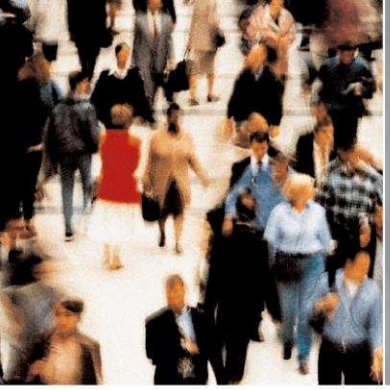

Class Action Alert
Recent developments in class action law

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Massachusetts SJC rules on class waivers days before United States Supreme Court issues Amex decision

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The United States Supreme Court stands poised to rule any day on whether "the Federal Arbitration Act permits courts, invoking the 'federal substantive law of arbitrability,' to invalidate arbitration agreements on the ground that they do not permit class arbitration of a federal-law claim." Question Presented and Grant of Cert., *Am. Express Co. v. Italian Colors Restaurant*, No. 12-133. The Supreme Judicial Court of Massachusetts (the "SJC") is not, however, waiting for a ruling from its federal counterpart. Instead, it has just held, in *Feeney v. Dell, Inc.*, 465 Mass. 470, 2013 WL 2479603 (June 12, 2013) ("*Feeney II*"), that a consumer-facing arbitration clause is unenforceable because its class waiver provision prevents customers from effectively vindicating their rights under Massachusetts's consumer protection statute.

The scope of the Federal Arbitration Act ("FAA"), 9 U.S.C.A. § 1-16 (West 2013), particularly its effect on consumer arbitration agreements that contain class action waivers, has been the subject of continual litigation in recent years (see prior alerts, below). Congress enacted the FAA in 1925 in response to widespread judicial hostility to arbitration agreements. The United States Supreme Court has defined the scope of the FAA broadly, stating that it "is a congressional declaration of a liberal federal policy favoring arbitration agreements, notwithstanding any state substantive or procedural policies to the contrary." *Moses H. Cone Memorial Hosp. v. Mercury Constr. Corp.*, 460 U.S. 1, 24 (1983). But Section 2 of the FAA (the "Savings Clause") also provides that "such grounds as exist at law or in equity for the revocation of any contract" will still apply to any purported agreement to arbitrate.

Despite the clear national policy favoring arbitration agreements, some state and federal courts have applied the Savings Clause to invalidate arbitration provisions containing class action waivers on the theory that such waivers are unconscionable as a matter of common law. Partially in response to this trend, the Supreme Court limited application of the Savings Clause in *AT&T Mobility LLC v. Concepcion*, 131 S.Ct. 1740 (2011), holding that defenses that, in theory, can be generally applied to all contracts, such as unconscionability, are still preempted by the FAA if they are disproportionately applied to invalidate arbitration agreements. In *Feeney II*, the SJC considered, in the wake of *Concepcion*, "under what conditions a State court may still invalidate an arbitration agreement containing a class waiver as unconscionable or against public policy without running afoul of the FAA." *Feeney II*, 465 Mass. 470, 2013 WL 2479603, at *14. The SJC held that *Concepcion* still allows the

invalidation of class waivers in cases where plaintiffs can prove, after an individualized factual inquiry, that class proceedings are the only viable way for plaintiffs to vindicate their claims.

Background: Feeney I

In 2003, consumer plaintiffs commenced a putative class action alleging that the Dell computer company had engaged in unfair or deceptive acts or practices in violation of the Massachusetts Consumer Protection Act, G.L. c. 93A ("93A"), by systematically charging and collecting from customers a charge falsely characterized as a "sales tax" on the purchase of optional service contracts for Dell computers. See *Feeney v. Dell, Inc.* 454 Mass. 192 (2009) (*Feeney I)*. Dell moved to stay the proceedings and to compel arbitration in accordance with Dell's "Terms and Conditions of Sale," a purchase agreement that contained terms mandating individual arbitration of customer disputes and precluding customers from bringing a class action. The terms did not bind Dell in connection with any claims it might have had against the consumer plaintiffs.

The plaintiffs resisted arbitration, arguing that the prohibition on class arbitration was unconscionable and undermined the purpose of 93A by unilaterally precluding class actions. A Massachusetts Superior Court allowed Dell's motion to compel arbitration and the plaintiffs sought interlocutory review, where a single justice of the Appeals Court denied plaintiffs' petition. Plaintiffs, thereafter, filed their arbitration claims "under protest," and, after failing to obtain any relief in arbitration, they again sought relief in Superior Court by filing a motion to vacate the arbitration award and to reconsider the order allowing Dell's motion to compel arbitration. The plaintiffs' motion was denied and the case was dismissed with prejudice. The SJC then granted direct appellate review and issued a decision reversing the order to compel arbitration, but dismissing the plaintiff's complaint, without prejudice, for failure to state a claim. In its ruling striking the arbitration clause, the SJC concluded that the class action prohibition "contravenes Massachusetts public policy," which it believed strongly favors class actions for 93A cases. *Feeney I*, 454 Mass. at 199. The plaintiffs filed an amended complaint, but, before the case could proceed further, the United States Supreme Court issued its opinion in *Concepcion*. That decision cast substantial doubt on the ground for the SJC's class waiver holding (see prior alerts below; U.S. Supreme Court upholds class action waivers in consumer contracts: *AT&T Mobility v. Concepcion*, dated April 27, 2011).

Concepcion: rejects argument that a class waiver is unconscionable and holds that "States cannot require a procedure that is inconsistent with the FAA, even if it is desirable for unrelated reasons"

In *Concepcion*, the Supreme Court considered whether the FAA prohibits states from conditioning the enforceability of certain arbitration agreements on the availability of class-wide arbitration procedures. In that case, plaintiffs had purchased AT&T services that purportedly included a free cellular telephone. But after plaintiffs were charged $30.22 in sales tax on the "free" telephones, they filed a class action lawsuit in federal district court alleging that AT&T had engaged in false advertising and fraud. AT&T moved to compel arbitration pursuant to the arbitration clause in its standard service agreement, which included a class action waiver. The contract contained other "consumer-friendly" terms aimed at encouraging arbitration, including a requirement that a customer awarded an amount in excess of AT&T's last settlement offer would be entitled to a $7,500 minimum recovery plus an award of twice the amount of the customer's attorney's fees. The District

Court nevertheless applied California's common law "*Discover Bank* rule,"[1] and found the arbitration agreement unconscionable because AT&T had not shown that bilateral arbitration adequately substituted for the deterrent effects of class actions. The United States Court of Appeals for the Ninth Circuit affirmed the District Court, and the Supreme Court granted certiorari.

Although the *Discover Bank* rule was rooted in California's version of the unconscionability doctrine—a state rule generally available to invalidate *any* contract—the Supreme Court found that California applied that rule in a way that had a disproportionate impact on arbitration agreements, and thus contravened the FAA's national policy favoring arbitration. In other words, the FAA preempted the *Discover Bank* rule "because [that rule] stands as an obstacle to the accomplishment and execution of the full purposes and objectives of the Congress." *Concepcion*, 131 S. Ct. 1740. In a pair of *per curiam* rulings since then, the Supreme Court has re-affirmed *Concepcion* and emphasized that any state law rules that categorically "prohibit[] outright the arbitration of a particular type of claim" are trumped by the FAA's pro-arbitration policy. *Marmet Health Care Ctr., Inc. v. Brown*, 132 S. Ct. 1201 (2012); *Nitro-Lift Techs., LLC v. Howard*, 133 S. Ct. 500 (2012).

SJC avoids Concepcion by applying the "vindication of statutory rights" doctrine

Following *Concepcion*, Dell filed a renewed motion to confirm the arbitration award, arguing that *Concepcion* abrogated the SJC's decision in *Feeney I*. After the superior court denied Dell's motion, the SJC granted direct appellate review.

The SJC acknowledged that *Concepcion* abrogated *Feeney I* insofar as *Feeney I* purported to strike the class action waiver based on a holding that the waiver violated a fundamental public policy of the Commonwealth of Massachusetts (a policy very similar to California's *Discover Bank* rule). Nevertheless, the court believed that Dell's class waiver remained unenforceable under the so-called "vindication of statutory rights doctrine," mentioned in another line of United States Supreme Court cases. See, e.g., *Green Tree Fin. Corp.-Ala. v. Randolph*, 531 U.S. 79 (2000); *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*, 473 U.S. 614 (1985). The SJC reasoned that Congress enacted the FAA to "preserve the availability of an arbitral forum and remedy for the resolution of disputes between parties to a commercial contract," and that it would be "contrary to Congressional intent to interpret the FAA to permit arbitration clauses that effectively deny consumers any remedy for wrongs committed in violation of other Federal and state laws intended to protect them." *Feeney II*, 2013 WL 2479603, at *1. Accordingly, in situations where a court determines, following an individualized factual inquiry, "that class proceedings are the *only* viable way for a consumer plaintiff to bring a claim against a defendant, as may be the case where the claims are complex, the damages are demonstrably small[,] and the arbitration agreement does not feature the safeguards found in the *Concepcion* agreement, a court may still invalidate a class waiver." *Id.* at *20 (emphasis added).

The SJC noted that *Concepcion* "did not render the Savings Clause of [FAA Section 2] a dead letter," and there must remain grounds at law or in equity for the revocation of a contract that may be properly invoked to void an arbitration agreement containing a class waiver. It relied for this proposition on the Supreme Court's statements in *Randolph* acknowledging that an arbitration clause would not be enforceable in the face of a showing that "the existence of large arbitration costs could preclude a litigant … from effectively vindicating her federal statutory rights in the arbitral forum …"

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[1] *Discover Bank v. Superior Ct.*, 113 P.3d 1100 (2005) (holding that arbitration clauses in consumer contracts that require consumers to arbitrate all claims and surrender the right to proceed as a class are unconscionable).

531 U.S. at 90-91. The SJC concluded that this line of reasoning remained undisturbed by *Concepcion*, as evidenced by efforts in the *Concepcion* majority opinion to emphasize the overall fairness of AT&T's arbitration agreement, and the court's ultimate conclusion that an AT&T customer could successfully pursue a remedy under the arbitration regime established by AT&T's agreement. According to the *Feeney II* court, this discussion of the AT&T agreement would have been superfluous if the majority intended to establish a blanket rule completely preempting all state law unconscionability defenses. See *Feeney II,* 2013 WL 2479603, at *16 (citing *Concepcion,* 131 S. Ct. at 1753).[2]

The SJC also addressed the Supreme Court's admonition in *Concepcion* that: "States cannot require a procedure that is inconsistent with the FAA, even if it is desirable for unrelated reasons[,]" including the fear that absent the availability of class procedures "small-dollar claims … might otherwise slip through the legal system." *Concepcion*, 131 S. Ct. at 1753. The SJC contended that this line of argument focused on the concern that plaintiffs would have insufficient *incentive* to file claims, not that they would be completely or effectively foreclosed from vindicating their substantive rights. In support of this argument, the SJC cited several recent decisions that have also read *Concepcion* narrowly, suggesting an exception to FAA preemption where substantive rights might be lost in arbitration; see *Feeney II*, 2013 WL 2479603, at *16-18 (citing, e.g., *Coneff v. AT&T Corp*, 673 F.3d 1155, 1159 (9th Cir. 2012); *Sutherland v. Ernst & Young LLP*, 847 F. Supp. 2d 528, 537 (S.D.N.Y. 2012); *Franco v. Arakelian Enters., Inc.*, 211 Cal. App. 4th 314, 370 (Cal. Ct. App. 2012)). The SJC also acknowledged, with little discussion, a contrary line of authority, largely in the Third Circuit, that has concluded that *Concepcion* prohibits a court from invalidating a class waiver provision in an arbitration agreement even where every indication points to claims being nonremediable in the absence of class proceedings. See id., at *17 (citing *Quillon v. Tenet HealthSystem Philadelphia, Inc.*, 673 F.3d 221, 232 (3d Cir. 2012), and collecting other similar cases).[3]

After finding the ability to invalidate an arbitration agreement under the vindication of statutory rights doctrine on a factually specific basis, the SJC concluded that Dell's arbitration agreement, which stood "in stark contrast to the AT&T agreement in Conception," *Feeney II*, 2013 WL 2479603, at *22, met that burden by rendering the plaintiffs' claims nonremediable. The Dell agreement provided no pro-consumer incentives to arbitrate, and simply required arbitration of all disputes, even those that would not (in the SJC's view) possibly justify the expense in light of the amount in controversy. In addition, Dell's arbitration clause did not permit a consumer to bring qualifying claims in small claims court in lieu of arbitration. These factors meant, according to the court, that there was no realistic individual claim arbitration process that the FAA could promote and that the arbitration clause effectively precluded relief for many individual plaintiffs.

Feeney II faces additional preemption issue

The vindication of statutory rights doctrine is essentially the same argument accepted by the United States Court of Appeals for the Second Circuit in *In re Am. Express Merchants' Litig.*, 667 F.3d 204 (2d Cir. 2011) (*Amex III*), cert. granted, 133 S. Ct. 594 (2012). A decision may be issued any day now in

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[2] Similarly, according to the SJC, the Supreme Court struck down the *Discover Bank* rule because it categorically invalidated class action waivers without regard to whether a consumer could viably resolve her claims through individual arbitration.

[3] The SJC also completely ignored decisions in other states—issued well before *Concepcion*—that held that their state policies (also expressed in strong consumer-protection acts) freely permit class action waivers. See, e.g., *Ranieri v. Bell Atl. Mobile,* 759 N.Y.S.2d 448, 449 (N.Y App. Div. 2003) (collecting cases).

that case. (See prior alert, U.S. Supreme Court will hear landmark class action waiver case*: American Express Co. v. Italian Colors Restaurant*, dated November 19, 2012). But even assuming the United States Supreme Court were to invalidate the class action waiver in that case on a theory of vindication of statutory rights, that might not protect the *Feeney II* decision. The plaintiffs' argument in *Amex III* is premised on the vindication of federal rights, as are the other United States Supreme Court precedents to which the SJC looked for guidance in *Feeney II*. The United States Supreme Court has never clearly held that FAA preemption can be defeated for purposes of vindicating a *state* statutory claim, and, given the import of the Supremacy Clause of the United States Constitution, there is good reason to believe the vindication-of-rights analysis will be different in the context of a state law claim. See *Kilgore v. KeyBank Nat'l Ass'n*, 673 F.3d 947, 961 (2012), aff'd on rehearing on other grounds, Nos. 09-16703, 10-15934 (9th Cir. 2013) (en banc); *Orman v. Citigroup, Inc.*, No. 11-CV-7086, 2012 WL 4039850 (S.D.N.Y. 2012).

In analyzing the state law issue, the SJC held that the FAA would not conflict with a state court's invalidation of an arbitration provision on the grounds that, if enforced, the clause would deny a consumer any remedy. It acknowledged, however, that other courts have rejected this argument with respect to claims based on state statutes. See *Feeney II*, 2013 WL 2479603, at *14–15 (collecting cases). But, according to the SJC, these decisions "miss[] the point" because the real issue is whether a state court's invalidation of an arbitration agreement that effectively precludes consumers from obtaining a remedy to which they are lawfully entitled "stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress." Id. at *15 (quoting *Concepcion,* 131 S. Ct. at 1753).

Looking ahead: Consumer-facing businesses and employers should continue to provide "consumer-friendly" incentives to arbitrate

Feeney II presents another example of the continuing complexity courts and parties face in trying to define the scope of FAA preemption and the FAA Savings Clause, even after *Concepcion*. Although the Supreme Court's decision in *Amex III* is likely to bring some clarity—particularly with regard to whether the vindication of statutory rights doctrine can be applied to invalidate class action waivers—the additional question highlighted in *Feeney II* as to whether that doctrine applies to purely state law claims will likely remain open. The *Feeney II* decision (and the impending decision in *Amex III*) adds further incentive for companies to review their arbitration agreements with consumers and employees. The nearly constant developments in this area of the law require vigilance. Moreover, as *Feeney II* highlights, despite the efforts of Congress and the Supreme Court to bring uniformity to the treatment of arbitration agreements, divergences between jurisdictions stubbornly persist. Companies with a presence in multiple states must be aware that different rules of construction may apply to their arbitration clauses depending upon where a dispute arises.

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- Update on the Kilgore Ninth Circuit appeal: California's public injunction exception escapes for another day, but the en banc court reads the exception to arbitration narrowly and rejects plaintiffs' attempt at artful pleading (April 16, 2013)
- U.S. Supreme Court tells Oklahoma state court that state law does not trump the Federal Arbitration Act: *Nitro-Lift Technologies, L.L.C. v. Howard* (November 29, 2012)
- U.S. Supreme Court will hear landmark class action waiver case: *American Express Co. v. Italian Colors Restaurant* (November 19, 2012)
- Ninth Circuit applies *Concepcion* to invalidate California's "public injunction" exception to arbitration and further upholds KeyBank's "opt-out" clause (March 12, 2012)
- U.S. Supreme Court upholds class action waivers in consumer contracts: *AT&T Mobility v. Concepcion* (April 27, 2011)