

THE AT&T ARBITRATION CLAUSE AS A REPLACEMENT FOR
CLASS ACTION

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Recently, the Supreme Court heard oral arguments in the suit between AT&T and Vincent and Liza Concepcion on whether the Federal Arbitration Act preempts California contract law.¹ This case raises a policy issue that will not necessarily be answered by the Supreme Court: the efficacy of the class action lawsuit. While the class action definitely serves a significant purpose, there are other methods of solving the problem it seeks to address. In fact, the very arbitration clause the Supreme Court of California struck down as unconscionable² can both serve the same function as a class action suit and do so in a manner that is arguably better for the consumer.

Class action suits serve two main functions. The class action allows plaintiffs to pursue a legal claim that they otherwise would not, and the class action provides incentives for companies to behave in socially desirable ways. The first of these functions, while ostensibly served, hardly carries weight in the world today.³ Moreover, most plaintiffs are oblivious of the lawsuit throughout the proceedings⁴ explaining low “opt-out” rates for class actions,⁵ low opt-in rates

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¹ Transcript of Oral Argument, *AT&T Mobility LLC v. Concepcion*, 131 S.Ct. 45 (2010) (NO. 09-893).

² *Sonic-Calabazas A, Inc. v. Moreno*, No. S174475, 2011 WL 651877 (Cal.).

³ Class members are frequently “awarded” coupons or discounts to purchase more products from the defendant. See Martin H. Redish, *Class Action and the Democratic Difficulty: Rethinking the Intersection of Private Litigation and Public Goals*, 2003 U. CHI. LEGAL F. 71, 74 (2003).

⁴ Tiana Leia Russell, *Exporting Class Actions to the European Union*, 28 B.U. INT'L L.J. 141, 160 (2010); But see Charles S. Hwang, *More from the Respondents' Side: AT&T Mobility Views on Arbitration Fairness and FAA Preemption*, 29 ALTERNATIVES TO HIGH COST LITIG. 11, 13 (2011) (“[W]ithout the opportunity for class action, most of the class members would be unaware that their rights had been violated.”).

⁵ See Theodore Eisenberg & Geoffrey Miller, *The Role of Opt-Outs and Objectors in Class Action Litigation:*

for collective actions⁶, and large funds of unclaimed awards.⁷ Even if a plaintiff is aware, he may not choose to participate in the process because the process is annoying, confusing, and the average American does not care to fill out forms to receive a check for \$8.95 or a buy-one-get-one-free coupon to a franchised store.

The most important function of the class action procedure, then, is that it polices company behavior.⁸ Many large companies could increase revenues substantially by simply raising fees by a few dollars. However, companies are weary of raising or introducing new, unwarranted fees, not because customers will complain, but because an entrepreneurial lawyer may get wind of the increase and sue on the behalf of affected customers *en masse*.⁹ While the class action procedure can provide disincentives for corporate malfeasance,¹⁰ it does not fully solve this problem, as some suits may not be lucrative enough for class

Theoretical and Empirical Issues, 57 VAND. L. REV. 1529, 1549 (2004) (Providing a table showing the percentage of opt-outs per type of class action suit).

⁶ See Mathew W. Lampe & E. Michael Rossman, *Procedural Approaches for Countering Dual Filed FLSA Collective Action and State-Law Wage Class Action*, 20 LAB. LAW 311 (2005) (explaining that the typical opt-in rate in FLSA collective actions is only 15-30%).

⁷ See Redish, *Supra* note 3 at 74, 85 (explaining the paradox by allowing plaintiffs to passively join a lawsuit and expecting them to affirmatively claim the award); See also Martin H. Redish, Peter Julian & Samantha Zyontz, *Cy Pres Relief And The Pathologies Of The Modern Class Action: A Normative And Empirical Analysis*, 62 FLA. L. REV. 617 (discussing the increasing numbers of cy pres class actions); See also *In re Folding Carton Antitrust Litig.*, 557 F. Supp. 1091, 1104 (N.D. Ill. 1983) ("In virtually every class action, there remains a reserve fund after all claims and expenses have been paid.").

⁸ See Stephen Meili, *Collective Justice or Personal Gain? An Empirical Analysis of Consumer Class Action Lawyers and Named Plaintiffs*, 44 AKRON L. REV. 67, 127 (2011) ("This view is consistent with that of several named plaintiffs who saw their case as an opportunity to change the behavior of companies throughout a particular industry. These comments also reflect a more general confidence in the class action as the only way to reign in corporate excesses. Other attorneys sounded the same theme . . .").

⁹ See Alexander J. Casey, *Arbitration Nation: Wireless Services Providers and Class Action Waivers*, 6 WASH. J. L. TECH. & ARTS 15, 16 (2010) ("Class action suits . . . have long defended the public from questionable business practices."); *C.f.* *Credit Card Customers May Maintain Class Action under the FACTA*, 14 J. CONSUMER & COM. L. 103, 103-04 (2011) (discussing how class action lawsuits of identity theft victims discourage companies from releasing private consumer data, even when no harm results); John Armour, Jack B. Jacobs, & Curtis J. Milhaupt, *The Evolution of Hostile Takeover Regimes in Developed and Emerging Markets: An Analytical Framework*, 52 HARV. INT'L L.J. 219, 262 (2011) (mentioning how U.K. courts have much less control over corporate actions, largely because of the barriers those courts place on bringing class action lawsuits); *but see* Marvin Lowenthal, *Revitalizing Motive and Opportunity Pleading after Tellabs*, 109 MICH. L. REV. 625, 629 (2011) (noting the possibility that if companies are threatened with a class action every time they release negative information to investors, they may stop making voluntary disclosures).

¹⁰ *Supra* note 2.

action lawyers to litigate.¹¹

Public regulation within a given industry can provide another option for protecting consumers from corporate malfeasance.¹² Indeed, this is the paradigmatic European approach.¹³ A consumer regulatory agency could be employed to comb the market for businesses engaging in illegal behavior, thus displacing the exact role class action lawyers currently play. One could question the effectiveness of such governmental agencies, as class action lawyers currently have no trouble finding work,¹⁴ despite the existence of such agencies.¹⁵ This is not to say, however, that such agencies do not play an

¹¹ For example, consider any lawsuit seeking a declaratory judgment or an injunction. Kimberly Breedon, *Toward a Cumulative Effects Doctrine in First Amendment Jurisprudence*, 54 LOY. L. REV. 855, 904 n.57 (2008); See Mark M. Leitner & Joseph S. Goode, *Class Action Prohibitions and the Effect of Contract Rules on the Collective Pursuit of Common Claims*, 30-WTR FRANCHISE L.J. 166, 172 (2011) (noting that the costs of representing claimants and the potential payout is the main analysis that determines whether attorneys will take a case); C.f. Charles S. Hwang, *More from the Respondents' Side: AT&T Mobility Views on Arbitration Fairness and FAA Preemption*, 29 ALTERNATIVES TO HIGH COST LITIG. 11, 13 (2011) (noting that, even if the consumer was willing to pay for the litigation, attorneys would find it unethical to take a case where the costs of litigation exceeded the potential award); but see Kenneth W. Dam, *Class Actions: Efficiency, Compensation, Deterrence, and Conflict of Interest*, 4 J. LEGAL STUD. 47, 49 (1975) (“A key feature of the class action is that it holds the potential for making feasible the compensation of the victims of mass wrongs even though each victim has a loss that is too small to justify an individual action.”).

¹² See, e.g., Leo Donatucci, *Federal Regulation of the Insurance Industry: One for All And All for Who? How Federal Regulation Would Help The Industry Into The New Millennium*, 7 RUTGERS J. L. & PUB. POL'Y 398 (2010); Andrew S. Robertson, *Taking Responsibility: Regulations and Protections in Direct-to-Consumer Genetic Testing*, 24 BERKELEY TECH. L.J. 213 (2009); Nancy J. King, *When Mobile Phones Are RFID-Equipped--Finding E.U.-U.S. Solutions To Protect Consumer Privacy And Facilitate Mobile Commerce*, 15 MICH. TELECOMM. & TECH. L. REV. 107 (2008).

¹³ See Richard A. Nagareda, *Aggregate Litigation Across the Atlantic and the Future of American Exceptionalism*, 62 VAND. L. REV. 1, 2-10 (2009) (noting that Europe relies upon “robust beurocratic administration by public regulatory bodies” and receptiveness to aggregate litigation stops short of an embrace of U.S.-style class actions). But see Rhonda Wasserman, *Transnational Class Actions and Interjurisdictional Preclusion* (University of Pittsburg Law Sch, Kegak Studies Research Paper Series, Working Paper No. 2010-04, 2010) (Discussing the European trend of allowing more aggregate claims).

¹⁴ See Nan S. Ellis, *The Class Action Fairness Act of 2005: The Story Behind the Statute*, 35 J. LEGIS. 76, 112 (2009) (noting the increasing numbers of class action lawsuits filed each year); Edward F. Sherman, *Group Litigation Under Foreign Legal Systems: Variations and Alternatives to American Class Actions*, 52 DEPAUL L. REV. 401, 401-03 (2002) (noting the significantly higher rate of class actions filed in the United States compared to other countries); C.f. Redish, Julian, & Zyontz, *supra* note 7 (discussing the increasing number of cy pres class actions).

¹⁵ Hailyn Chen, *Attorneys' Fees and Reversionary Fund Settlements in Small Claims Consumer Class Actions*, 50 UCLA L. REV. 879, 894 (2003) (“Consumer fraud is a major problem, for which government regulation may provide an inadequate deterrent. . . . [C]lass actions may be the only way to call attention to such illegal

important role, even if their ability to provide an alternative to the class action procedure is limited.¹⁶

The Federal Trade Commission (FTC), for example, initiates its own investigations and investigates complaints by consumers.¹⁷ Unfortunately, the FTC, which is fettered with red tape and limited by a narrow mandate, is hardly in the position to fill the potential void that removing class actions would leave.¹⁸ However, class action lawyers, who are relatively unencumbered by bureaucratic issues, are only motivated to fulfill their function in profitable capacities.¹⁹ Therefore a crucial role for the government to play is to take up the causes that the private sector ignores.

There is perhaps an alternative to this division of labor, and its latest manifestation lies at the heart of the case at hand. The arbitration clause AT&T has included in its contracts, which California subsequently ruled as

profitmaking.”)

¹⁶ Douglas G. Smith, *The Intersection of Constitutional Law and Civil Procedure: Review of Wholesale Justice: Constitutional Democracy and the Problem of the Class Action Lawsuit (Part I)*, 104 NW. U. L. REV. 775, 785 n.41 (2010) (noting that many class actions are based on prior government regulatory action).

¹⁷ Federal Trade Commission Act, 15 U.S.C. §§ 46, 57b-1 (2006).

¹⁸ See Jeff Govern, *Private Actions Under The Deceptive Trade Practices Acts: Reconsidering The Ftc Act As Rule Model*, 52 OHIO ST. L.J. 437, 442 (1991) (stating that scarce resources and the Federal Trade Commission Act itself limits the number of worthwhile cases the FTC can bring); See, e.g., Lauren A. Matecki, *Update: COPPA is Ineffective Legislation! Next Steps for Protecting Youth Privacy Rights in the Social Networking Era*, 5 NW J. L. & SOC. POL'Y 369 (2010) (describing the FTC's ineffectiveness in protecting minors from inappropriate Web sites); Robert Sprague & Mary Ellen Wells, *Regulating Online Buzz Marketing: Untangling a Web of Deceit*, 47 AM. BUS. L.J. 415 (2010) (discussing the FTC's problems with regulating online word-of-mouth marketing); Renee Newman Knake, *From Research Conclusions to Real Change: Understanding the First Amendment's (Non)Response to the Negative Effects of Media on Children by Looking to The Example of Violent Video Game Regulations*, 63 SMU L. REV. 1197 (2010) (discussing the ineffective response the FTC has made toward protecting children from violent video games); Kelly Crandall, *Trust and the Green Consumer: The Fight for Accountability in Renewable Energy Credits*, 81 U. COLO. L. REV. 893, 952 (2010) (describing the FTC as “an ineffective, extemporaneous system” in relation to its regulation of green power marketers); C.f. Dennis D. Hirsch, *The Law and Policy of Online Privacy: Regulation, Self-Regulation, or Co-Regulation?*, 34 SEATTLE U. L. REV. 439, 462 (2011) (noting that the effectiveness of FTC regulations are limited by consumer behavior).

¹⁹ Kimberly Breedon, *Toward a Cumulative Effects Doctrine in First Amendment Jurisprudence*, 54 LOY. L. REV. 855, 904 n.57 (2008); See Mark M. Leitner & Joseph S. Goode, *Class Action Prohibitions and the Effect of Contract Rules on the Collective Pursuit of Common Claims*, 30-WTR FRANCHISE L.J. 166, 172 (2011) (noting that the costs of representing claimants and the potential payout is the main analysis that determines whether attorneys will take a case); C.f. Charles S. Hwang, *More from the Respondents' Side: AT&T Mobility Views on Arbitration Fairness and FAA Preemption*, 29 ALTERNATIVES TO HIGH COST LITIG. 11, 13 (2011) (noting that, even if the consumer were willing to pay for the litigation, attorneys would find it unethical to take a case where the costs of litigation exceeded the potential award).

unconscionable,²⁰ may be an attempt at a more efficient self-policing. Within the clause, if a customer has a dispute with AT&T, the customer can attempt to informally settle it with AT&T.²¹ If the dispute is not resolved, then a binding arbitration with a third party adjudicator, paid for by AT&T, will occur.²² The customer can choose to have the arbitration done over the telephone to save time and avoid inconvenience.²³ AT&T further includes as a clause that if the arbitrator awards the customer more than the value of the settlement offered by AT&T, then AT&T will pay the customer \$7,500.²⁴ This provides AT&T with a strong incentive to take its customers' complaints seriously. In a previous case, one California judge called AT&T's arbitration clause one of, "the most fair . . . this Court has ever seen."²⁵

The point at issue with AT&T's arbitration clause arises from the fact that AT&T forces the customer to waive his right to a class action lawsuit.²⁶ California rules that such a waiver in an adhesion contract is unconscionable.²⁷ The California Court of Appeals made a similar ruling of unconscionability in *Gatton v. T-Mobile USA, Inc.*²⁸ Whereas the AT&T clause provided for free arbitration and the \$7,500 safeguard, the T-Mobile clause in *Gatton* forced consumers to pay at least \$25 in arbitration costs and provided no safeguards.²⁹ The T-Mobile clause would have allowed T-Mobile to unwarrantedly hike fees for consumers up to \$24.99 before a consumer would have had an economic motivation to initiate arbitration.

At the oral arguments for *AT&T v. Concepcion*, Justice Scalia seemed to take issue with overruling a state's right to find certain contracts unconscionable.³⁰

²⁰ *Laster v. AT&T Mobility LLC*, 584 F.3d 849, 853 (9th Cir. 2009), cert. granted sub nom. *AT&T Mobility LLC v. Concepcion*, 130 S.Ct. 3322 (2010).

²¹ See *id.* at 856.

²² *Id.*

²³ *Id.*

²⁴ *Id.* at 855.

²⁵ *Makarowski v. AT&T Mobility LLC*, No. CV 09-1590-GAF, 2009 WL 1765661, at *3 (C.D. Cal. June 18, 2009).

²⁶ See *Laster*, 584 F.3d at 853.

²⁷ *Id.* at 855. See *Discover Bank v. Superior Court*, 36 Cal. 4th 148, 160-63 (2005) for the reasoning behind holding such clauses unconscionable.

²⁸ 152 Cal. App. 4th 571, 586-88 (2007).

²⁹ *Id.* at 576.

³⁰ *AT&T Mobility LLC*, supra note 1.

However, AT&T may not have to change California law to implement such an arbitration clause and class action waiver. In *Gatton*, the court found that for an arbitration clause to be unconscionable, it must be both procedurally and substantively unconscionable.³¹ The Court found the adhesion contract barely procedurally unconscionable, noting that only having a couple of alternate options within the market did not allow a consumer a sufficient option in choosing between contracts.³² AT&T may be able to offer a product or service with a discount for waiving the right to a class action. For example, AT&T could offer a product for \$X and offer the same product for \$X - \$5 with a class action waiver. California may accept such a waiver as valid because it is somewhat bargained for. Giving a consumer a choice, not just between market competitors, but also within the company itself, may allow California to find such a clause procedurally conscionable.

With such a clause, not only would the usual purpose of including arbitration clauses be served, in that companies would save money, but the customer would also receive something in return for waiving his rights to a class action. As long as the discount AT&T provides is less than the total reduction in its costs, it still has an incentive to include the arbitration clause. Thus, these clauses would allow a customer to share in the benefits of the reduction in litigation costs, reduce inefficiencies in the economy, and be more reflective of real negotiation.

AT&T's clause seems to fulfill the first justification for class actions in that it preserves the incentives for otherwise uneconomic claims to be adjudicated. Still, there is the concern that the arbitration clause is nothing more than an attempt to eliminate the threat of class actions. California and other states may be wary about such a clause's ability to provide incentives to companies to adjust their behavior.

Such a concern may not be entirely warranted. AT&T has, literally, millions of customers. There is a strong likelihood that if AT&T initiates a business practice that is unfair, at least one customer will be sufficiently upset to inform his fellow AT&T users. It will only take one person to send out a mass e-mail, write a blog post, inform some watchdog organization, or notify CNN.

³¹ *Gatton v. T-Mobile USA, Inc.*, 61 Cal. Rptr. 3d 344 at 350 (2007).

³² *Id.* at 356.

Assuming that telephone arbitration is only a phone call away and is as easily accessible as a company's help hotline, a consumer's typical lethargy may be overcome, as any consumer could initiate arbitration by dialing the number appearing on the TV screen, without having to get off of the couch. If this is the case, then there is a fair chance that a sufficient number of people might initiate arbitration to provide an incentive for AT&T to change its business practices. It is true that the arbitration rate will most assuredly be lower than the non-opt-out rate for class actions, however, from a purely cost-benefit perspective, the cost of phone arbitration combined with potential arbitral awards for thousands may outweigh the benefits a company could potentially gain through unfair business practices. This approach facilitates self-regulation; at the very least before condemning such an approach, courts could see how many people actually opt for arbitration.

Additionally, AT&T's arbitration clause provides a positive externality in that it enables punitive feedback. An action by the company that fails to trigger a class action suit may sufficiently upset customers to file mass applications for arbitration.³³ Even if they do not win the suit, the cost of providing arbitration for a mass of customers may cause AT&T to rethink its practice. Such a mechanism can provide a company with the immediate feedback that other mechanisms are incapable of providing.

There are obvious downsides to such an approach. Arbitrators may have inconsistent verdicts or award inconsistent amounts of damages.³⁴ Moreover, the arbitration process may be prohibitively complex or the consumer may be sufficiently lazy to avoid initiating the arbitration process; allowing for telephone arbitration attempts to counter this concern, but its efficacy is untested. In any case, even if such downsides are completely eliminated, they remain moot unless California and other states allow for such arbitration clauses to exist.

Both of the primary functions of the class action lawsuit can theoretically be met with AT&T's arbitration clause. Despite the potential of allowing companies to self-regulate with arbitration clauses, it is unlikely that contractual damage

³³ Thomas W.H. Barlow, *Arbitration: The Enforceability of Class Action Waivers in Arbitration Clauses*, 2009 J. DISP. RESOL. 31.

³⁴ Shelley McGill, *Consumer Arbitration Clause Enforcement: A Balanced Legislative Response*, 47 AM. BUS. L.J. 361.

class action suits will be replaced. However, the Supreme Court's ruling on the AT&T case in 2011 will provide a glimpse into the future of self-regulation through arbitration clauses.