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AT&T MOBILITY AND FAA OVER-PREEMPTION

Jill Gross*

It is no secret that pre-dispute arbitration clauses in adhesive consumer and employment agreements have been harshly criticized in this country in recent years. Critics label these clauses, which often contain one-sided provisions, such as class arbitration waivers and inconvenient venue and cost-shifting provisions, as oppressive and unfair to those with inferior bargaining power.¹

The Supreme Court's most recent decisions under the Federal Arbitration Act ("FAA")² have only exacerbated this ongoing debate. These rulings have stripped the arbitrators of the power to construe silence in an arbitration agreement as consent to class arbitration,³ reaffirmed the arbitrability of federal statutory claims,⁴ upheld a clause in an arbitration agreement delegating to arbitrators the power to rule on the unconscionability of the arbitration clause,⁵ and enforced a class arbitration waiver in an arbitration agreement.⁶ Among other impacts, these decisions have effectively foreclosed the ability of consumers and employees to pursue low-dollar value claims, as they can no longer consolidate them in an arbitration proceeding.⁷

These decisions clearly reflect the Court's strong support of arbitration agreements. That strong support does not come without a cost, however, as these decisions also severely limit the states' powers to police the fairness of arbitration agreements. In particular, the Court's decision in *AT&T Mobility LLC v. Concepcion*⁸ expands the FAA preemption doctrine beyond its prior boundaries, signaling how far the Court is willing to go to support arbitration clauses at the expense of states' rights and the values of federalism. This article will explore the impact of *AT&T Mobility* on the preemption of state law and the concomitant impact on the balance

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¹ See, e.g., Richard M. Alderman, *Pre-Dispute Mandatory Arbitration in Consumer Contracts: A Call for Reform*, 38 HOUS. L. REV. 1237 (2001); Mark E. Budnitz, *The High Cost of Mandatory Consumer Arbitration*, 67 LAW & CONTEMP. PROBS. 133 (2004); Sarah Rudolph Cole, *Incentives and Arbitration: The Case Against Enforcement of Executory Arbitration Agreements Between Employers and Employees*, 64 UMKC L. REV. 449 (1996); David S. Schwartz, *Enforcing Small Print to Protect Big Business: Employee and Consumer Rights Claims in an Age of Compelled Arbitration*, 1997 WIS. L. REV. 33 (1997); Jean R. Sternlight, *Creeping Mandatory Arbitration: Is It Just?*, 57 STAN. L. REV. 1631 (2005); Jean R. Sternlight, *Panacea or Corporate Tool?: Debunking the Supreme Court's Preference for Binding Arbitration*, 74 WASH. U. L. Q. 637 (1996); Katherine Van Wezel Stone, *Rustic Justice: Community and Coercion Under the Federal Arbitration Act*, 77 N.C. L. REV. 931 (1999). But see Stephen J. Ware, *The Case for Enforcing Adhesive Arbitration Agreements— With Particular Consideration of Class Actions and Arbitration Fees*, 5 J. AM. ARB. 251, 264 (2006) (arguing against legislation prohibiting enforcement of adhesive pre-dispute arbitration agreements and stating that "the general enforcement of adhesive arbitration agreements benefits society as a whole by reducing process costs and, in particular, benefits most consumers, employees and other adhering parties").

² 9 U.S.C. §§ 1-16 (2007).

³ See *Stolt-Nielsen S.A. v. AnimalFeeds Int'l. Corp.*, 130 S. Ct. 1758 (2010).

⁴ *CompuCredit Corp. v. Greenwood*, 132 S. Ct. 665 (2012).

⁵ *Rent-A-Center, W., Inc. v. Jackson*, 130 S. Ct. 2772 (2010).

⁶ 131 S. Ct. 1740 (2011).

⁷ See Jean Sternlight, *Tsunami: AT&T Mobility v. Concepcion Impedes Access to Justice*, 90 OR. L. REV. 703, 723 (2012); Sarah Cole, *On Babies and Bathwater: The Arbitration Fairness Act and the Supreme Court's Recent Arbitration Jurisprudence*, 48 HOUS. L. REV. 457 (2011).

⁸ *AT&T Mobility*, 131 S. Ct. at 1740.

between state and federal power in the arbitration arena. This article argues that *AT&T Mobility* results in FAA over-preemption,⁹ as it unduly shifts arbitration law-making power away from the states, in violation of the FAA's savings clause.

I. THE FAA PREEMPTION DOCTRINE

Congress enacted the FAA in 1925 “to overrule the judiciary’s long-standing refusal to enforce agreements to arbitrate.”¹⁰ Animated by the overarching principle of contractual autonomy, the FAA’s primary purpose was to “require[] courts to enforce privately negotiated agreements to arbitrate, like other contracts, in accordance with their terms.”¹¹

The Supreme Court has interpreted the FAA to embody a strong national policy favoring arbitration as an alternative dispute resolution mechanism.¹² In the past twenty-five years, the Court’s FAA jurisprudence has imbued the FAA with super-status: it governs virtually every arbitration clause arising out of a commercial transaction,¹³ and its substantive provisions apply in both state and federal court.¹⁴ Although it is well-settled that the FAA does not create federal subject matter jurisdiction,¹⁵ the Court has declared repeatedly that the FAA “creates a body of federal substantive law of arbitrability, applicable to any arbitration agreement within the coverage of the Act.”¹⁶

Another consistent holding in the Supreme Court’s FAA jurisprudence is that its primary substantive provision, § 2, which declares that agreements to arbitrate are “valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract”¹⁷ preempting state laws that place an arbitration agreement on unequal footing from other contracts.¹⁸ Under the FAA preemption doctrine, § 2 preempts in federal and state court any state law that “actually conflicts with federal law, that is, to the extent that it ‘stands as an

⁹ I have previously argued that state courts over-preempt their own laws providing grounds to vacate arbitration awards. See Jill I. Gross, *Over-Preemption of State Vacatur Law: State Courts and the FAA*, 3 J. AM. ARB. 1 (2004).

¹⁰ *Volt Info. Scis., Inc. v. Bd. of Trs. of Leland Stanford Junior Univ.*, 489 U.S. 468, 478 (1989); *Dean Witter Reynolds Inc. v. Byrd*, 470 U.S. 213, 219-20 (1985).

¹¹ *Volt*, 489 U.S. at 478.

¹² *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*, 473 U.S. 614 (1985); *Moses H. Cone Mem’l Hosp. v. Mercury Constr. Corp.*, 460 U.S. 1, 24 (1983) (recognizing a “liberal federal policy favoring arbitration agreements”).

¹³ By its terms, the FAA governs agreements to arbitrate involving “transactions involving commerce.” 9 U.S.C. § 2 (2010). The Supreme Court has interpreted this phrase very broadly to include any transaction that *in fact* involves interstate commerce, even if the parties did not anticipate an interstate impact. See *Citizens Bank v. Alafabco, Inc.*, 539 U.S. 52 (2003) (applying FAA to debt restructuring agreements as “involving commerce”); *Howsam v. Dean Witter Reynolds, Inc.*, 537 U.S. 79 (2002) (applying FAA to securities arbitrations); *Allied-Bruce Terminix Cos. v. Dobson*, 513 U.S. 265, 273-74, 281 (1995) (interpreting the reach of the FAA broadly to all transactions “involving commerce” and stating that “‘involving’ is broad and is indeed the functional equivalent of ‘affecting’”).

¹⁴ See *Southland Corp. v. Keating*, 465 U.S. 1, 12 (1984) (“The statements of the Court in *Prima Paint* that the Arbitration Act was an exercise of the Commerce Clause power clearly implied that the substantive rules of the Act were to apply in state as well as federal courts.”).

¹⁵ See *Vaden v. Discover Bank*, 556 U.S. 49, 59 (2009); *Hall Street Assoc., L.L.C. v. Mattel, Inc.*, 552 U.S. 576, 581-82 (2008); *Moses H. Cone Mem’l Hosp.*, 460 U.S. at 25 n.32.

¹⁶ See, e.g., *Moses H. Cone Mem’l Hosp.*, 460 U.S. at 24. The Court defined arbitrability in this context as “the duty to honor an agreement to arbitrate.” *Id.* at 25 n.32.

¹⁷ 9 U.S.C. § 2. This latter phrase of § 2 is known as the FAA’s “savings clause.”

¹⁸ See *Preston v. Ferrer*, 552 U.S. 346 (2008).

obstacle to the accomplishment and execution of the full purposes and objectives of Congress.”¹⁹ Thus, FAA preemption is a sub-species of “conflict preemption” known as “obstacle preemption.”²⁰

The FAA’s substantive provision, § 2, reflects a classic federalism balance. On the one hand, it displaces conflicting state law. Through FAA obstacle preemption, the Supreme Court has rebuffed state law-based defenses to the enforcement of arbitration agreements to the extent those defenses single out arbitration agreements for hostile treatment.²¹ Thus, the Court has held that the FAA preempts state statutes that prohibit the arbitration of a particular type of claim,²² state statutes that invalidate arbitration agreements on grounds different than those that invalidate other contracts,²³ and state judicial rules that display vestiges of the ancient judicial hostility to arbitration.²⁴ In these situations, lower courts have had no choice but to declare arbitration agreements enforceable under federal law even if they might be deemed unenforceable under state law.²⁵

On the other side of the federalism balance, the savings clause of § 2 preserves for the states the ability to declare arbitration agreements invalid on grounds traditionally reserved for state law: common law contract defenses to the enforceability of any contract. Thus, courts (either state courts or federal courts applying state contract law) have struck down arbitration

¹⁹ See *Volt Info. Scis., Inc. v. Bd. of Trs. of Leland Stanford Junior Univ.*, 489 U.S. 468, 477 (1989) (quoting *Hines v. Davidowitz*, 312 U.S. 52, 67 (1941)); *Moses H. Cone Mem’l Hosp.*, 460 U.S. at 1; *Prima Paint Corp. v. Flood & Conklin Mfg. Co.*, 388 U.S. 395 (1967); see also *Perry v. Thomas*, 482 U.S. 483 (1987) (preempting California statute requiring wage collection actions to be resolved in court).

²⁰ The Supreme Court has explained that it will find a state law preempted by a Congressional Act when: (1) the federal law expressly provides it displaces state law (“express preemption”); (2) Congress intends the federal law in an area to “occupy the field” (“field preemption”); (3) it is impossible for a party to comply with both the state and federal law (“impossibility preemption”); and (4) the challenged state law stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress (“obstacle preemption”). See *Crosby v. Nat’l Foreign Trade Council*, 530 U.S. 363, 372-73 (2000) (internal citations and quotations omitted). Impossibility and obstacle preemption are both subcategories of conflict preemption. *Id.*; see generally Caleb Nelson, *Preemption*, 86 VA. L. REV. 225, 228 (2000) (describing preemption categories).

²¹ None of these decisions preempt a state *arbitration* law—laws that primarily address arbitration procedures and award enforcement, and almost uniformly further a pro-arbitration policy. Rather, the Court has preempted state laws on non-arbitration matters that contain “lingering anti-arbitration sentiment.” Stephen L. Hayford & Alan R. Palmiter, *Arbitration Federalism: A State Role in Commercial Arbitration*, 54 FLA. L. REV. 175, 195 (2002).

²² See *Preston*, 552 U.S. 346, 356-57 (preempting California law granting exclusive jurisdiction to Labor Commissioner to decide disputes arising under the Talent Agencies Act); *Southland Corp. v. Keating*, 465 U.S. 1, 8 (1984) (preempting provision of the California Franchise Investment Law that required judicial, not arbitral, resolution of claims brought under the statute).

²³ See *Doctor’s Assocs., Inc. v. Casarotto*, 517 U.S. 681, 685 (1996) (preempting Montana statute requiring specific type of notice in contract containing arbitration clause); *Allied-Bruce Terminix Cos. v. Dobson*, 513 U.S. 265, 292-93 (1995) (preempting Alabama statute invalidating pre-dispute arbitration agreements in consumer contracts).

²⁴ See *Marmet Health Care Ctr., Inc. v. Brown*, 132 S. Ct. 1201 (2012) (preempting West Virginia Supreme Court rule voiding as against public policy pre-dispute arbitration clauses in nursing home contracts with respect to negligence claims); *Buckeye Check Cashing, Inc. v. Cardegna*, 546 U.S. 440 (2006) (preempting Florida judicial rule that precluded arbitrators from deciding the legality of an allegedly usurious contract containing an arbitration agreement); *Mastrobuono v. Shearson Lehman Hutton*, 514 U.S. 52 (1995) (preempting New York law precluding arbitrators from awarding punitive damages). In contrast, the FAA does not preempt a state arbitration statute that merely dictates the order of proceedings with respect to an arbitration and related third-party litigation, but does not regulate the viability or scope of the arbitration agreement itself. See *Volt*, 489 U.S. at 471.

²⁵ Exhibit A to this article charts all of the Supreme Court’s FAA preemption decisions and describes the state law at issue, the Court’s preemption holding, and the outcome of the case.

agreements on contract law grounds such as lack of mutual assent,²⁶ unconscionability,²⁷ an illusory agreement,²⁸ or violating the contract's implied covenant of good faith and fair dealing.²⁹ As long as the ground for revocation of the arbitration clause is a ground applicable to all contracts, and not just arbitration agreements, the states are free to apply their law, free of FAA preemption. But what happens where courts apply a generally applicable contract defense, such as unconscionability, in a manner that arguably *de facto* disfavors arbitration?

II. THE AT&T MOBILITY DECISION

The Court faced such a question in its 2010-11 term. In *AT&T Mobility, LLC v. Concepcion*,³⁰ the Court held for the seventh time that the FAA preempted a state law, this time a state law that on its face was not anti-arbitration but was being applied by lower courts in a manner that *de facto* disfavored arbitration. The decision, while noteworthy for its condemnation of class arbitration, confirms the Court's intent to severely circumscribe the ability of state law to regulate the fairness of arbitration, and to that extent is consistent with its previous FAA jurisprudence.

In *AT&T Mobility*, the Court ruled that the FAA preempts California's *Discover Bank* rule, which "classif[ied] most collective-arbitration waivers in consumer contracts as unconscionable."³¹ In its consumer cellular phone service contracts, AT&T Mobility, LLC ("AT&T") included a pre-dispute arbitration agreement which, *inter alia*, prohibited plaintiffs from bringing class action arbitrations, instead requiring claims to be arbitrated on an individual basis. In 2006, the Concepcions sued AT&T in district court, alleging that AT&T's practice of charging sales tax on a phone advertised as "free" was fraudulent.³² In December 2006, after the Concepcions filed their claim, AT&T revised the arbitration agreement to provide that AT&T would pay a customer \$7,500 if an arbitrator found in favor of a California customer on the merits of a customer dispute, and awarded more than the last AT&T settlement offer.³³ Two years later, after the Concepcions' case was consolidated with a putative class action alleging, *inter alia*, identical claims of false advertising and fraud, AT&T moved to compel arbitration under the revised agreement.³⁴

The district court refused to enforce the arbitration agreement under the savings clause of FAA § 2. The court concluded that the class action waiver of the arbitration agreement was unconscionable because it had a deterrent effect on class actions and the efficient resolution of third party claims.³⁵ After the Ninth Circuit affirmed, on an interlocutory appeal, the district

²⁶ See, e.g., *Phillips v. Mazyck*, 643 S.E.2d 172 (Va. 2007); *Kloss v. Edward D. Jones & Co.*, 54 P.3d 1 (Mont. 2002).

²⁷ See, e.g., *State ex rel. Richmond Am. Homes of W. Va., Inc. v. Sanders*, 717 S.E.2d 909 (W. Va. 2011); *Rivera v. Am. Gen. Fin. Servs., Inc.*, 259 P.3d 803 (N.M. 2011).

²⁸ See, e.g., *Penn v. Ryan's Family Steak Houses*, 269 F.3d 753 (7th Cir. 2001) (applying Indiana law).

²⁹ See, e.g., *Hooters of Am., Inc. v. Phillips*, 173 F.3d 933, 940 (4th Cir. 1999) (applying Restatement of Contracts and South Carolina contract law).

³⁰ *AT&T Mobility LLC v. Concepcion* 131 S. Ct. 1740 (2011).

³¹ *Id.* at 1746.

³² See *Laster v. AT&T Mobility LLC*, 584 F.3d 849, 853 (9th Cir. 2009), *rev'd sub nom.* *AT&T Mobility LLC v. Concepcion*, 131 S. Ct. 1740 (2011) (*Concepcion* was consolidated with *Laster* in September 2006).

³³ *Id.*

³⁴ *Id.*

³⁵ *Id.*

court's conclusion that the class-arbitration waiver was unconscionable and that the FAA did not preempt the *Discover Bank* rule,³⁶ AT&T sought review in the Supreme Court.

On April 27, 2011, the Supreme Court, in a 5-4 decision authored by Justice Scalia (joined by Justices Roberts, Kennedy, Thomas, and Alito), held that the FAA preempts California's *Discover Bank* interpretation of the state's unconscionability rule. The Court concluded that the *Discover Bank* rule created a different law of unconscionability for class action waivers in adhesive arbitration contracts.³⁷ Thus, the FAA preempts the rule as it singles out arbitration clauses for suspect treatment.³⁸

The Court rejected the Concepcions' argument that the Court should defer to the California Supreme Court's analysis of its own unconscionability doctrine and instead use an objective determination on whether or not the rule is "tantamount to a rule of non-enforceability of arbitration agreements."³⁹ The majority was persuaded by research which demonstrated that state courts had become more likely to find an arbitration agreement unconscionable as opposed to other contracts.⁴⁰ The Court also noted that although California's "rule does not *require* class-wide arbitration, it allows any party to a consumer contract to demand it *ex post*," thus defeating the purposes of the FAA.⁴¹

³⁶ *Id.* at 853-69.

³⁷ The Supreme Court noted that, under California law, a court may refuse to enforce a contract that it finds "'to have been unconscionable at the time it was made,'" or it may "'limit the application of any unconscionable clause.'" *AT&T Mobility*, 131 S. Ct. at 1746 (quoting CAL. CIV. CODE § 1670.5(a) (West 1985)) ("A finding of unconscionability requires a 'procedural' and a 'substantive' element, the former focusing on 'oppression' or 'surprise' due to unequal bargaining power, the latter on 'overly harsh' or 'one-sided' results.") (citations omitted). In *Discover Bank v. Superior Court*, 113 P.3d 1100 (Cal. 2005), *abrogated by AT&T Mobility*, 131 S. Ct. 1740, the California Supreme Court applied this unconscionability law to class-action waivers in arbitration agreements and held:

[W]hen the 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 the superior bargaining power has carried out a scheme to deliberately cheat large numbers of consumers out of individually small sums of money, then . . . the waiver becomes in practice the exemption of the party "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.

Id. at 1110 (citation omitted).

³⁸ AT&T identified three principles from *Discover Bank* that it contended courts applied differently to arbitration agreements than to other contracts: (1) the effect on third parties; (2) the timing of the unconscionability decisions; and (3) the shock the conscience standard. *See* Transcript of Oral Argument at 12, *AT&T Mobility LLC v. Concepcion*, 131 S. Ct. 1740 (2011) (No. 09-893).

³⁹ *Id.* at 39.

⁴⁰ *AT&T Mobility*, 131 S. Ct. at 1747.

⁴¹ *Id.* at 1750. The Court discussed three characteristics of class arbitration that it concluded defeat the purposes of the FAA and hinder the flexible party-driven process of arbitration: (1) sacrifice of informality and speed; (2) a requisite increase in procedural formality; and (3) an increase in risks to defendants in the lack of judicial review. *Id.* at 1751-52. Although the plurality expressly included the procedural expediency of arbitration as one of the FAA's purposes with which the *Discover Bank* rule interferes, the dissent referred to the Court's *Dean Witter* decision in which it specifically "reject[s] the suggestion that the overriding goal of the [FAA] was to promote the expeditious resolution of claims." *Id.* at 1758 (Breyer, J., dissenting) (citing *Dean Witter Reynolds Inc. v. Byrd*, 470 U.S. 213, 219 (1985)).

Justice Scalia's majority opinion was fueled by a singular distrust of class arbitration - a distrust that also appeared in the Court's 2010 decision in *Stolt-Nielsen S.A. v. AnimalFeeds International Corporation*.⁴² In contrast, the *AT&T Mobility* dissent claimed that class proceedings are necessary to protect against small-value claims falling through the cracks of the legal system.⁴³ Justice Scalia responded to the dissent's concern by stating that "[s]tates cannot require a procedure that is inconsistent with the FAA, even if it is desirable for unrelated reasons."⁴⁴ Thus, the Court went so far as to characterize class arbitration as not arbitration at all within the meaning of the FAA, but a process that alters the fundamental attributes of arbitration.

Justice Thomas "reluctantly join[ed]" the majority, but wrote "separately to explain how [he] would find [a] limit" on contract defenses permitted by FAA § 2.⁴⁵ In his concurring opinion, Justice Thomas reasoned that the savings clause of the FAA permits exceptions to the enforceability of arbitration agreements only for defenses that "relate[] to the making of the [arbitration] agreement."⁴⁶ Because the *Discover Bank* rule did not relate to the formation of the arbitration agreement within the meaning of FAA §§ 2 and 4, Justice Thomas concluded that it was preempted by the FAA. While Justice Thomas' interpretation of FAA § 2 differed from prior Supreme Court jurisprudence and was not briefed or advocated by the parties, his vote was necessary for the 5-4 reversal.

In the *AT&T Mobility* dissent, Justice Breyer (joined by Justices Ginsburg, Sotomayor and Kagan) argued that California's *Discover Bank* rule "represents the 'application of a more general [unconscionability] principle.'"⁴⁷ Because it is a rule of state law applicable to all contracts and not just arbitration agreements, it falls within the savings clause and the FAA should not preempt it.⁴⁸ Additionally, the dissent criticized the plurality's conclusion that class arbitration is lacking the "fundamental attribute[s]" of arbitration within the meaning of the FAA. Justice Breyer opined that barring class arbitration and forcing lower courts to enforce adhesive class arbitration waivers would "have the effect of depriving claimants of their claims."⁴⁹

⁴² *Stolt-Nielsen S.A. v. AnimalFeeds Int'l Corp.*, 130 S. Ct. 1758 (2010).

⁴³ *AT&T Mobility*, 131 S. Ct. at 1760-61 (Breyer, J., dissenting).

⁴⁴ *Id.* at 1753 (majority opinion).

⁴⁵ *Id.* at 1753-54 (Thomas, J., concurring). Justice Thomas felt compelled to articulate his reading of the savings clause because, in past preemption cases, he dissented based on his view, first articulated in *Allied-Bruce Terminix Cos. v. Dobson*, 513 U.S. 265, 284-97 (1995) (Thomas, J., dissenting), that the FAA does not apply in state courts. Since this case came up through the federal courts, that basis of dissent did not apply.

⁴⁶ *AT&T Mobility*, 131 S. Ct. at 1754-55 (Thomas, J., concurring) (quoting 9 U.S.C. § 4 (2010)).

⁴⁷ *Id.* at 1757 (Breyer, J., dissenting) (citing *Gentry v. Superior Court*, 165 P.3d 556, 564 (Cal. 2007)).

⁴⁸ *Id.*

⁴⁹ *Id.* at 1761. Justice Breyer asked the *Concepcion* majority, "What rational lawyer would have signed on to represent the *Concepcions* in litigation for the possibility of fees stemming from a \$30.22 claim?" *Id.* (citing *Carnegie v. Household Int'l, Inc.*, 376 F.3d 656, 661 (7th Cir. 2004) ("...only a lunatic or a fanatic sues for \$30.")). In doing so, he cited an appellate court which recognized previously the "realistic alternative to a class action is not 17 million individual suits, but zero individual suits,..." *Id.*

Finally, the dissent expressed deep concern for the impact of the decision on principles of federalism:

Through [the savings clause], Congress reiterated a basic federal idea that has long informed the nature of this Nation’s laws. We have often expressed this idea in opinions that set forth presumptions. Here, recognition of that federalist ideal, embodied in specific language in this particular statute, should lead us to uphold California’s law, not strike it down. We do not honor federalist principles in their breach.⁵⁰

Academic and media reaction to *AT&T Mobility* was swift and harsh.⁵¹ Much of the criticism focused on the certain death of class arbitration as a method to redress small dollar value claims through arbitration.⁵² Commentators agreed with the dissent that many consumers would not be able to pursue their claims, and thus vindicate their statutory rights, if they could not consolidate their claims with others into larger groups.⁵³ Is *AT&T Mobility* such an unparalleled disaster - a “tsunami,” as Professor Sternlight termed it?⁵⁴

III. *AT&T MOBILITY* AND FAA PREEMPTION

In some ways, *AT&T Mobility* is logically consistent with the Court’s previous cases imposing FAA preemption. As in most of the Court’s previous preemption cases (except *Mastrobuono*),⁵⁵ the Court’s decision resulted in the imposition of arbitration on an unwilling disputant. This decision, like the previous ones, preempted a state law that did not involve arbitration procedures. And, like in its previous preemption opinions, the Court elevated principles of contractual autonomy over state law consumer protection regulations.

⁵⁰ *Id.* at 1762 (citation omitted).

⁵¹ See, e.g., Jean Sternlight, *supra* note 7; S.I. Strong, *Does Class Arbitration ‘Change the Nature’ of Arbitration? Stolt-Nielsen, AT&T and a Return to First Principles*, HARV. NEGOT. L. REV. (forthcoming), available at <http://ssrn.com/abstract=1791928>; Sarah Cole, *Continuing the Discussion of the AT&T v. Concepcion Decision: Implications for the Future*, ADR Prof Blog, Apr. 27, 2011, <http://www.indisputably.org/?p=2312> (“It would appear that the era of class arbitration is over before it really ever began – unless Congress can be persuaded to amend the FAA to permit class arbitration, at least in cases involving low value claims, where consumers are unlikely to have practical recourse to a remedy through traditional bilateral arbitration.”); Marcia Coyle, *Divided Justices Back Mandatory Arbitration for Consumer Complaints*, NEW YORK LAW JOURNAL, Apr. 28, 2011, available at <http://www.law.com/jsp/article.jsp?id=1202491963074&slreturn=1> (quoting lawyer for Concepcions as stating “[t]he decision will make it harder for people with civil rights, labor, consumer and other kinds of claims that stem from corporate wrongdoing to join together to obtain their rightful compensation”).

⁵² Sternlight, *supra* note 7, at 704 (“It is highly ironic but no less distressing that a case with a name meaning “conception” should come to signify death for the legal claims of many potential plaintiffs.”); Sarah Cole, *On Babies and Bathwater*, *supra* note 7, at 464 (“most pressing issue in consumer arbitration, in the wake of recent Supreme Court decisions, is the lack of a viable forum for consumers with low value claims”).

⁵³ See, e.g., Myriam Gilles, *AT&T Mobility v. Concepcion: From Unconscionability to Vindication of Rights*, SCOTUSBLOG, Sept. 15, 2011, <http://www.scotusblog.com/2011/09/att-mobility-vs-concepcion-from-unconscionability-to-vindication-of-rights> (last visited Jan. 28, 2012) (“The *AT&T* ruling is the real game-changer for class action litigation, as it permits most of the companies that touch consumers’ day-to-day lives to place themselves beyond the reach of aggregate litigation by simply incorporating class waiver language into their standard-form contracts.”).

⁵⁴ See Sternlight, *Tsunami*, *supra* note 7.

⁵⁵ See Exhibit A.

Indeed, the Court’s very first FAA preemption case, *Southland v Keating*,⁵⁶ preempted a California state law that, as interpreted by California’s high court, provided a ground for the revocation of any contract - just as in *AT&T Mobility*. In *Southland*, several 7-Eleven franchisees sued franchisor Southland in California state court alleging various common law claims, as well as claims arising under the California Franchise Investment Law (CFIL).⁵⁷ After the claims were consolidated with other franchisees’ similar claims, Southland invoked the arbitration clause in the franchise agreements and moved to compel arbitration of the action.⁵⁸ Ultimately, the issue of the arbitrability of the CFIL claims made its way to the California Supreme Court, which held that they were not arbitrable in light of § 31512 of the statute – a provision that voided any “condition, stipulation or provision purporting to bind [a franchisee] to waive compliance with any provision of [the CFIL].”⁵⁹

The Supreme Court of the United States reversed, holding that the FAA preempted § 31512 of the CFIL. Dismissing the dissent’s contention that the savings clause preserves this defense to arbitration for the states, the Court concluded that § 31512 was *not* a ground for the revocation of *any* contract (and thus not within the scope of the savings clause), but was a “ground that exists for the revocation of arbitration provisions in contracts subject to the [CFIL].”⁶⁰ The Court reached this conclusion even though § 31512 on its face did not mention arbitration and presumably applied to many different kinds of agreements, not just arbitration agreements. When considered through the lens of *Southland*’s preemption of a seemingly contract-neutral state law, *AT&T Mobility* paves no new ground.

In some ways, however, this case appears to stretch the FAA preemption doctrine beyond its previous scope, as it reflects the Court’s first preemption of a traditional common law defense to the enforcement of any contract (here, unconscionability).⁶¹ The Court found latent anti-arbitration animus in California’s unconscionability defense in the way that California courts *applied* the *Discover Bank* doctrine to arbitration agreements.⁶² At the core of previous preemption decisions was not a traditional common law defense to contracts that easily associated with the savings clause.⁶³ Those decisions involved the preemption of a state statute or rule that was enacted to remove forum choice from contracting parties (*Southland*, *Preston*, *Allied-Bruce Terminix*, and *Perry*) or was patently anti-arbitration (*Cassarotto and Mastrobuono* (and post-*AT&T Mobility*, *Marmet*)).

Another striking difference from prior preemption cases is the *AT&T Mobility* Court’s measures to strip arbitrators of a power – the power to conduct class arbitration proceedings (unless all parties expressly agreed to them). In contrast, the Court’s previous preemption cases endorsed arbitrators’ broad powers to fashion procedures and remedies to suit the parties’ needs

⁵⁶ See *Southland Corp. v. Keating*, 465 U.S. 1, 2-3 (1984).

⁵⁷ *Id.* at 4.

⁵⁸ *Id.*

⁵⁹ *Id.* at 10 (citing CAL. CORP. CODE § 31512 (West 1977)). The California high court interpreted this language to require judicial consideration of claims arising under the law.

⁶⁰ *Id.* at 16 n.11.

⁶¹ Although California codified the unconscionability doctrine (see CAL. CIV. CODE § 1670.5(a) (West 1979)), and thus *AT&T Mobility* involved a California statute as interpreted by California courts, unconscionability has long-standing roots in the common law of contracts.

⁶² See *AT&T Mobility LLC v. Concepcion*, 131 S. Ct. 1740, 1750 (2011).

⁶³ See *Doctor’s Assocs., Inc. v. Casarotto*, 517 U.S. 681, 687 (1996) (“[G]enerally applicable contract defenses, such as fraud, duress, or *unconscionability*, may be applied to invalidate arbitration agreements without contravening § 2.”) (emphasis added).

and the dispute.⁶⁴ Ironically enough, the end result in *Southland*, which arose out of a purported class action of convenience store franchisee claims, was forcing unwilling franchisees into arbitration, possibly using class action-type procedures.⁶⁵ The end result in *AT&T Mobility* is somewhat the inverse – forcing consumers who sought class arbitration into individual, small claims arbitration.

Why didn't the *Southland* Court balk at sending franchisees into class arbitration? Possibly because the parties did not litigate the issue of the propriety of class arbitration in 1984.⁶⁶ Or was class arbitration in 1984 closer to FAA arbitration than it is in 2011?

What was different in 1984 was that the FAA federalism see-saw still tipped towards the states, and the Supreme Court had just begun its expansion of the preemptive force of the FAA. In fact, as recently as 2009, before the Court's "third arbitration trilogy,"⁶⁷ the Court in *Vaden* stated that "[g]iven the substantive supremacy of the FAA, but the Act's nonjurisdictional cast, state courts have a prominent role to play as enforcers of agreements to arbitrate."⁶⁸ The third arbitration trilogy, and, in particular, *AT&T Mobility*, strips the courts of one of the only doctrines remaining to play that enforcer role, raising serious federalism concerns.⁶⁹ Despite the *Vaden* Court's polite nod to the states acknowledging that they have a "prominent role to play," state courts have few weapons left to police the fairness of arbitration agreements.⁷⁰

IV. FAA PREEMPTION POST-*AT&T MOBILITY*

Where does *AT&T Mobility* leave the FAA preemption doctrine? States are now struggling to regulate the fairness of arbitration agreements sought to be enforced within their borders. It is now crystal-clear that states cannot enact substantive statutes either expressly or implicitly hostile to arbitration. States also cannot circumvent the enforceability of arbitration

⁶⁴ See, e.g., *Mastrobuono v. Shearson Lehman Hutton, Inc.*, 514 U.S. 52, 56-57 (1995) (preempting state law that stripped arbitrators of power to award punitive damages).

⁶⁵ See *Southland*, 465 U.S. at 2-3. Interestingly, the Court noted that "as to the question whether the Federal Arbitration Act precludes a class action arbitration and any other issues not raised in the California courts, no decision by this Court would be appropriate at this time." *Id.* at 17.

⁶⁶ *Id.* at 17 ("as to the question whether the Federal Arbitration Act precludes a class action arbitration and any other issues not raised in the California courts, no decision by this Court would be appropriate at this time").

⁶⁷ See Thomas Stipanowich, *The Third Arbitration Trilogy: Stolt-Nielsen, Rent-a-Center, Concepcion and the Future of American Arbitration*, 22 AM. REV. INT'L ARB. 323 (2012) (labeling *Stolt-Nielsen*, *Rent-A-Center* and *AT&T Mobility* as the third arbitration trilogy because they "represent[] a milestone in American arbitration" as they "aggressively expand[] the 'revealed' penumbra of substantive arbitration law under the Federal Arbitration Act and shore[] up the bulwarks of private, binding dispute resolution under standardized contracts of adhesion binding employees and consumers").

⁶⁸ *Vaden v. Discover Bank*, 556 U.S. 49, 59 (2009). The Court reiterated this view post-*AT&T Mobility* in *KPMG LLP v. Cocchi*, 132 S. Ct. 23, 24 (2011) (holding that, even if a lower court concludes that some claims in a multi-claim action are not arbitrable, court must compel arbitration of remaining claims).

⁶⁹ Professor Stipanowich points out that language in dicta in *Perry v. Thomas*, 482 U.S. 483 (1987), foreshadowed this preemption of unconscionability doctrine. See Stipanowich, *supra* note 67, at 356 (citing *Perry*, 482 U.S. at 492 n.9).

⁷⁰ See *Vaden*, 556 U.S. at 59. Even more disturbing is the reasoning of Justice Thomas' concurrence. Under his unprecedented and narrow reading of the savings clause, the only exceptions to §2's enforcement of arbitration clauses are common law contract defenses that go to the *making of the arbitration agreement*, rather than all common law defenses to the enforcement of any contract. If his view is adopted by other Justices in future FAA decisions, state law would have virtually no ability to successfully invalidate arbitration agreements.

agreements through administrative regulations that prefer administrative forums over arbitration for the resolution of disputes. And state courts cannot create common law rules that *de facto* are hostile to arbitration, even if on their face they treat all agreements equally. The Supreme Court's FAA preemption decisions have reduced the savings clause to a largely symbolic nod to federalism, toothless in its application. By over-preempting state law grounds for revocation of any contract, the Court has ignored federalism concerns and tipped the carefully prescribed balance of power away from the states, expanding the FAA even more than it had before.

How can courts invalidate unfair arbitration agreements under the current FAA over-preemption regime? Some decisions emanating from states' high courts post-*AT&T Mobility* reflect unyielding FAA preemption of state law with respect to the enforceability of arbitration agreements containing class action waivers.⁷¹ Likewise, Professor Sternlight's analysis of federal court reaction in the six months after the case revealed that most decisions applied the *AT&T Mobility* holding rigorously, despite ample grounds for distinction from *AT&T Mobility*.⁷²

However, a few federal courts have been more willing to distinguish *AT&T Mobility* and strike down a class action waiver under the "vindicating statutory rights" doctrine.⁷³ Under this doctrine, derived from the Supreme Court's pronouncement in *Mitsubishi*⁷⁴ that "so long as the prospective litigant effectively may vindicate its statutory cause of action in the arbitral forum, the [federal] statute [providing that cause of action] will continue to serve both its remedial and deterrent function," a disputant can argue that an arbitration agreement is unenforceable because an unfair aspect of the arbitration process would preclude that party from vindicating its statutory rights.⁷⁵

For example, in *In Re American Express Merchants' Litigation*,⁷⁶ a purported class action arising under federal antitrust laws, the Second Circuit Court of Appeals reconsidered, in light of *AT&T Mobility*, its prior decisions that a class action waiver clause in a credit card agreement was unenforceable under the FAA⁷⁷ because "enforcement of the clause would effectively preclude any action seeking to vindicate the [plaintiffs'] statutory rights."⁷⁸ The Court of Appeals found that *AT&T Mobility* did not alter its prior analysis, which rested on a different ground than *AT&T*

⁷¹ See, e.g., *State ex rel. Richmond Am. Homes of W. Va., Inc. v. Sanders*, 717 S.E.2d 909, 924 (2011) (upholding class action waiver in arbitration clause under *AT&T Mobility* but declaring clause unconscionable on other grounds); *NAACP of Camden County. E. v. Foulke Mgmt. Corp.*, 24 A.3d 777, 794-95 (2011) (upholding class action waiver but denying motion to compel arbitration on ground that arbitration provisions lacked mutual assent).

⁷² See Sternlight, *supra* note 7, at 708 (concluding that "most courts are rejecting all potential distinctions and are instead applying *Concepcion* broadly as a 'get out of class actions free' card").

⁷³ See, e.g., *Chen-Oster v. Goldman, Sachs & Co.*, No. 10 Civ. 6950 (LBS) (JCF), 2011 WL 2671813 at *3 (S.D.N.Y. July 7, 2011) (refusing to reconsider its holding in a Title VII action that an arbitration clause was unenforceable because plaintiffs would not be able to vindicate their statutory rights absent the availability of class proceedings and distinguishing *AT&T Mobility*).

⁷⁴ *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*, 473 U.S. 614, 637 (1985).

⁷⁵ See *Green Tree Fin. Corp.-Ala. v. Randolph*, 531 U.S. 79, 92 (2000) (recognizing in *dicta* that, if a party showed that pursuing its statutory claims through arbitration would be prohibitively expensive, and thus it could not vindicate its statutory rights, a court could validly refuse to enforce a pre-dispute arbitration agreement).

⁷⁶ See *In re Am. Express Merchants' Litig.*, 667 F.3d 204 (2d Cir. 2012) (*Amex III*).

⁷⁷ See *In re Am. Express Merchants' Litig.*, 634 F.3d 187 (2d Cir. 2011) (*Amex II*); *In re Am. Express Merchants' Litig.*, 554 F.3d 300 (2d Cir. 2009) (*Amex I*). The Court of Appeals reconsidered *Amex I* in light of the Supreme Court's subsequent ruling in *Stolt-Nielsen S.A. v. AnimalFeeds Int'l Corp.*, 130 S. Ct. 1758 (2010).

⁷⁸ *Amex I*, 554 F.3d at 304.

Mobility.⁷⁹ Rather, the Court of Appeals recognized, “[h]ere...our holding rests squarely on a ‘vindication of statutory rights analysis, which is part of the federal substantive law of arbitrability.’”⁸⁰ Because plaintiffs demonstrated through expert testimony that pursuing their statutory claims individually, as opposed to through class arbitration, would not be economically feasible, thereby “effectively depriving plaintiffs of the statutory protections of the antitrust laws,”⁸¹ the Second Circuit directed the district court to deny defendant’s motion to compel arbitration.⁸²

Amex III does not equalize the federalism balance because it dealt with the federal law of arbitrability, not the preemption of an arguably conflicting state law.⁸³ However, states can distinguish *AT&T Mobility* on numerous grounds to limit its federalism impact.⁸⁴ Courts can limit it to the class action waiver contract, yet still find other grounds for unconscionability of the arbitration clause. Courts also can apply a contract-neutral state unconscionability doctrine to void a class action waiver.⁸⁵

Additionally, if a primary reason parties try to void arbitration agreements is to avoid a process they perceive as unfair, then states can offer secondary protection to those parties in the form of regulation of the process. The Supreme Court has not ruled that a section of the FAA other than § 2 applies in state court or preempts conflicting state law, nor has it held that state arbitration law is preempted to the extent it regulates arbitration *procedures*. In fact, the one time the Court considered and *rejected* an FAA preemption argument involved a state procedural law that governed the order of proceedings, not the viability of arbitration itself.⁸⁶ Thus, states can still enact procedural arbitration law that can have some impact on the integrity of the process, and then to some extent, address the concerns of disputants seeking to avoid an arbitration agreement.

State courts can also seize upon the “vindicating rights” federal law doctrine and carve out an exception to arbitrability under *state law* if a party can show some aspect of the arbitration contract or agreement precludes it from being able to vindicate its state statutory rights in arbitration. Courts can still resuscitate the savings clause by applying relevant common law

⁷⁹ See *Amex III*, 667 F.3d at 214 (“What *Stolt-Nielsen* and *Concepcion* do not do is require that all class-action waivers be deemed *per se* enforceable. That leaves open the question presented on this appeal: whether a mandatory class action waiver clause is enforceable even if the plaintiffs are able to demonstrate that the practical effect of enforcement would be to preclude their ability to bring federal antitrust claims.”).

⁸⁰ *Id.* at 213 (quoting *Amex I*, 554 F.3d at 320).

⁸¹ *Id.* at 217.

⁸² *Id.* at 219-20. Professor Sarah Cole wrote about the Second Circuit’s decision: “It would seem, then, that a plaintiff subject to a class action waiver in an arbitration agreement could attack that provision on the ground of unconscionability if it can show that bilateral arbitration would effectively preclude it from vindicating its statutory rights. Although this analysis must be done on a case-by-case basis, according to the Second Circuit, it certainly gives plaintiffs a basis for challenging a class action waiver. American Express says that it is going to appeal the decision.” Sarah Cole, *Class Action Waiver in Arbitration Agreement Unenforceable*, INDISPUTABLY BLOG, Feb. 2, 2012, <http://www.indisputably.org/?p=3326>.

⁸³ The National Labor Relations Board carved out another non-state law based exception to *AT&T Mobility* in the labor and employment context, finding that federal labor law bars class action waivers in labor and employment contracts. See *D. R. Horton, Inc.*, 357 N.L.R.B. No. 184 at *9 (2012).

⁸⁴ Professor Sternlight lists several possible bases of distinction. See Sternlight, *supra* note 7, at 726-27.

⁸⁵ This option remains open to the West Virginia State Supreme Court of Appeals on remand in *Marmet Health Care Ctr., Inc. v. Brown*, 132 S. Ct. 1201, 1202 (2012) (On remand, the West Virginia court must consider whether, absent that general public policy, the arbitration clauses in Brown’s case and Taylor’s case are unenforceable under state common law principles that are not specific to arbitration and pre-empted by the FAA).

⁸⁶ See *Volt Info. Scis., Inc. v. Bd. of Trs. of Leland Stanford Junior Univ.*, 489 U.S. 468, 470-79 (1989).

contract defenses to the enforcement of arbitration agreements. Unless Congress amends the FAA to eliminate the savings clause altogether, the Supreme Court would be hard-pressed to find that the FAA preempts common law defenses to the enforcement of any contract.

V. CONCLUSION

There seems to be little doubt that *AT&T Mobility* will have an adverse impact on consumer arbitration, as it effectively eliminates the states' ability to preserve class arbitration as a procedural method of aggregating low-value claims. In my view, the Court's decision differs from its prior preemption cases in both the type of rule preempted and its respect for arbitrators' powers. These differences contribute to the resulting over-preemption of the FAA.

Yet, despite the Court's consistent message to the states that there is no room to circumvent the FAA's ironclad support of arbitration agreements, I remain hopeful that - even post *AT&T Mobility* - lower state and federal courts will find ways to counter the seemingly over-preemptive, super-status of the FAA. The FAA preempts only state laws, not federal laws, thus, federal unconscionability law may still invalidate a class arbitration waiver. In addition, other federal statutes may trump the FAA, such as the Securities Exchange Act of 1934's anti-waiver provision, which may prevent the enforcement of a class arbitration waiver in the securities context.⁸⁷ Finally, like the Second Circuit did in *Amex III*, courts can give more teeth to the "vindicating statutory rights" ground as the ultimate policer of the fairness of arbitration, and thus rebalance the allocation of power between the states and federal government in the arbitration law arena.

⁸⁷ See Barbara Black, *Arbitration of Investors' Claims Against Issuers: An Idea Whose Time Has Come?*, 75 LAW & CONTEMP. PROBS. 107, 116-18 (2012) (arguing that a class action waiver in the securities context could violate anti-waiver provisions of federal securities laws because it would weaken investors' ability to recover under those laws).

Exhibit A

| <u>Case name</u> | <u>Year</u> | <u>Law at issue</u> | <u>Preemption?</u> | <u>Outcome</u> |
|--|--------------------|--|---|--|
| Southland Corp. v. Keating | 1984 | § 31512 of California Franchise Investment Law requiring judicial resolution of claims | Yes, of California Supreme Court's ruling on anti-arbitration state statute | Convenience store franchisees must bring their CFIL claims in arbitration, possibly using class procedures |
| Perry v. Thomas | 1987 | California Labor Law § 229 allowing wage collection actions to be resolved in court, regardless of arbitration agreement | Yes, of California Supreme Court's refusal under anti-arb state statute to compel arbitration of securities broker's claim against firm for commissions | Kidder Peabody could force its broker into arbitration |
| Volt Information Sciences v. Bd. of Trs. of Leland Stanford Junior Univ. | 1989 | § 1281 of California Arbitration Act allowing stay of arbitration pending outcome of related litigation with third party | No; affirmed California Court of Appeals' denial of contractor's motion to compel arbitration in favor of University; arbitration procedural rule | Enforced CAA in construction contract; stayed arbitration; allowed litigation to proceed with third party |
| Allied-Bruce Terminix Cos. v. Dobson | 1995 | Alabama statute invalidating pre-dispute arbitration agreements in consumer contracts | Yes, of Alabama Supreme Court's refusal to compel arbitration under anti-arbitration state statute | Homeowners had to arbitrate claims against termite company |
| Mastrobuono v. Shearson Lehman Hutton | 1995 | New York judicial rule precluding arbitrators from awarding punitive damages | Yes; reversed Seventh Circuit vacatur of punitive damages award under anti-arbitration state judicial rule | Permitted recovery for investors from completed arbitration |
| Doctor's Assocs. v. Cassarotto | 1996 | Montana statute requiring specific type of notice in contract | Yes; reversed Montana Supreme Court's refusal to enforce PDAA in franchise agreement under anti-arb state statute | Franchisees forced into arbitration |

Exhibit A - Continued

| <u>Case name</u> | <u>Year</u> | <u>Law at issue</u> | <u>Preemption?</u> | <u>Outcome</u> |
|--|--------------------|---|--|---|
| Buckeye Check Cashing, Inc. v. Cardegna | 2006 | Florida judicial rule precluding arbitrators from deciding legality of contract containing arbitration agreement | Yes; reversed Florida Supreme Court's refusal to permit arbitrators to decide whether allegedly usurious contract was void <i>ab initio</i> for illegality | Borrowers forced to arbitrate their claim of usury |
| Preston v. Ferrer | 2008 | California statute allowing administrative forum for claims arising under Talent Agencies Act | Yes, reversed California Court of Appeals' grant of stay of arbitration pending proceedings before Labor Commissioner under anti-arbitration state statute | Attorney allowed to proceed with fee claim against Judge Alex in arbitration |
| AT&T Mobility LLC v. Concepcion | 2011 | California judicial decision declaring class arbitration waivers unconscionable in most consumer agreements | Yes, of California Supreme Court's anti-arbitration judicial rule interpreting state unconscionability statute | Consumer forced to bring arbitration claim on an individual, not class, basis |
| Marmet Health Care Ctr. v. Brown | 2012 | West Virginia Supreme Court rule voiding as against public policy pre-dispute arbitration clauses in nursing home contracts with respect to negligence claims | Yes, remanding back to West Virginia Supreme Court to decide unconscionability of contract apart from anti-arbitration public policy rule | Highest state court forced to reconsider its own state law |