al.*⁹⁴ Unfortunately discussion by the justices during oral arguments indicated that their decision is going to be a reiteration of majority’s support of pre-dispute arbitration agreements. One final possibility is that the Consumer Financial Protection Bureau (CFPB), under the provisions of the Dodd-Frank Act, might be able to limit the future use of arbitration agreements (at least as they apply to consumer financial products such as credit cards, auto financing, installment loans, and checking and deposit accounts.) Congress authorized the CFPB is authorized to study the use of mandatory arbitration clauses in consumer contracts and, if it

was found to be in the public interest and would protect consumers, issue regulations prohibiting the use of mandatory arbitration agreements.⁹⁵

The Roberts' Court has demonstrated in case after case that it is indeed "the Corporate Court." Its willingness to enforce a mandatory arbitration clause that prohibits class actions by consumers is a lopsided decision in favor of business interests. Consumers and employees have no real bargaining power when they enter into standard form contracts that preclude litigation. They know that they are in a "take it or leave it" position. This is even more so now that the Court has concluded that a claim of substantive unconscionability will not be allowed to frustrate what it understands to be the higher goal of the FAA.

ENDNOTES

¹ 9 U.S.C. 1 *et seq.*.

² 131 S. Ct. 1740; 563 U.S. ____ (2011).

³ *Laster v. T-Mobile USA, Inc.*, 2008 U.S. Dist. LEXIS 103712 (S.D. Cal., Aug. 11, 2009), 5.

⁴ *Id.* at 5.

⁵ *Id.* at 5-6, citing *Berinhout Decl.*, Exh. 11.

⁶ *Id.* at 6.

⁷ *Id.* at 6-7, citing *Berinhout Decl.*, Exh. 16.

⁸ *Id.* at 6.

⁹ *Id.* at 7, quoting *Berinhout Decl.*, Exh. 2. It should be noted that under the California Code of Civil Procedure § 116.221, \$7,500 is the maximum claim that can be brought in a small claims court. *Laster and Concepcion v. AT&T Mobility LLC*, 584 F.3d 849, 853 (2008).

¹⁰ *Id.* at 8, quoting *Berinhout Decl.*, Exh. 2.

¹¹ *Id.* at 8, quoting *Berinhout Decl.*, Exh. 2.

¹² *Id.* at 8.

¹³ *Id.* at 8.

¹⁴ *Id.* at 8.

¹⁵ *Id.* at 11.

¹⁶ 28 U.S.C. §§ 1711, *et seq.*.

¹⁷ *Supra* note 3, at 12.

¹⁸ Cal. Bus. & Prof. Code § 17500, *et seq.*

¹⁹ Cal. Bus. & Prof. Code § 17200, *et seq.*

²⁰ Cal. Civ. Code § 1770, *et seq.*

²¹ *Supra* note 3, at 12-13.

²² *Id.* at 13.

²³ *Id.* at 13.

²⁴ 498 F.3d 976 (9th Cir., 2007).

²⁵ *Id.* at 978.

²⁶ *Supra* note 3, at 14.

²⁷ *Id.* at 14.

²⁸ *Id.* at 15.

²⁹ *Id.* at 17-18.

³⁰ *Id.* at 43. The District Court relied on the three prong test articulated in the case of *Discover Bank v. Superior Court*, 36 Cal. 4th 148; 113 P. 3d 1100 (June 27, 2005) to conclude that the class waiver in the consumer contract was in fact unconscionable and, therefore, unenforceable under California law.

³¹ *Id.* at 29.

³² *Id.* at 37.

³³ *Id.* at 42.

³⁴ *Supra* note 9, *Laster* at 852.

³⁵ *Supra* note 30. *Discover Bank* involved a claim by a California credit cardholder that Discover Bank had misrepresented the time at which it would begin to charge late fees. The adhesion contract between the bank and its credit card customers included a class action waiver that the California Supreme Court ruled to be unconscionable and unenforceable based on its three prong test.

³⁶ *Supra* note 9, *Laster* at 854, quoting *Discover Bank*, *supra* note 30.

³⁷ *Id.* at 855-856.

³⁸ *Id.* at 857, quoting *Shroyer*, *supra* note 24, at 987.

³⁹ *Id.* at 857-858, citing *Shroyer* at 989-991.

⁴⁰ *Id.* at 858, citing *Shroyer*, at 990.

⁴¹ *Supra* note 2, at 1745, quoting *Moses H. Cone Memorial Hospital v. Mercury Constr. Corp.*, 460 U.S. 1, 24, 103 S. Ct. 927 (1983).

⁴² 9 U.S.C. §2.

⁴³ *Supra* note 2, at 1744.

⁴⁴ *Id.* at 1745, quoting *Moses H. Cone Memorial Hospital*, *supra* note 41, at 24.

⁴⁵ *Id.* at 1745, quoting *Rent-Center, West, Inc. v. Jackson*, 561 U.S. ____, 130 S. Ct. 2772, 2776 (2010).

⁴⁶ *Id.* at 1746.

⁴⁷ Cal. Civ. Code Ann. § 1670.5(a) (West 1985).

⁴⁸ *Supra* note 2, at 1747, citing *Perry v. Thomas*, 482 U.S. 483, 492, 107 S. Ct. 2520 (1987), in which it was noted that the FAA could preempt state grounds traditionally thought to exist "at law or in equity for the revocation of any contract."

⁴⁹ *Supra* note 2, at 1748.

⁵⁰ *Id.* at 1748.

⁵¹ *Id.* at 1748, citing *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*, 473 U.S. 614, 628, 105 S. Ct. 3346 (1985).

⁵² *Id.* at 1749, citing *Volt Information Systems, Inc. v. Board of Trustees of Leland Stanford Junior University*, 489 U.S. 468, 479, 109 S. Ct. 1248 (1989).

⁵³ *Id.* at 1749, citing *Stolt-Nielsen S.A. v. AnimalFeeds Int'l Corp.*, 559 U.S. ____, ____, 130 S. Ct. 1758 (2010).

⁵⁴ 470 U.S. 213, 219 (1985).

⁵⁵ *Id.* at 219.

⁵⁶ *Id.* at 220.

⁵⁷ *Supra* note 2, at 1749, citing *Preston v. Ferrer*, 552 U.S. 346, 357-358 (2008).

⁵⁸ *Supra* note 53.

⁵⁹ *Supra* note 2, at 1750, quoting *Stolt*, *supra* note 53, at 1776.

⁶⁰ *Id.* at 1751, quoting *Stolt*, at 1776.

⁶¹ *Id.* at 1751, citing AAA, Analysis of the AAA's Consumer Arbitration Caseload, online at <http://www.adr.org/si.asp?id=5027>.

⁶² *Id.* at 1751, citing Brief for AAA as *Amicus Curiae* in *Stolt-Nielsen*, O.T. 2009, No. 09-1198, pp. 22-24.

⁶³ *Id.* at 1751.

⁶⁴ 9 U.S.C. §10.

⁶⁵ *Supra* note 2, at 1753.

⁶⁶ *Id.* at 1753, quoting *Hines v. Davidowitz*, 312 U.S. 52, 67, 61 S. Ct. 399 (1941).

⁶⁷ *Id.* at 1753.

⁶⁸ *Id.* at 1755.

⁶⁹ *Id.* at 1754-1755.

⁷⁰ *Id.* at 1756.

⁷¹ *Id.* at 1757.

⁷² *Id.* at 1757.

⁷³ *Id.* at 1758.

⁷⁴ *Id.* at 1758, referring to Scalia's examples, *id.* at 1747.

⁷⁵ *Id.* at 1758, quoting Brief for AAA, *supra* n. 62, at 25.

⁷⁶ *Id.* at 1759.

⁷⁷ *Id.* at 1759.

⁷⁸ *Id.* at 1759.

⁷⁹ *Id.* at 1759.

⁸⁰ *Id.* at 1759, quoting Brief for AAA, *supra* note 62, at 24.

⁸¹ *Id.* at 1760, citing a series of publicized arbitration cases that resulted in settlements of \$500 million, \$1.5 billion, and \$833 million.

⁸² *Id.* at 1760.

⁸³ *Id.* at 1761.

⁸⁴ *Id.* at 1761, citing *Mitsubishi Motors*, *supra* note 51, at 629.

⁸⁵ *Id.* at 1761, citing *Volt*, *supra* note 52, at 477-479.

⁸⁶ *Id.* at 1761, citing *Preston*, *supra* note 57, at 355-356.

⁸⁷ *Id.* at 1761, citing *Buckeye Check Cashing, Inc. v. Cardegna*, 546 U.S. 440, 447 (2006); *Vaden v. Discover Bank*, 556 U.S. 49, 64 (2009); *Doctor's Associate, Inc. v. Casarotto*, 517 U.S. 681, 687 (1996); *Allied-Bruce Terminix Cos. v. Dobson*, 513 U.S. 265, 281 (1995); *Rodriguez de Quijas v. Shearson/American Express, Inc.*, 490 U.S. 477, 483-484; *Perry*, *supra* note 48, at 492-493, note 9; *Mitsubishi Motors*, *supra*, note 84, at 627.

⁸⁸ *Id.* at 1761, citing *Prima Paint Corp. v. Flood & Conklin Mfg. Co.*, 388 U.S. 395, 404, note 12 (1967); *Marchant v. Mead-Morrison Mfg. Co.*, 252 N.Y. 284, 299, 169 N.E. 386, 391 (1929).

⁸⁹ *Id.* at 1762.

⁹⁰ *The \$30 Bonanza*, WALL STREET JOURNAL, November 11, 2010, <http://wsj.com/article/SB10001424052748704635704575604342012494842.html>.

⁹¹ *The Arbitration War*, N.Y. TIMES, November 27, 2010, at A18.

⁹² 532 U.S. 105 (2001).

⁹³ H.R. 1873; S. 987.

⁹⁴ No. 10-948; 615 F. 3d 1204; 2010 U.S. App. LEXIS 17128 (9th Cir., 2010). In this case, the Court must decide if a mandatory arbitration clause in a consumer contract trumps an explicit statutory right to sue that was created under the Credit Card Accountability, Responsibility and Disclosure Act of 2009.

⁹⁵ Kate Davidson, *High Court Gives Banks A Win, But Will It Last?*, 176 AMERICAN BANKER 1 n. 66 (April 28, 2011).

HOW THE LEGAL ENVIRONMENT AFFECTS
EARNINGS MANAGEMENT

by

John Paul *

INTRODUCTION

Earnings management has been on the rise. The recent corporate accounting scandals involving large well-known companies such as Enron, WorldCom, Xerox and Tyco – all audited by large accounting firms – suggest serious deficiencies in the accounting standards and corporate governance and regulatory systems designed to guide and monitor the financial information process.¹ While large firms may have received more media attention, financial statement fraud occurred more frequently in smaller companies (companies with total assets of less than \$100 million) than larger ones.²

Since earnings management has been on the rise, a definition of earnings management is in order. Earnings management is when managers alter their entities' accounting and financial information by using their discretion in financial reporting and transaction structuring.

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