"Justice Denied: Forced Arbitration and the Erosion of Our Legal System"
House Committee on the Judiciary
Subcommittee on Antitrust, Commercial, and Administrative Law
May 16, 2019

Question for the Record for Andrew Pincus
Submitted by Representative Ken Buck

The Supreme Court case *AT&T Mobility v. Concepcion* was raised during the hearing by Representative Raskin. I know that you argued that case on behalf of AT&T. Please provide a full discussion of the case, including its underlying facts, what the Supreme Court decided, and how the ruling relates to the use of arbitration today.

The *Concepcion* case clearly illustrates the benefits to all parties of consumer arbitration agreements, especially when compared with the class-action system.

The *Concepcion* lawsuit and district-court proceedings

The plaintiffs in *Concepcion*, Vincent and Liza Concepcion, were wireless customers of AT&T Mobility LLC who filed a putative class action against the company in the United States District Court for the Southern District of California in 2006. At that time, customers of most wireless carriers, including AT&T, typically purchased cell phones and subscribed to wireless service in a bundled transaction, in which the phone was free or steeply discounted in exchange for a commitment to maintain service for a specified term (often one or two years). But California law required that sales tax be paid on the full retail value of a phone when it is sold as part of a bundled transaction.[1] Despite this legal requirement, when the Concepcions were charged sales tax based on the full retail price of phones that were free or discounted, they sued AT&T, alleging that in addition to violating several common-law doctrines, AT&T had violated California's Unfair Competition Law ("UCL"),[2] False Advertising Law ("FAL"),[3] and Consumer Legal Remedies Act ("CLRA"),[4] and should be required to pay damages and restitution to consumers and attorneys' fees and costs to the Concepcions' lawyers.

The Concepcions' legal claims were of dubious merit.[5] That is not unusual. Large companies frequently are targeted by consumer class actions by the plaintiffs'

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1 Cal. Code Regs. tit. 18, §§ 1585(a)(4), (b)(3).

2 Cal. Bus. & Prof. Code §§ 17200 *et seq*.

3 Cal. Bus. & Prof. Code §§ 17500 *et seq*.

4 Cal. Civ. Code §§ 1750 *et seq*.

5 The California state courts dismissed a copycat class action for failure to state a claim—holding that the claim was legally insufficient. *Yabsley v. Cingular Wireless, LLC*, 98 Cal. Rptr. 3d

bar, on the theory that even claims with a low probability of success can be used to coerce what Judge Friendly famously characterized as a "blackmail settlement" from the company because of the sheer size of the aggregate potential liability.[6]

AT&T responded to the lawsuit by seeking to enforce the arbitration provision in AT&T's contracts with customers, including the Concepcions. That arbitration provision required that arbitration proceed in its traditional form—on a one-to-one, individual basis. And the provision included a number of features designed to make arbitration convenient and attractive for consumers with small claims:

- **Cost-free arbitration:** AT&T committed to pay all of the filing, administrative, and arbitrator costs for any claim that the arbitrator did not find to be frivolous under the same Federal Rule of Civil Procedure 11(b) standard applicable in federal court;

- **Independent arbitration administrator:** Arbitration would be administered by the independent non-profit American Arbitration Association, using rules it had designed to make arbitration easy for consumers, and its roster of retired judges and experienced arbitrators;

- **Convenient hearings:** Arbitration would take place in the county of the customer's billing address, and the customer had the sole right to choose whether the arbitrator would conduct an in-person hearing, a hearing by telephone, or dispense with a hearing and rule on the basis of the documents submitted by the parties;

- **Small claims court option:** Either party could bring a claim in small claims court in lieu of arbitration;

- **Full remedies:** The arbitrator could award the customer any form of individual relief (including statutory attorneys' fees, statutory or punitive damages, and injunctions) that a court could award;

- **Possibility to earn large bonus recovery:** If the arbitrator awarded a customer relief that was greater than AT&T's last written settlement offer before the arbitrator was appointed, the customer's minimum recovery would be either $5,000 or (if greater) the jurisdictional maximum for the customer's local small claims court (which at the time in California was $7,500); and

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657 (Ct. App. 2009) (affirming order granting demurrer), *review granted*, 219 P.3d 151 (Cal. 2009), *review dismissed*, 328 P.3d 67 (2014); *see also Loefler v. Target Corp.*, 324 P.3d 50, 53 (Cal. 2014) (holding that "consumer-protection statutes . . . cannot be employed" to challenge collection of "sales taxes" by retailers).

6 HENRY J. FRIENDLY, FEDERAL JURISDICTION: A GENERAL VIEW 120 (1973).

- **Possibility to earn double attorneys' fees:** If the arbitrator awarded a customer more than AT&T's last written settlement offer, then AT&T also would pay the customer's attorney, if any, twice the amount of attorneys' fees, and reimburse any expenses, that were reasonably accrued for investigating, preparing, and pursuing the claim in arbitration.

Despite these consumer-friendly features, the Concepcions resisted enforcement of their arbitration agreement on the ground that it was unconscionable under California law because it prohibited class procedures in arbitration.

In ruling on AT&T's motion, the district court noted the powerful incentives under the agreement for consumers to arbitrate individual claims: "If [AT&T] denies an informal claim"—that is, a complaint submitted to the legal department prior to the commencement of an arbitration, which can be as simple as a one-page letter—"or offers less than the [California] consumer requests," then "the amount of the consumer's award upon prevailing at arbitration jumps to $7,500 . . ., plus double attorney's fees, if the consumer is represented by counsel."[7] For the Concepcions, who were seeking only $30 in damages—the amount of the sales tax on their phone—AT&T's arbitration provision gave them "the potential to recover two hundred fifty times [their] actual damages[.]"[8]

The district court also noted the corresponding incentives for AT&T to resolve claims. Because the agreement committed AT&T to pay all arbitration costs and obligated it to pay heightened recoveries to customers who recover more in arbitration than AT&T had offered to settle, the agreement "prompts [AT&T] to *accept liability* . . . during the *informal claims process*" that precedes arbitration, "even for claims of questionable merit and for claims it does not owe."[9] As a consequence, under AT&T's arbitration provision, the district court found that "nearly all consumers who pursue the informal claims process are very likely to be compensated promptly and in full," with customers "virtually guaranteed a payment by [AT&T]."[10]

By contrast, the district court found, "consumers who are members of a class [action] do not fare as well."[11] The court noted "studies that show class members

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7 *Laster v. T-Mobile USA, Inc.*, 2008 WL 52162555, at *10 (S.D. Cal. Aug. 11, 2008), *affirmed sub nom. Laster v. AT&T Mobility LLC*, 584 F.3d 849 (9th Cir. 2009), *rev'd sub nom. AT&T Mobility LLC v. Concepcion*, 563 U.S. 333 (2011).

8 *Id.*

9 *Id.* at *11.

10 *Id.*

11 *Id.*

rarely receive more than pennies on the dollar for their claims, and that few class members (approximately 1-3%) bother to file a claim when the amount they would receive is small."[12] The court found that "the record . . . establishes that a reasonable consumer may well prefer quick informal resolution with likely full payment over class litigation that could take months, if not years, and which may merely yield an opportunity to submit a claim for recovery of a small percentage of a few dollars."[13] The court held that AT&T's arbitration provision "sufficiently incentivizes consumers" to pursue "small dollar" claims and "is an adequate substitute for class arbitration[.]"[14]

The district court nonetheless held that AT&T's arbitration provision is unenforceable under California law. Under California's *Discover Bank* rule—named for the California Supreme Court decision that had announced it (*Discover Bank v. Superior Court*[15])—"[f]aithful adherence to California's stated policy of favoring class litigation and arbitration to deter fraudulent conduct in cases involving large numbers of consumers with small amounts of damages[] compel[ed] the Court to invalidate" AT&T's arbitration provision.[16] The district court also rejected AT&T's arguments that the Federal Arbitration Act ("FAA") preempts California's *Discover Bank* rule.[17]

AT&T's appeal to the Ninth Circuit and Supreme Court

AT&T appealed the denial of its motion to compel arbitration. A three-judge panel of the Ninth Circuit affirmed the district court's rulings that California's *Discover Bank* rule invalidates AT&T's arbitration provision and that the FAA does not preempt the *Discover Bank* rule.[18] The Ninth Circuit concluded that although AT&T's arbitration provision "essentially guaranteed that the company will make any aggrieved customer whole who files a claim," this was insufficient to comply with California law because class proceedings were unavailable in arbitration.[19] And the Ninth Circuit held that California's *Discover Bank* rule was consistent with the FAA because it was "simply a refinement of the unconscionability analysis

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12 *Id.*

13 *Id.* at *12.

14 *Id.* at *11-12.

15 113 P.3d 1100 (Cal. 2005).

16 *Laster*, 2008 WL 5216255, at *14.

17 *Id.* at *14 n.11.

18 *Laster v. AT&T Mobility LLC*, 584 F.3d 849 (9th Cir. 2009), *rev'd sub nom. AT&T Mobility LLC v. Concepcion*, 563 U.S. 333 (2011).

19 *Id.* at 856 & n.10.

applicable to contracts generally in California" and therefore did not discriminate against arbitration agreements in violation of the FAA.[20]

The Supreme Court then granted review to determine whether the FAA preempts California's *Discover Bank* rule. The Court then reversed the Ninth Circuit's decision.[21]

The Supreme Court began by noting that Congress enacted the FAA "in response to widespread judicial hostility to arbitration agreements."[22] Section 2 of the FAA requires that written arbitration agreements be deemed to be "valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract."[23] The Supreme Court explained that this non-discrimination principle means that arbitration agreements may "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."[24] In other words, courts cannot deem inherent characteristics of arbitration agreements—such as the lack of "judicially monitored discovery" or "disposition by jury"—to be unconscionable or against public policy.[25] The Court observed that these "examples are not fanciful, since the judicial hostility towards arbitration that prompted the FAA had manifested itself in a 'great variety' of 'devices and formulas' declaring arbitration against public policy."[26]

The Supreme Court then held that California's *Discover Bank* rule contravened this principle, because "[r]equiring the availability of classwide arbitration interferes with fundamental attributes of arbitration and thus creates a scheme inconsistent with the FAA."[27]

First, the Court explained, "the switch from bilateral" (*i.e.*, individual) "to class arbitration sacrifices the principle advantage of arbitration—its informality—and makes the process slower, more costly, and more likely to generate procedural

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[20] *Id.* at 857-58.

[21] *Concepcion*, 563 U.S. 351.

[22] *Id.* at 339.

[23] 9 U.S.C. § 2.

[24] *Concepcion*, 563 U.S. at 339 (quoting *Doctor's Assocs., Inc. v. Casarotto*, 517 U.S. 681, 687 (1996)).

[25] *Id.* at 341-42.

[26] *Id.* at 342 (quoting *Robert Lawrence Co. v. Devonshire Fabrics, Inc.*, 271 F.2d 402, 406 (2d Cir. 1959)).

[27] *Id.* at 344.

morass than final judgment."[28] For example, in a class proceeding, the arbitrator must decide "whether the class itself may be certified, whether the named parties are sufficiently representative and typical, and how discovery for the class should be conducted."[29]

Second, the Court noted, "class arbitration *requires* procedural formality," with class arbitration procedures "mimic[king] the Federal Rules of Civil Procedure for class litigation."[30]

Third, "class arbitration greatly increases risks to defendants."[31] The Court explained that "[a]rbitration is poorly suited to the higher stakes of class litigation" because judicial review of arbitral decisions is sharply limited under the FAA.[32] Accordingly, the Court concluded, "[w]e find it hard to believe that defendants would bet the company with no effective means of review," and so if the *Discover Bank* rule were allowed to persist, it would lead to the abandonment of arbitration, frustrating the FAA's purpose of "promot[ing] arbitration."[33]

The Court therefore concluded that the class arbitration mandated by California's *Discover Bank* rule "is not arbitration as envisioned by the FAA, lacks its benefits, and therefore may not be required by state law."[34]

Finally, the Court rejected the criticism that "class proceedings are necessary to prosecute small-dollar claims that might otherwise slip through the legal system."[35] The Court explained that "States cannot require a procedure that is inconsistent with the FAA, even if it is desirable for unrelated reasons."[36] Moreover, the Court explained, given the pro-consumer features of AT&T's arbitration provision, AT&T customers "were *better off* under their arbitration agreement with AT&T than they would have been as participants in a class action, which could take months, if not years, and which may merely yield an opportunity to submit a claim for recovery of a small percentage of a few dollars."[37]

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28 *Id.* at 348.

29 *Id.*

30 *Id.* at 349.

31 *Id.* at 350.

32 *Id.*

33 *Id.* at 345, 351.

34 *Id.* at 351.

35 *Id.*

36 *Id.*

37 *Id.* at 352 (internal quotation marks omitted).

The impact of *Concepcion* on consumer arbitration agreements

The Supreme Court's decision in *Concepcion* is significant to consumer arbitration in a number of respects.

First, although the Court held that the FAA preempts California's *Discover Bank* rule, the Court emphasized the continued ability of courts to police consumer arbitration agreements for unfairness. "Generally applicable contract defenses," such as "fraud" and "unconscionability," remain available to courts to prevent overreaching by drafters of consumer arbitration agreements.[38] Today, courts routinely invalidate one-sided arbitration agreements or sever unfair provisions that impose excessive costs on consumers, unfairly limit a consumer's remedies, or improperly give the company control over the selection of the arbitrator.[39]

Second, the decision in *Concepcion* encouraged companies to adopt more consumer-friendly arbitration programs, such as AT&T's provision, under which consumers may arbitrate most claims for free and might obtain greater remedies in arbitration than a court could award.

Specifically, a number of other companies have followed AT&T's lead and given consumers special rights in arbitration that are unavailable in court. For example, a number of companies give prevailing customers the right to recover their attorneys' fees.[40] By contrast, consumers who win a breach-of-contract claim in court generally cannot recover their attorneys' fees, because under the American rule, each party pays for its own attorneys unless an applicable fee-shifting statute applies.[41] Other companies have agreed to pay heightened minimum recoveries to consumers to whom an arbitrator awards greater relief than the company's last settlement offer.[42] And many companies fully subsidize the cost of arbitration for

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38 *Id.* at 339 (internal quotation marks omitted).

39 *See*, *e.g.*, *Ridgeway v. Nabors Completion & Prods. Servs. Co.*, 725 F. App'x 472, 474 (9th Cir. 2018) (holding that limitation on arbitrator's ability to award prevailing plaintiff discovery and expert witness costs must be severed from arbitration agreement); *Zaborowski v. MHN Gov't Servs., Inc.*, 601 F. App'x 461, 463-64 (9th Cir. 2014) (affirming denial of motion to compel arbitration under agreement that limited remedies and allowed the company to select the arbitrators)

40 *See*, *e.g.*, http://www.t-mobile.com/responsibility/legal/terms-and-conditions-aug-22-2018+Dispute%20Resolution.

41 *See*, *e.g.*, *Baker Botts L.L.P. v. ASARCO LLC*, 135 S. Ct. 2158, 2164 (2015).

42 *See*, *e.g.*, http://www.verizonwireless.com/legal/notices/customer-agreement (minimum recovery of $5,00 and reasonable attorneys' fees and expenses to customers who best Verizon Wireless's settlement offer in arbitration); http://www.frontier.com/~/media/corporate/terms/general-arbitration-provision.ashx (minimum recovery of $5,000 to customers who best Frontier Communication's settlement offer in arbitration); http://www.microsoft.com/en-us/servicesagreement (minimum recovery of $1,00 and attorneys' fees and expenses to customers who best Microsoft's settlement offer in arbitration).

consumers, paying the consumer's already low filing fee under the consumer fee schedules of the American Arbitration Association or JAMS.

The ease and simplicity of using these arbitration programs to resolve disputes—which frequently result in mutually agreeable settlements, without the consumer having to go to the bother of actually commencing an arbitration—makes it easier than ever for consumers with small claims to obtain relief. Indeed, plaintiffs' lawyers are increasingly agreeing to represent consumers in arbitration. And businesses have formed to help consumers bring arbitrations.

As *Concepcion* points out—rightly—consumers and businesses both benefit from the "informality," and inexpensive, "efficient," and "streamlined procedures" of arbitration.[43] Indeed, as the Supreme Court explained in a previous case, without arbitration, the "typical consumer who has only a small damages claim (who seeks, say, the value of only a defective refrigerator or television set)," would be left "without any remedy but a court remedy, the costs and delays of which could eat up the value of an eventual small recovery."[44]

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43 *Concepcion*, 563 U.S. at 344-45.

44 *Allied-Bruce Terminix Cos. v. Dobson*, 513 U.S. 265, 281 (1995).