



Class Actions and Derivative Suits

FROM THE SECTION OF LITIGATION CLASS ACTIONS AND DERIVATIVE SUITS COMMITTEE

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ARTICLES

The End of Federal Injunctions of State Certification?

By Stuart M. Feinblatt – November 21, 2011

Undoubtedly, one of the most challenging aspects of management in class-action litigation is when multiple, overlapping, competing class actions relating to essentially the same conduct or activities are all filed in state and federal court. In particular, when a hard-fought federal class-action, national in scope, results in a determination that a class cannot be certified, what effect should that ruling have on other pending and related class actions in which the class-certification decision has not yet been reached? Certainly, overlapping class actions can create several forms of mischief. For example, the ABA Task Force on Class Action Legislation noted in 2003 that “[s]uch overlapping class actions consume unnecessary litigation resources, encourage ‘gaming’ of court filings, and risk inconsistent treatment of like cases.”

One potential solution is to allow the first court to reach a class-certification decision to enjoin other courts from addressing the same issue in related cases. The propriety of such an injunction is particularly vexing when a federal court seeks to enjoin a parallel proceeding in a state court. This issue was recently addressed by the U.S. Supreme Court in *Smith v. Bayer Corp.*, 131 S. Ct. 2368 (2011).

The *Smith v. Bayer* Ruling

The parallel class actions at issue in *Smith v. Bayer* involved claims by West Virginia residents that they had been injured because of their use of Bayer’s anticholesterol medication, Baycol. Two similar putative class actions were brought by plaintiffs in West Virginia state court. One, brought by George McCollins, was removed to the U.S. District Court for the Southern District of West Virginia on the basis of diversity jurisdiction. The other case, brought by Keith Smith and others, remained in state court. The federal trial court assigned to manage multidistrict litigation over Baycol, including McCollins’s class action, reached the class-certification issue first. The court denied class certification on the plaintiffs’ economic loss claims, finding that individual issues of fact predominated over issues common to all members of the proposed class because each plaintiff would have to prove either actual injury from his or her use of Baycol or that the drug did not provide any health benefits to recover, and that such showings would necessarily vary from plaintiff to plaintiff. The district court also later dismissed McCollins’s claims on the merits.

Following this ruling, Bayer asked the district court to enjoin a West Virginia state court from considering a class-certification motion in the parallel economic loss class action that had been brought by Keith Smith. Bayer asserted that an injunction order was necessary to protect the district court’s judgment in the McCollins case denying class certification. The district court agreed and granted the injunction. The Eighth Circuit affirmed, finding that the “re-litigation”



exception to the Anti-Injunction Act, 28 U.S.C. § 2283, authorized the injunction because basic rules of issue preclusion barred Smith from seeking the certification of his proposed class. *In re Baycol Products Litig.*, 593 F.3d 716 (8th Cir. 2010).

In her unanimous opinion reversing the Eighth Circuit's decision, Justice Kagan noted that the Supreme Court granted certiorari because the order below implicated two circuit splits on two key issues relating to the application of the Anti-Injunction Act's re-litigation exception: whether the federal-court decision addressed the "same issue" as the one presented in the state tribunal and the extent to which the re-litigation exception can bind nonparties, such as Smith, who bring state-court actions and were merely non-named putative class members in the federal case.

Justice Kagan found that the Eighth Circuit incorrectly addressed both of these issues when it considered whether an injunction was appropriate. In so ruling, the Court noted that the Anti-Injunction Act generally precludes a federal court from enjoining a state-court proceeding, given that the act's "core message is one of respect for state courts." *Smith*, 131 S. Ct. at 2375. The Court further observed that the re-litigation exception, which essentially allows injunctions of state-court proceedings to protect the integrity of federal-court judgments and rulings, is designed to implement concepts of claim and issue preclusion. Given that this exception should be employed only in narrow circumstances and that it deviates from the general rule that a court cannot dictate to other courts the preclusive effect of its own judgment, the Court described the issuance of an injunction under the re-litigation exception as "resorting to heavy artillery." *Id.* at 2376. By couching the propriety of a state-court injunction in this restrictive way, it is not surprising that the Court ultimately reversed the issuance of the injunction.

On the first issue of whether the federal court decided the same issue as the one presented to the state tribunal, the Court first noted that the Eighth Circuit correctly found that both the federal court and the State of West Virginia use essentially the same rules for determining whether a class action should be certified. But that was only the beginning of the inquiry. In addition, it must be determined whether the federal and state courts *apply* the essentially identically worded procedural provisions in the same or different ways. Here, the highest court found that the West Virginia Supreme Court has made it quite clear that it does not apply West Virginia's equivalent of Federal Rule 23 in the same way that the federal courts do. In particular, the West Virginia Supreme Court has disapproved the federal courts' approach to the predominance requirement of Rule 23(b)(3) by adopting an all-things-considered balancing test, rather than the federal approach, which holds that the presence of a single individualized issue prevents class certification. In short, given the different methods of applying the legal standard for class certification, the Court concluded that the West Virginia state court would effectively be deciding a different question than the one the federal court had resolved previously.

Arguably, the Court applied an even more stringent standard on the second issue of whether the first federal-court ruling could ever bind nonparties in the class-action context. The Court began its analysis by noting that a judgment typically binds only the parties to the suit subject to a handful of limited exceptions. Bayer unsuccessfully tried to argue that the district court's

judgment bound Smith under the recognized exception that an unnamed member of a certified class may be considered a “party” for certain purposes. The Court flatly rejected this argument, noting that it would make no sense to treat Smith as a party to the federal lawsuit once certification was denied. From the Court’s perspective, the definition of a “party” “can on no account be stretched so far as to cover a person like Smith, whom the plaintiff in a lawsuit was denied leave to represent.” *Smith*, 131 S. Ct. at 2379. The Court acknowledged that its ruling would potentially enable class counsel to repeatedly try to certify the same class by simply changing the named plaintiff in the next class action, but the Court noted that such problems are generally resolved by employing principles of issue preclusion and stare decisis rather than binding and enjoining nonparties to an earlier judgment.

Are State-Court Injunctions History?

Undoubtedly, Justice Kagan took a strict view as to when a federal court can apply the re-litigation exception. In particular, the Court’s determination that a federal-court judgment can apparently never bind an unnamed member of a putative class denied certification in federal court suggests that, as a practical matter, federal courts are never authorized to enjoin state-court class-action proceedings, at least under the re-litigation exception. This is so for a simple reason. Class counsel in the state-court action can prevent an injunction simply by substituting the named plaintiff from the federal court with another member of the proposed class.

How Can a Successful Defendant Guard Against Repeated Litigation?

Assuming a defendant, following a victory in federal court over class certification, is effectively precluded from seeking an injunction of similar certification proceedings in state court, what other steps can the defendant take to prevent repeated efforts to pursue class certification on the same issue? The Court itself suggested some possible solutions. First, the Court noted that “our legal system generally relies on principles of *stare decisis* and comity among courts to mitigate the sometimes substantial costs of similar litigation brought by different plaintiffs.” *Smith*, 131 S. Ct. at 2381. This solution appears to be small solace for a defendant confronted with continuing and harassing efforts to certify the same issues, particularly when it is possible that one state court will simply ignore what the federal courts and the majority of state courts have done with the same issue. *See, e.g., In re Bridgestone/Firestone, Inc., Tires Prods. Liab. Litig.*, 333 F. 3d 763, 766–67 (7th Cir. 2003) (observing that multiple state class-action proceedings covering the same issues mathematically will likely result in at least one class certification victory for the plaintiffs that “trumps all the negatives”).

Second, the Court suggested that the Class Action Fairness Act (CAFA), with its relaxed rules for removal to federal court of any sizable class action involving a minimal diversity of citizenship, might protect aggrieved litigants. (CAFA was not in effect when the *Smith* state-court case was initiated.) This may be a source of protection, provided that plaintiffs’ counsel are not able to circumvent CAFA’s relaxed requirements (for example, presenting the case as coming in just below the \$5 million minimum threshold requirement).



Another possible solution is to seek an injunction based on another federal statute. The natural candidate that comes to mind is the All Writs Act, 28 U.S.C. § 1651(a). This act, which allows federal courts to issue “all writs necessary or appropriate in aid of their respective jurisdictions,” has been construed as authorizing an injunction, like under the Anti-Injunction Act, to enforce federal judgments and to reinforce the effects of the doctrines of res judicata and collateral estoppel. *See, e.g., Charlton v. Estate of Charlton*, 841 F. 2d 988 (9th Cir. 1988). One of the most interesting decisions in recent years addressing the use of the All Writs Act in the class-certification context was authored by Judge Richard Posner in *Thorogood v. Sears, Roebuck & Co.*, 624 F. 3d 842 (7th Cir. 2010). *See* Dawn Goulet and Amy Keller, “[Preemptive Collateral Estoppel Blocks Consumer Class Actions in Thorogood](#)” [PDF] *CADS Report*, Winter 2011, Vol. 21, No. 2, at 1. Although it can be argued that the *Thorogood* court took an expansive view of the All Writs Act, Judge Posner recognized that the ability of a federal court to enjoin copycat class-action suits in state court would be affected by the not-yet-decided U.S. Supreme Court decision in *Smith v. Bayer*. Indeed, one must wonder whether, in the wake of the *Smith v. Bayer* decision, a federal court can ever enjoin any other state or federal class-action proceeding under the All Writs Act, except when the named parties to the proceedings are the same. After all, the authority of the All Writs Act to enjoin other class-certification proceedings is essentially bottomed on the same principles of res judicata and collateral estoppel utilized under the Anti-Injunction Act’s re-litigation exception.

As suggested by the U.S. Supreme Court itself in its *Smith* opinion, it is possible that Congress could enact legislation, such as a modification to CAFA, to modify current principles of issue preclusion, “should Congress decide that CAFA does not sufficiently prevent re-litigation of class certification motions.” *Smith*, 131 S. Ct. at 2375 at n.12. A potential change to the Federal Rules of Civil Procedure pertaining to class certification is also possible. In light of the strictness of the *Smith* decision and its effective foreclosure of future injunctions of state class-action proceedings, it is probable that interested parties will seek to persuade Congress to amend the class-action legislation.

Keywords: litigation, class actions, derivative suits, class certification, *Smith v. Bayer*, injunction

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What You Need to Know about *Wal-Mart v. Dukes*

By Stephen G. Harvey and Angelo A. Stio III – November 21, 2011

In July 2011, the Supreme Court issued its much-anticipated decision in *Wal-Mart Stores, Inc. v. Dukes*, 131 S. Ct. 2541 (2011). In a highly technical decision, the Court held that “one of the most expansive class actions ever,” consisting of 1.5 million female Wal-Mart employees, could

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not be certified as a class action. All nine justices agreed that the class could not recover back pay under Federal Rule of Civil Procedure 23(b)(2), which applies only to declaratory and injunctive relief. A five-justice majority led by Justice Scalia went a step further and held that the class could not even meet Rule 23(a)'s requirement that there be "questions of law or fact common to the class." The *Wal-Mart* decision is regarded by both supporters and detractors as "momentous." "Supreme Court Tightens Rules in Class Actions," *New York Times*, New York ed. June 20, 2011, at A1.

The Claims at Issue in *Wal-Mart*

Wal-Mart involved a class brought on behalf of 1.5 million female Wal-Mart employees who were allegedly subject to unlawful discrimination in violation of Title VII based on subjective pay and promotion decisions. Specifically, the plaintiffs claimed that pay and promotion decisions at Wal-Mart are generally committed to local managers' broad discretion, which is exercised disproportionately in favor of men, leading to an unlawful disparate impact on female employees. They also claimed that Wal-Mart's failure to control management's subjective decision-making amounts to disparate treatment in violation of Title VII of the Civil Rights Act of 1964. The plaintiffs sought to certify a class consisting of current and former female Wal-Mart employees who held positions ranging from part-time, entry-level hourly employees to salaried managers. For relief, plaintiffs sought, among other things, back pay. They did not seek compensatory damages.

Background of the *Wal-Mart* Issues

One of the recognized means of proving unlawful discrimination under Title VII is by proving that the defendant has a policy or a practice that, while facially neutral, in fact has a disparate statistical impact such that members of the protected class are treated differently and worse than other employees. The plaintiff in a disparate impact case has the burden of isolating a specific policy or practice and proving that it causes a statistical disparity. In some cases, however, plaintiffs have prevailed on a theory that the policy or practice that caused the statistical disparity is one of delegating unfettered discretions to managers to make employment decisions. The courts accepted the argument, including the Supreme Court in *Watson v. Ft. Worth Bank & Trust*, 487 U.S. 977, 991 (1988) ("subjective or discretionary employment practices may be analyzed under the disparate impact approach in appropriate cases."). See also *Wards Cove Packing Co. v. Antonio*, 490 U.S. 642, 657 (1989). This theory of recovery was also accepted outside the context of Title VII, such as in cases involving alleged lending discrimination in violation of the Equal Credit Opportunity Act.

During this same period, the courts struggled with another class-action issue that arose in the employment context but manifested in other areas of the law—the extent to which plaintiffs could recover monetary relief under Rule 23(b)(2). Rule 23(b)(2) applies where "injunctive relief or corresponding declaratory relief is appropriate respecting the class as a whole." It does not require that class members receive notice of the class action or the right to opt out of the class. Rule 23(b)(3) applies to claims for money damages. It requires notice and the right to opt out. It

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has some other exacting requirements, including proof that the common issues “predominate over any questions affecting only individual members” and that a class action would be “superior to other available methods for fairly and efficiently adjudicating the controversy.”

Perceiving the difficulty of establishing the right to proceed under Rule 23(b)(3), class plaintiffs who wish to receive some form of monetary compensation attempted to squeeze their request for class certification into Rule 23(b)(2). The issue arose most often in cases involving requests for back pay under Title VII, and various federal courts of appeals applying different rationales accepted the argument that back pay could be awarded as class relief under Rule 23(b)(2). *See, e.g., Robinson v. Metro-North Commuter R.R. Co.*, 267 F.3d 147, 164 (2d Cir. 2001); *Allison v. Citgo Petroleum Corp.*, 151 F.3d 402, 415 (5th Cir. 1998). Other circuits disagreed, and the split between the circuits on this issue led to the grant of certiorari in *Wal-Mart*.

The *Wal-Mart* Decision

In the part of the decision joined by five justices, Justice Scalia noted that the commonality requirement under Rule 23(a) is the “crux of this case.” He had this to say about proving that there are “questions of law or fact common to the class”:

Quite obviously, the mere claim by employees of the same company that they have suffered a Title VII injury, or even a disparate-impact Title VII injury, gives no cause to believe that all their claims can productively be litigated at once. Their claims must depend upon a common contention—for example, the assertion of discriminatory bias on the part of the same supervisor. That common contention, moreover, must be of such a nature that it is capable of class-wide resolution—which means that determination of its truth or falsity will resolve an issue that is central to the validity of each one of the claims in one stroke.

He reinforced the point by noting that “[w]hat matters to class certification . . . is not the raising of common ‘questions’—even in droves—but, rather the capacity of a class-wide proceeding to generate common answers apt to drive the resolution of the litigation.”

The majority swept aside statistical evidence about pay and promotion disparities, anecdotal reports of discrimination, and the controversial testimony of a sociologist about Wal-Mart’s culture and personnel practices as basis for proof of a common discriminatory policy. The majority also made clear that the class-certification inquiry may involve an analysis of evidence relating to the merits of the case.

Unlike the 5–4 split on commonality, all nine justices agreed that the trial court improperly certified the class plaintiffs’ claims for back pay under Rule 23(b)(2). While the Court refused to reach the broader question of whether Rule 23(b)(2) applies only to claims of injunctive or declaratory relief and does not apply to monetary claims at all, Justice Scalia writing for the majority emphasized that, “at a minimum, claims for individualized [monetary] relief (like the back pay at issue here) do not satisfy the Rule.” He also noted that “Rule 23(b)(2) applies only

when a single injunction would provide relief to each member of the class. It does not authorize class certification when each individual class member would be entitled to a different injunction or declaratory judgment against the defendant. Similarly, it does not authorize class certification when each class member would be entitled to an individualized award of money damages.”

The dissent, written by Justice Ginsburg, defended the evidence that subjective delegation of personnel decisions could constitute a common discriminatory policy and noted that the “plaintiffs’ evidence, including class members’ tales of their own experience, suggests that gender bias suffused Wal-Mart’s company culture.” The dissent also criticized the majority for deciding the case under Rule 23(a) and suggested that the decision could have far-reaching implications and preclude certification of claims that are worthy of certification, such as claims for injunctive relief.

Implications of *Wal-Mart*

Wal-Mart is noteworthy not just because of the size of the class and the prominence of the defendant, but because it makes it more difficult to bring a large discrimination claim as a class action. The unfettered delegation theory, while it may state a claim for liability, can no longer serve as a basis for a class action. This is a big setback for class action plaintiffs.

But the expected impact of the decision does not end there. *Wal-Mart* will make it harder to obtain class certification in virtually all class actions. To begin with, the majority—in a footnote—explicitly rejected the oft-cited proposition that the Court’s decision in *Eisen v. Carlisle & Jacquelin*, 417 U.S. 156 (1974), precluded an examination of the merits at the class-certification stage. In stark contrast, the majority held that a district court must examine evidentiary issues that go to the merits of the case if their resolution is necessary to rule on class certification. The majority even suggested in passing that a district court may be able to exclude expert testimony at the class stage under *Daubert v. Merrell Dow Pharmaceuticals, Inc.* While some lower courts had previously embraced such an expansive view of the district court’s ability to weigh evidence on class certification, the majority’s opinion makes clear that this heightened evidentiary procedure will now be the practice throughout the country.

The aspect of the decision that has the biggest potential impact is the approach to commonality. The majority significantly increased the proof required to meet the requirement of Rule 23(a)(2) that “there are questions of law or fact common to the class.” In the past, many district courts had held that this requirement was satisfied if the plaintiff identified only one common issue in the case—an easy task in almost any case. Lawyers for companies facing class actions will surely seize on the language describing the commonality requirement mentioned above to argue in the future that each class member’s injury must have a common cause and that the dissimilarities between the claims are fatal to class certification. This approach not only heightens the plaintiffs’ burden, but arguably requires strict proof of causation of injury for class certification.

Last, but not least, the Court’s unanimous decision that back pay cannot be awarded under Rule 23(b)(2) all but kills class actions as a means to redress employment discrimination, even where



the class can prove a policy or practice of discrimination under Rule 23(b) (2). It is hard to think of any form of monetary relief that could be awarded under Rule 23(b)(2) as interpreted in *Wal-Mart*, with the possible exception of claims for statutory penalties, such as those available under some federal statutes (for example, the Fair Credit Reporting Act) and some state unfair and deceptive trade practices acts.

In all of these ways, *Wal-Mart* undercuts the advantages of the class action from the perspective of plaintiffs and their lawyers. For the same reasons, *Wal-Mart* represents a big victory for class-action defendants.

Keywords: litigation, class actions, derivative suits, commonality, discrimination

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Statistical Analysis and *Wal-Mart v. Dukes*

By Chip Hunter – November 21, 2011

To a practitioner in the field of economic analysis and econometrics, the most interesting part of the Supreme Court’s decision, and the part with the most impact on expert testimony, in *Wal-Mart v. Dukes* is the recognition of the plaintiffs’ failure to satisfy Rule 23(a)(2)—the requirement that states the party seeking class certification must demonstrate that the members of the class have common questions of law or fact. Although the statistical and economic approach proffered by the plaintiffs’ experts was similar to that in other cases that had been certified, the *Dukes* decision highlighted a fundamental disconnect between the plaintiffs’ theory of the case and the expert evidence they used to support it. The gap is the difference between presenting an analysis with conclusions that are consistent with a common question of law or fact and presenting an analysis that is evidence of a common question. The Court’s statement regarding the requirement for satisfying Rule 23(a) is as follows:

Rule 23 does not set forth a mere pleading standard. A party seeking class certification must *affirmatively* demonstrate his compliance with the Rule—that is, he must be prepared to prove that there are in fact sufficiently numerous parties, common questions of law or fact, etc.

Wal-Mart Stores, Inc. v. Dukes, 131 S. Ct. 2541 (2011) (emphasis added)

Thus, demonstrating the existence of a common question may require an examination of evidence commonly associated with the merits phase of the case. Addressing preliminary matters, the Court says, is a common part of litigation, and, in this case, “necessarily overlaps with respondents’ merits contention that Wal-Mart engages in a pattern or practice of discrimination.”

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While the complete impact of the *Dukes* decision remains to be seen, it has clear implications for the nature of expert testimony in class-certification proceedings. The decision affects not only labor cases, but also other types of class-action cases in which there is a question about a defendant's action and its impact on potential class members. Examples include both antitrust and consumer-fraud actions.

For experts and attorneys working with experts addressing questions of commonality, there are two primary points to note from the *Dukes* decision. First, for an analysis to be persuasive, it must be designed so that it can provide statistical insight into whether evidence of common questions exists for the class as a whole, not simply a finding that may be characterized as consistent with the existence of common questions. Second, the analyses must also be able to demonstrate that commonality of impact is due to the challenged behavior of the defendant and not other factors.

The first point primarily deals with the power of an econometric or statistical test to discern, at a fine enough level, whether the "impact" of the alleged bad act is sufficiently common across the class. The second point is focused on whether the results of the statistical analysis are sufficiently supportive of the theory of harm. These two points are complementary, and the questions they ask can usually be answered within the same analysis, but the *Dukes* decision divided them when it ruled that neither hurdle was surmounted.

Designing Analyses to Address the Existence of a Common Question

In *Dukes*, the plaintiffs claimed a company-wide practice led to a disparity in pay between women and men. The question common to class members was whether that practice impacted each of them. Accepting that an individual analysis of 1.5 million class members was impractical, the experts were left with the task of designing an analysis that, from a statistical point of view, would sufficiently demonstrate commonality within the proposed class. The Court concluded that the plaintiffs' experts did not meet that burden.

Attorneys and experts are advised to remember that most statistical or econometric analyses designed to measure differential impact are measuring *average* effects, not individual effects. For example, a regression analysis designed to test for a wage disparity between two groups (class members and non-class members) measures the average disparity between the groups and whether the difference between the groups is statistically significant. That is, it answers the question "How different are class members from non-class members *on average*?" The commonality test, however, is concerned with answering the question "Is the impact of the alleged practice sufficiently common *among* class members?"

A simple example illustrates this point: Suppose there is a firm with 200 employees, half that work at Factory A and half that work at Factory B. Half of the employees at each factory are left-handed, and half are right-handed; each right-handed employee has to be matched with a left-handed employee to run a specialized machine. Left-handed employees at Factory A make \$10 an hour, and right-handed employees make \$15 an hour, and all Factory B employees make \$15



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an hour. A regression of hourly wage on “handedness” will result in a (very) statistically significant finding that left-handed employees make *on average* \$2.50 an hour less than right-handed employees. However, by construction, we know that there is meaningful variation in wages *within* left-handed employees: Half of them make exactly what right-handed employees make. The regression coefficient on left-handedness has revealed nothing about the variation in wages within the left-handed employees, and it has not revealed that the difference in pay for left-handed workers is related to which factory they work in.

The plaintiffs’ statistical expert performed his econometric analysis at the level of a Wal-Mart “region,” each of which contains 80 to 85 stores. The Court found that, from a statistical point of view, the plaintiffs’ experts’ analyses were performed at too great a level of aggregation:

A regional pay disparity, for example, may be attributable to only a small set of Wal-Mart stores, and cannot by itself establish the uniform, store-by-store disparity upon which the plaintiffs’ theory of commonality depends.

In other words, any effect detected by the expert’s analysis is for such a large part of the proposed class that it would be reasonably possible that the results were driven by only a *portion* of the proposed class. A region consists of many stores, managers, and decision-makers. The regression analysis provided insufficient insight into whether decisions at a more granular level, such as the store level, were consistently impacting female employees. A moderate disparate impact occurring at all stores in a region and a strong disparate impact at only some stores could both deliver the same statistical outcome when examined at a disaggregate level.

The proper level of disaggregation is a function of the nature of the plaintiffs’ claim. For example, if the claim concerns a group of sellers allegedly colluding on prices in different geographic markets, the commonality inquiry should be performed at least at the level of each local market. If more disaggregate data are available, the plaintiffs’ case will be stronger if they can demonstrate commonality at even finer and finer levels of disaggregation. With the advent of increased data-processing power, often, such detailed data are available, as are the computational tools that allow for such an analysis.

For example, in the factory illustration above, regressions done at the factory level would reveal that left-handed people were paid less at only one location, which would weigh against certifying a company-wide class of left-handed employees.

Even among practitioners, the standards for assessing commonality are contested. In their amicus brief, a group of labor economists and statisticians advocated that “when there is a legitimate choice between two possible levels of analysis, an expert generally should use the broader level.” *Brief of Amici Curiae, Labor Economists and Statisticians in Support of Respondents* at page 15. The Court’s decision, however, has ruled out broad, aggregate analyses from the set of legitimate choices. The amici cite literature supports the idea that aggregate data are useful for studying “general patterns.” The relevant goal, however, for a class certification inquiry is to determine

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whether there is commonality within a group, not an average effect for the group. And, unlike many academic studies where only aggregate data are available, the parties in the *Dukes* case had access to very detailed data, which allowed for a finer examination of the alleged impact.

Connecting Statistical Evidence with the Theory of Harm

One likely change we may expect as a result of the *Dukes* decision is that successful class actions will have smaller proposed classes supported by expert analyses that rely on disaggregate data. A perhaps less obvious change comes from the Court's highlighting the importance of tying together the theory of harm with the statistical analysis.

There is another, more fundamental, respect in which respondents' statistical proof fails. Even if it established (as it does not) a pay or promotion pattern that differs from the nationwide figures or the regional figures in *all* of Wal-Mart's 3,400 stores, that would still not demonstrate that commonality of issue exists.

Dukes, 131 S. Ct. 2541

Stated differently, the expert's statistical analysis must not only demonstrate that the alleged impact is sufficiently common to the class, but it also must support an inference that the specific practice being challenged is the common cause of the impact. In the *Dukes* case, the Court found no specific employment practice alleged as the basis for disparate impact.

Return to the stylized example from above but now assume that *every* left-handed worker is paid only \$10 per hour. A statistical analysis would show that left-handed workers were paid less at both locations. To satisfy their burden, however, plaintiffs would need to show that the wage disparities at each location are due to a common challenged practice. To the extent practicable, experts should include in their analyses the effects of local labor market conditions to help ensure that the differential impact is not due to factors other than the alleged practice. For example, a surplus of left-handed workers in the market near Factory A could lead to reduced wages for left-handed workers there.

Conclusion

The *Dukes* decision sharpens the focus on the use of economic and statistical expert analysis and testimony in class-certification matters, and the depth of inquiry will be more akin to what is done at the merits stage. Plaintiffs' experts will likely need to perform analyses at a very disaggregate level to demonstrate that impact is widely distributed among the class and not simply present at some aggregate level. Simultaneously, the statistical analyses must be able to discern whether plaintiffs' theory of harm is reasonably the cause of any measured disparity and not due to other factors. This will likely lead to fewer class-action cases being filed, while those that do get filed will likely have smaller class sizes and more focused claims, making them perhaps easier to certify.

Keywords: litigation, class actions, derivative suits, statistical analysis, aggregate analysis



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Fraud on the Market Is Reaffirmed in *Halliburton*

By Travis Neal – November 21, 2011

Presumptions generally make the legal process more efficient by allowing a party to meet its burden with reduced effort. Since *Wal-Mart Stores, Inc. v. Dukes*, 131 S.Ct. 2541 (2011), however, certain presumptions afforded securities fraud plaintiffs on a motion for class certification may no longer minimize the plaintiffs' burden. While the Supreme Court reaffirmed the "fraud-on-the-market" theory as a basis for a presumption of reliance in *Erica P. John Fund, Inc. v. Halliburton*, 131 S.Ct. 2179 (2011), Justice Scalia's opinion in *Wal-Mart* subjects securities' plaintiffs to a "rigorous analysis" of whether the misrepresentations were publicly known, the defendant's stock traded in an efficient market, and the plaintiffs' transactions took place during the relevant period before they may invoke the presumption. As highlighted by Mark A. Chavez's prescient article, "[Raising the Class-Certification Hurdle](#)," in the *CADS Report*'s Winter 2011 issue, plaintiffs now face a riskier and more expensive class-certification process.

Basic History

Plaintiffs in a securities-fraud case must show that they relied on the defendant's alleged misrepresentations when deciding to purchase or sell the defendant's stock. This can be a significant stumbling block for class-action plaintiffs, as most potential class members—investors—never read a defendant company's statements or disclosures. The Supreme Court addressed this issue and the issue of a statement's materiality in *Basic, Inc. v. Levinson*, 485 U.S. 224 (1988).

The Court defined the materiality of a statement in relation to a reasonable investor. If there is a "substantial likelihood" that the misstatement or omitted fact would have "significantly altered" the "total mix" of information for the reasonable investor, the misstatement or omitted fact is material. Put succinctly, "materiality depends on the significance the reasonable investor would place on the withheld or misrepresented information."

The Court next addressed if it is proper to apply a rebuttable presumption of reliance, an element of a Rule 10b-5 cause of action, supported by the fraud-on-the-market theory. The Court answered in the affirmative, viewing presumptions favorably as they support judicial economy and are useful in allocating burdens of proof.

As the Court explained, the fraud-on-the-market theory rests on another: the efficient capital markets theory. This theory posits that in efficient capital markets, security prices reflect all the information publicly available about the securities in that market. It is irrelevant whether an individual investor relied on a company's statements when purchasing the stock because the stock's price already reflected the company's alleged misrepresentation. Further, the presumption of reliance created by the fraud-on-the-market theory is supported by the congressional policy underlying the Securities Exchange Act of 1934—an investor must be allowed to rely on the integrity of markets that are affected by publicly available information.

The presumption of reliance is rebuttable, as “[a]ny showing that severs the link between the alleged misrepresentations and either the price received (or paid) by the plaintiff, or his decision to trade at a fair market price, will be sufficient to rebut the presumption of reliance.”

In 2011, the Supreme Court confirmed *Basic*'s materiality requirement and the fraud-on-the-market theory. First, in a case involving a pharmaceutical company's liability for failure to disclose adverse event reports, the Supreme Court reaffirmed that the materiality requirement is satisfied when there is “a substantial likelihood that the disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the ‘total mix’ of information made available.” *Matrixx Initiatives, Inc. v. Siracusano*, 131 S. Ct. 1309 (2011).

Pharmaceutical companies need not disclose every negative report; they only need to disclose reports or information that the reasonable investor would view “as having significantly altered the ‘total mix’ of information made available.” *Id.* at 1321–22. (In 2009, the FDA received 500,000 reports of adverse events.) The existence of a few adverse events reports will not alter the total mix of information. The Court validated *Basic*'s requirement that a court undergo a fact-intensive, case-by-case inquiry to answer the following question: Will a reasonable investor view adverse statements, reports, or information as material? Almost six months later, the Court addressed *Basic*'s other significant holding—the presumption of reliance based on the fraud-on-the-market theory.

Halliburton

The *Halliburton* case is succinct and limited in scope. The Supreme Court unanimously held that private securities-fraud plaintiffs do not need to prove loss causation “as a precondition for invoking *Basic*'s rebuttable presumption of reliance.” *Halliburton*, 131 S. Ct. at 2186. Plaintiffs only need to show three elements to invoke the fraud-on-the-market presumption of reliance: The alleged misrepresentations must have been publicly known, that defendant's security must have traded in an efficient market, and the plaintiff must have traded the defendant's security between the time the defendant made the alleged misrepresentations and the time the defendant corrected its allegedly fraudulent statement. While the holding resolved a circuit split, overturning the Fifth Circuit's line of cases requiring loss causation and upholding the Second, Third, and Seventh's rejection of such a requirement, it did not provide direction on a number of issues, including when defendants may rebut the presumption of reliance. Some of these issues were answered, at least implicitly, in the later *Wal-Mart* decision.



Petitioner Erica P. John Fund, Inc. (EPJ), the lead securities-fraud, class-action plaintiff, sued Halliburton and David Lesar, its COO or CEO during the operative period, alleging that the defendants made false statements that artificially inflated Halliburton's stock price in violation of section 10(b) of the Securities Exchange Act of 1934 and Securities and Exchange Commission Rule 10b-5. The alleged misrepresentations concerned Halliburton's exposure in asbestos litigation, the revenue from construction contracts, and the benefits of a recent merger. Subsequent investors lost money when Halliburton's later corrective disclosures caused its stock price to drop.

The plaintiffs defeated a motion to dismiss, but failed in their motion for class certification. The district court held that EPJ met the Rule 23(a) prerequisites for class actions, but that they failed to satisfy Rule 23(b)(3)'s requirement that "questions of law or fact common to class members predominate over any questions affecting only individual members." The plaintiffs could not meet the Fifth Circuit's requirement of "loss causation" necessary to invoke the presumption of reliance on the part of the entire class based on the fraud-on-the-market theory. Specifically, they failed to show, by a preponderance of the evidence, any connection between Halliburton's material misrepresentations, the corrective disclosures, and the stock price's decline. The Fifth Circuit affirmed the district court's denial of class certification, holding that EPJ failed to show that certain disclosures had a "corrective effect linked" to a prior misrepresentation. *Archdiocese of Milwaukee Supporting Fund, Inc. v. Halliburton Co.*, 597 F.3d 330, 338 (5th Cir. 2010). For the Fifth Circuit court, requiring a securities plaintiff to show loss causation is crucial because "[l]oss causation is a direct causal link between the misstatement and the [plaintiff's] economic loss."

The Supreme Court, in an opinion authored by Chief Justice Roberts, reversed. Echoing the Fifth Circuit, the Court stressed that proof of reliance is critical because it ensures a link between the defendant's misrepresentation and the plaintiff's injury. However, the Supreme Court affirmed the continuing validity of *Basic*'s rebuttable presumption of reliance based on the fraud-on-the-market theory and held that plaintiffs need not prove loss causation to invoke the presumption.

In determining whether EPJ satisfied Rule 23(b)(3), the Court turned to the elements of the underlying cause of action, a violation of section 10(b) and Rule 10b-5: a material misrepresentation by the defendant, scienter, a connection between the defendant's misrepresentation or omission and the purchase or sale of a security, the plaintiff's reliance on the misrepresentation, economic loss, and loss causation. The strength of a securities-fraud action often depends on the fourth element, reliance, and, as explained in *Basic*, if courts required plaintiffs show their individual reliance on defendants' misstatements, securities-fraud plaintiffs would rarely succeed on a motion for class certification. The fraud-on-the-market theory of reliance allows plaintiffs to overcome this burden, though only after plaintiffs have proven "certain things." These things include, for example, that the stock traded in an efficient market and that the defendant's misstatements were publicly known. Nowhere, in either *Basic*'s

opinion or its logic, did the Court find “loss causation” as a prerequisite for invoking the rebuttable presumption of reliance.

The fact that a subsequent loss may have been caused by factors other than the revelation of a misrepresentation has nothing to do with whether an investor relied on the misrepresentation in the first place, either directly or presumptively through the “fraud-on-the-market” theory. As noted by EPJ in its brief, because the effect of the defendant’s misstatements and the subsequent corrections are necessarily questions common to all proposed class members, the answer to those questions should not defeat certification.

The opinion does not address any other “question about *Basic*, its presumption, or how and when it may be rebutted.” *Halliburton*, on remand, may challenge class certification on grounds other than EPJ’s failure to prove loss causation at this stage in the litigation. The Court also failed to address the merits of *Halliburton*’s price-impact theory, which states that “if a misrepresentation does not affect market price, an investor cannot be said to have relied on the misrepresentation merely because he purchased stock at that price.” *Halliburton* argued that the Fifth Circuit’s “loss causation” analysis was really a price-impact analysis, but the Court rejected that argument without passing on the validity of the price-impact theory.

The *Halliburton* Court did not address the plaintiff’s burden of proof at the class-certification stage, even though both parties raised the issue. The Fifth Circuit’s opinion held that Rule 23 factors must be established by a preponderance of the evidence and the U.S. Solicitor General seemingly admitted this point in its brief, but the Court remanded the case without providing any guidance to the Fifth Circuit or any other lower court.

Halliburton* after *Wal-Mart

Before *Wal-Mart Stores, Inc. v. Dukes*, 131 S.Ct. 2541 (2011), courts generally did not consider the merits of a plaintiff’s claims when deciding a motion for class certification. Instead, courts focused on whether a plaintiff’s claims applied to the entire class, not whether a plaintiff would likely prevail on his or her claims at trial. After *Wal-Mart*, courts will be more willing or may be required to make a finding on a merits issue when that issue overlaps with a class-certification requirement. While this may seem beneficial to defense attorneys, the Supreme Court warned in *Eisen v. Carlisle & Jacquelin*, 417 U.S. 156 (1974), that if merits are considered at the class-certification stage, defendants could later be prejudiced by that ruling.

A court may not certify a class unless class counsel has met each Rule 23 factor, regardless of whether resolving those requirements entails some analysis of the merits of the case. “Rule 23 does not set forth a mere pleading standard,” and in the securities-class-action context, the Court’s opinion strongly suggests that district courts not only may, but must engage in fact-finding on any issue relevant to the Rule 23 factors. In support of considering merits issues at the Rule 23 stage, the Court cited *Halliburton* and noted that, in securities class actions, it is common for merits questions to affect Rule 23 factors, specifically the requirement that plaintiffs must prove the defendant’s stock traded on an efficient market to rely on the fraud-on-the-market

theory. Even if plaintiffs must prove the existence of an efficient market at trial again, they still bear the burden of showing the same issue on a motion for class certification.

Unlike *Halliburton*, *Wal-Mart* addressed the question of burden of proof at the class-certification stage. The Court stressed that district courts must engage in a “rigorous analysis” of the Rule 23 factors, and they should “probe behind the pleadings.” The Court examined the anecdotal, statistical, and sociological evidence offered by plaintiffs. And, in at least the employment-discrimination context, the Court may require plaintiffs to provide “significant proof” of Rule 23 factors. If plaintiffs provide expert testimony to withstand a court’s rigorous analysis, the Court suggested that the witness providing such testimony must first qualify as an expert under the standards in *Daubert v. Merrill Dow Pharmaceuticals, Inc.* 509 U.S. 579 (1993). *Id.* at 2553–54. This suggestion—the Court merely “doubted” the district court’s conclusion that *Daubert* did not apply at the class-certification stage—is especially relevant in securities cases because the existence of an efficient market will often depend entirely on expert witness testimony.

Conclusion

In its last term, the Supreme Court offered up a mixed bag for securities-class-action practitioners. *Halliburton* established the continuing vitality of the fraud-on-the-market theory and plaintiffs’ ability to presume that the class relied on the defendants’ alleged misstatements. To invoke that theory, securities’ plaintiffs must show three elements: that the alleged misrepresentations were publicly known, that the defendant’s security traded in an efficient market, and that the plaintiffs traded the defendant’s security between the time the defendant made the alleged misrepresentations and the time the defendant corrected its allegedly fraudulent statement. After *Wal-Mart*, proving the existence of each element has become more daunting. Plaintiffs’ proffers of evidence will be subject to a “rigorous analysis,” and their expert witnesses must meet *Daubert* standards. Even if the trial court invokes the presumption of reliance and certifies the class, the basis for the presumption may be relitigated at trial. Defendants may challenge the trial court’s previous finding that their securities traded in an efficient market, and if successful, defendants will have eliminated the basis for the certification of the class. Considering *Halliburton*’s limited holding, specifically its decision not to decide the burden-of-proof issue, and *Wal-Mart*’s requirement of a rigorous analysis at the class-certification stage, a second *Halliburton* decision may not be too far off.

Keywords: litigation, class actions, derivative suits, fraud on the market, class certification

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Employment Law and Class-Action Waivers

By David A. Pahl – November 21, 2011

Prior to the U.S. Supreme Court's recent decision in *AT&T Mobility v. Concepcion*, 131 S. Ct. 1740 (2011), the validity of arbitration agreements containing class-action-waiver provisions—which provide that disputes subject to arbitration agreements may only be arbitrated on an individual basis, not on a class-wide basis—varied widely by jurisdiction. Under California law, for example, class-action waivers were prohibited in most employment law contexts prior to *Concepcion*. New York and Texas law, however, appeared to allow for the enforcement of class-action waivers.

Concepcion has the potential to settle much of the uncertainty regarding the validity of class-action waivers in arbitration agreements. In striking down California's rule prohibiting class-action waivers in most consumer contracts, the Supreme Court in *Concepcion* used broad, forceful language that could extend the impact of its decision well beyond the consumer law context. This continued the Court's trend of upholding arbitration agreements and emphasizing, above all else, the agreement of the parties. Indeed, the Court decided *Concepcion* only a year after deciding *Stolt-Neilsen S.A. v. Animalfeeds International, Corp.*, 130 S. Ct. 1758 (2010), in which it restricted the imposition of class-wide arbitration where a valid arbitration agreement is silent on the issue.

Not surprisingly, *Concepcion* has already led to significant new pro-arbitration decisions by the lower courts in several different areas of law. Whether *Concepcion* causes the sea change that many are predicting, however, remains to be seen. Indeed, despite the flood of new pro-arbitration decisions, courts have declined to extend *Concepcion* in certain specific contexts, and the lasting impact of the decision will surely take years to solidify. Nowhere is this clearer than the employment law context.

The Decision

Concepcion involved a proposed class action asserting claims of fraud and false advertising stemming from the plaintiffs' purchase of cellular telephone service from AT&T. The plaintiffs claimed that they purchased the service having relied on advertising by AT&T promising a "free" telephone, only to discover that they were later required to pay sales tax on the retail value of the phone. The phone service agreement included a broadly worded arbitration provision that required any disputes between AT&T and the customer to be submitted to arbitration and prohibited customers from bringing any claims in a class action or other representative proceeding. On the plaintiffs' filing of the lawsuit, AT&T moved to compel arbitration.

The district court denied AT&T's motion to compel arbitration, holding that the arbitration agreement's class-action waiver was unconscionable and therefore unenforceable under *Discover Bank v. Superior Court*, 36 Cal. 4th 148 (2005), a California Supreme Court decision that, in effect, held most class-action waivers in consumer contracts to be unconscionable. Notably, however, the district court simultaneously observed that the terms of the arbitration agreement were so favorable to plaintiffs that they would likely be better off proceeding through arbitration than as plaintiffs in a class action. Indeed, the arbitration provision provided, among other things, that AT&T was required to pay all arbitration costs for nonfrivolous claims; arbitration was to

take place in the county of the customer's billing address; as to claims for \$10,000 or less, the customer could choose whether the arbitration would proceed in person, by phone, or based on submissions; and AT&T was unable to seek reimbursement for its attorney fees, and, in the event the customer received an arbitration award in an amount greater than AT&T's last settlement offer, AT&T would be required to pay a \$7,500 recovery fee and double the amount of the customer's attorney fees.

In affirming the district court, the Ninth Circuit held that the class-action waiver was "exculpatory" and void as a matter of public policy because it protected AT&T against all types of class actions. The Ninth Circuit further found that the Federal Arbitration Act (FAA) did not preempt the so-called *Discover Bank* rule that most class-action waivers in consumer contracts are unconscionable. In this regard, the Ninth Circuit relied on section 2 of the FAA, which permits arbitration agreements to be invalidated "upon such grounds as exist at law or equity for the revocation of any contract." The Ninth Circuit reasoned that the *Discover Bank* rule fell within the ambit of section 2 because it constituted the California Supreme Court's "refinement" of California's unconscionability doctrine—a ground existing under California law for the revocation of contracts—in the context of consumer class-action waivers.

The Supreme Court reversed, and, in a 5–4 decision authored by Justice Scalia, held that the FAA preempts the *Discover Bank* rule. The Court emphasized that "[t]he overarching purpose of the FAA . . . is to ensure the enforcement of arbitration agreements according to their terms so as to facilitate streamlined proceedings" and that the FAA reflects a "liberal federal policy favoring arbitration agreements, notwithstanding any state substantive or procedural policies to the contrary." In light of the purposes and policies behind the FAA, the Court further found that the *Discover Bank* rule's prohibition of class-action waivers presented "an obstacle to the accomplishment and execution of the full purposes and objectives" of the FAA.

The Court rejected the claim that the *Discover Bank* rule constituted a "ground . . . at law or equity for the revocation of any contract" under section 2 of the FAA. In doing so, the Court drew an important distinction between "generally applicable" contract defenses—which section 2 allows to be utilized to invalidate arbitration agreements—and "state law rules" (such as the *Discover Bank* rule) that employ such "generally applicable" contract defenses in a manner that specifically targets particular types of contracts such as arbitration agreements. The Court held that such "state law rules" conflict with the FAA's purpose of ensuring the enforcement of arbitration agreements according to their terms because they inevitably fail to place arbitration agreements "on equal footing" with other types of contracts.

In the context of this discussion, the Court strongly emphasized the difficulties of implementing class-wide arbitration procedures in arbitration agreements that are, by their terms, "bilateral." As the Court observed, "[c]lasswide arbitration includes absent parties, necessitating additional and different procedures . . . involving higher stakes," "[c]onfidentiality becomes more difficult," and "arbitrators are not generally knowledgeable in the often-dominant procedural aspects of certification, such as the protection of absent parties." The Court thus concluded that

“manufactured” class arbitration is inconsistent with—and preempted by—the FAA because it makes the arbitration “slower, more costly, and more likely to generate procedural morass than final judgment,” it requires the very procedural formality that bilateral arbitration is intended to minimize, and it “greatly increases risks to defendants” and is “poorly suited to the higher stakes of class litigation” due to the inherent risk in arbitration that errors go uncorrected due to the lack of an appeals process. As the Court noted, “Requiring the availability of classwide arbitration interferes with the fundamental attributes of arbitration and thus creates a scheme inconsistent with the FAA.”

The Impact

Though it will take years to ascertain the lasting legal effect of *Concepcion*, it is sure to have immediate practical impacts. For example, *Concepcion* will inevitably cause entities that do not utilize arbitration agreements with class-action waiver provisions to seriously consider adding them to their contracts. *Concepcion* will likewise cause entities with class-action waiver provisions already in their arbitration agreements to attempt to compel bilateral arbitration more frequently than they otherwise would have. The latter impact has already become apparent, as there has been a notable uptick in the number of arbitration-related decisions since *Concepcion* came down.

Predictably, this uptick in arbitration-related decisions has not been limited to the consumer context in which *Concepcion* arose. This makes sense, given the breadth of the Court’s decision. Though the core holding of *Concepcion* addressed a consumer contract, the rationale supporting its holding was not limited to the consumer contract context and was generally hostile to the class-action process. Indeed, because the *Concepcion* Court drew such a stark contrast between class-wide arbitration and the FAA’s dual purposes of enforcing the terms of arbitration agreements and promoting efficiency, it is not unreasonable to read the decision as generally prohibiting the addition of class procedures to arbitration agreements that are expressly bilateral. As the Court flatly noted, “States cannot require a procedure that is inconsistent with the FAA, even if it is undesirable for unrelated reasons.”

The employment context is one area in which *Concepcion* has had a quick and significant impact. In California, for example, *Concepcion* has resulted in a growing body of authority holding that the California Supreme Court’s decision in *Gentry v. Superior Court*, 42 Cal. 4th 443, 463 (2007)—historically the basis for invalidating class-action waiver provisions in employment agreements in California—is no longer good law. The Northern District of California held in this manner in *Valle, et al. v. Lowe’s HIW, Inc.*, No. 11-1489-SC (N. D. Cal. Aug. 22, 2011), a putative class action involving alleged wage-and-hour violations under California law. The Court reasoned that *Gentry*, much like the *Discover Bank* decision addressed in *Concepcion*, articulated a “rule of enforceability that applies only to arbitration provisions” and, as such, is overruled by *Concepcion*. *Valle* is one of at least three decisions holding that *Gentry* is no longer good law. See also *Murphy v. DIRECTV*, No. 07-6465, 2011 WL 3319574, at *4 (C.D. Cal. August 2, 2011) (holding *Concepcion* overruled *Gentry*); *Morse v.*



ServiceMaster Global Holdings, Inc., No. 10-0628, 2011 WL 3203919, at *3, n.1 (N.D. Cal. July 27, 2011) (*Concepcion* rejected the reasoning and precedent behind *Gentry*).

Courts outside of California have issued similar decisions in the employment context. In *D’Antuono v. Service Road Corp.*, 2011 U.S. Dist. LEXIS 57367 (D. Conn. May 25, 2011), the U.S. District Court for the District of Connecticut granted the defendant’s motion to compel arbitration in a wage-and-hour class action in which the plaintiffs claimed they were misclassified as independent contractors. Though the court based its decision largely on the fact that the arbitration agreement was not unconscionable under Connecticut law (which did not prohibit class-action waivers to begin with), it did address *Concepcion* at length, noting that the decision “cast[s] significant doubt on virtually any ‘device [or] formula’ which might be a vehicle for ‘judicial hostility toward arbitration.’”

Concepcion’s impact has not all been employer-friendly, however. In *Brown v. Ralphs Grocery Co.*, 197 Cal. App. 4th 489 (2011), California’s Second District Court of Appeal held a class action waiver to be unenforceable as to the plaintiffs’ representative claims under the California Labor Code’s Private Attorneys General Act of 2004 (PAGA). The court reasoned that PAGA actions, which enable plaintiffs to seek statutory penalties for wage-and-hour violations on behalf of other employees, are designed to enforce public rights and, therefore, are not subject to the holding of *Concepcion*, which arose in the context of private actions seeking damages. *Brown* is also notable for a footnote in which it suggests, but does not hold, that the California Supreme Court’s *Gentry* decision may still be good law despite *Concepcion*. This, of course, suggests the potential for future decisions that are at odds with *Valle*’s holding that *Concepcion* overruled *Gentry*.

Though decisions like *Valle*, *D’Antuono*, and *Brown* are significant, they represent just the tip of the *Concepcion* iceberg in the employment context. As more employers seek to implement and enforce their arbitration agreements, more substantial challenges to state-law arbitration standards will mount. In California, for example, employers will likely rely on *Concepcion* to challenge not just *Gentry* and its prohibition of class-action waiver provisions in employment arbitration agreements, but also *Armendariz v. Foundation Health Psychare Services, Inc.*, 24 Cal. 4th 83 (2000), the California Supreme Court’s most significant articulation of unconscionability standards for employment arbitration agreements. Indeed, though *Concepcion* does not uniformly ban states from imposing limitations on arbitration agreements, it does restrict them from utilizing “generally applicable” contract defenses in a manner that targets or discriminates against arbitration agreements or that otherwise fails to put arbitration agreements “on equal footing” with other contracts. *Armendariz* and its progeny are therefore potentially problematic to the extent that they articulate unconscionability standards pertaining specifically to arbitration agreements.

Until such challenges are fleshed out, employers seeking to add arbitration agreements with class-action waivers to their employment agreements (or beef up existing agreements) are likely to be conservative in their approaches to doing so. For example, *Brown*, in which the court held

that class-based PAGA actions in California are not subject to the holding of *Concepcion*, has given employers pause in this regard. *Brown* shows that some courts are willing to draw distinctions between types of claims in evaluating the reach of *Concepcion*, despite the *Concepcion* Court's seemingly claim-neutral rationale. Employers are therefore likely to think long and hard about which claims to include in their class-action waiver provisions.

Employers also face the interesting question of whether to make their class-action waiver provisions applicable to pending class actions. While it would seem defensible for employers to do so from an arbitration-centric perspective in light of *Concepcion*, at least one court has looked at the issue from a different perspective and concluded it is not. In *Williams v. Securitas Security Services USA, Inc.*, C.A. No. 2:2010-7181, 2011 WL 2713741 (E.D. Pa. July 13, 2011), the Eastern District of Pennsylvania rejected an employer's attempt to implement a new class-action waiver as to proposed class members in a pending Fair Labor Standards Act (FLSA) collective action. The court held that the employer's attempt to implement the agreement did not implicate *Concepcion* because it constituted an improper attempt to influence the litigation through communication with proposed class members and, as a result, interfered with the court's authority to control communications with potential plaintiffs under the Supreme Court's decision in *Hoffman La Roche, Inc. v. Sperling*, 493 U.S. 165, 171 (1989). The court focused in particular on the fact that the communication was not well drafted and was therefore likely to confuse those putative class members who read it. *Williams* thus provides another cautionary tale that will cause employers to ensure that their class-action waiver provisions are clear and easily understandable, particularly those that may apply to pending, putative class actions.

But employers are not the only ones who are busy following *Concepcion*. Just as employers rush to implement arbitration provisions with class-action waivers in their employment agreements, employees will mount new attacks designed to limit *Concepcion*'s impact in different employment contexts. Employees have already challenged *Concepcion* under the National Labor Relations Act (NLRA) by arguing that compelled, bilateral arbitration violates section 7 of the act, which guarantees all employees, including those who are not represented by a union, the right to engage in "concerted activities." As more motions to compel are filed and more challenges are mounted, the impact will become much clearer.

But courts may not have the final word in this fight. On the day of the *Concepcion* decision, Senator Al Franken of Minnesota issued a press release criticizing the decision and promising to reintroduce the Arbitration Fairness Act (AFA), which had previously been proposed in 2009 and, if passed, would eliminate forced arbitration clauses in employment, consumer, and civil rights cases. It would also allow consumers and workers to choose arbitration in the event of a dispute. Franken, along with Senator Richard Blumenthal and Congressman Hank Johnson, has since reintroduced the AFA. While the current makeup of Congress makes it unlikely that the AFA will gain much traction in the near term, its reintroduction serves as a reminder that the issue of the validity of class-action waivers is controversial and unlikely to be resolved any time soon.



Keywords: litigation, class actions, derivative suits, class-action waivers, arbitration agreements

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Consumer Protection and Employment Cases after *Concepcion*

By Kirsten Scott and Nicole D. Reynolds – November 21, 2011

In April 2011, the U.S. Supreme Court issued an opinion of such potential breadth that commentators immediately posed the question, “Has the Supreme Court killed the class action?” The case, *AT&T Mobility, LLC v. Concepcion*, 131 S. Ct. 1740 (2011), involved AT&T Mobility’s allegedly false advertising that it would provide customers with “free” phones when in fact charged a sales tax of approximately \$30 on each phone. Like many companies providing services and products to consumers, AT&T Mobility inserts in its customer agreements an arbitration clause prohibiting customers from suing it in court. More significantly, the arbitration clause forbids customers from bringing claims against the company as part of a class action. The issue presented in *Concepcion* was whether AT&T Mobility’s arbitration clause, with its class-action prohibition, was enforceable.

The district court and the Ninth Circuit found AT&T Mobility’s arbitration agreement to be unconscionable pursuant to the California Supreme Court’s holding in *Discover Bank v. Superior Court*, 36 Cal. 4th 148 (Cal. 2005). Under the *Discover Bank* rule as interpreted by the Supreme Court, class-action prohibitions are unenforceable when found in consumer adhesion contracts and where small amounts of individual damages are at stake. The rule recognizes that in such contexts, absent a class mechanism, consumers would be unlikely to obtain *any* redress for the wrongs alleged.

The Supreme Court, however, reversed the lower courts’ decisions, with a 5–4 majority holding that the *Discover Bank* rule is preempted by the Federal Arbitration Act (FAA). The FAA contains a “savings clause” allowing arbitration clauses to be invalidated by general state-law contract defenses. Nevertheless, since the 1980s, the Supreme Court has steadily expanded the preemptive scope of the FAA to disallow any state law that is applied in a manner that disfavors arbitration. Writing for the majority in *Concepcion*, Justice Scalia broadened the FAA’s preemptive reach by finding that the FAA’s principle purposes are to “ensure that private arbitration agreements are enforced according to their terms” and to allow for informal, efficient, and relatively inexpensive procedures for resolving disputes. Justice Scalia concluded that the *Discover Bank* rule conflicts with these objectives by allowing a party, who has purportedly “agreed” to an arbitration clause with a class-action prohibition, to demand *ex post* class-wide arbitration.

While there is no question that *Concepcion* handed a victory to businesses, interpretations of *Concepcion* and views on whether it actually does sound in the “death knell” of class actions are wide-ranging. Defense counsel representing corporate interests have unsurprisingly insisted that *Concepcion* forbids applying any state unconscionability or public policy analysis to arbitration clauses. The plaintiff’s bar, on the other hand, has emphasized various reasons why *Concepcion* should be narrowly construed, including the unique consumer-friendly features of AT&T’s arbitration clause. Class-action prohibitions in arbitration clauses have become commonplace not only in consumer agreements, but also in the employment context, where they are typically found in employee handbooks.

***Concepcion*’s Impact on Consumer-Protection Cases**

Because *Concepcion* was a consumer-protection case, it predictably has had the most direct impact on such cases including those brought under the states’ various unfair and deceptive acts and practices (UDAP) laws. Many courts in UDAP actions have applied *Concepcion* broadly, holding that arbitration agreements with class-action prohibitions may no longer be defeated on *substantive* unconscionability or public policy grounds. Other courts have disagreed with this approach, determining that *Concepcion* “simply does not go that far.” *Mission Viejo Emergency Med. Assoc. v. Beta Healthcare Group*, No. G043815, 2011 WL 2565363 at *7, n.4 (Cal. Ct. App. June 29, 2011). Courts have disagreed over whether *Concepcion* has any impact on *procedural* unconscionability, with some holding that adhesiveness is no longer enough by itself to support a finding of procedural unconscionability and others solely evaluating substantive unconscionability. The courts have almost universally agreed, however, that an arbitration clause may no longer be declared unenforceable based on the fact that, without a class action, individuals will likely not be able to pursue their small-dollar claims.

Three UDAP cases against DirecTV, involving an identical arbitration clause and nearly identical claims, illustrate several post-*Concepcion* arguments asserted by consumers seeking to avoid individual (non-class) arbitration and the contradictory judicial reactions to such arguments. One court denied DirecTV’s motion to compel, another granted the motion in full, and a third granted the motion in part but denied the motion with respect to the plaintiffs’ injunctive relief claims.

In the first case, *Murray v. Pro Sat and Home Entertainment and DirecTV, Inc.*, No. CV 2010-093-3 (Ark. Cir. Ct. June 30, 2011), the plaintiff alleged that DirecTV failed to disclose early cancellation fees. The court found DirecTV’s arbitration clause with a class-action prohibition to be unenforceable for several reasons, most notably for lack of mutuality. The court determined that, while the customers waived their right to sue in court, DirecTV retained the right to sue in many instances. And, while customers were prohibited from asserting claims together as a class, no practical equal limitation was imposed on DirecTV. The court concluded that the customer agreement containing the arbitration clause was “merely an exhaustive list of self-serving disclaimers and obligations imposed on DIRECTV’s customers,” without any corresponding obligations placed on DirecTV. A Florida court similarly found lack of mutuality to prevent the



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enforcement of an arbitration clause, although that court based its holding on aspects of the clause other than the class action prohibition. *See In re Checking Account Overdraft Litig.*, No. 09-MD-02036-JLK (S.D. Fla. Sept. 1, 2011).

In a second DirecTV case, *Murphy v. DirecTV, Inc.*, No. 2:07-cv-06465-JHN-VBKx, 2011 WL 3319574 (C.D. Cal. Aug. 2, 2011), the court analyzed the same arbitration agreement, but granted DirecTV's motion to compel arbitration. In *Murphy*, the plaintiffs alleged that DirecTV failed to disclose that its receiving equipment, for which consumers paid hundreds of dollars, was leased and that a consumer must return the equipment on cancellation or face hefty fees. The plaintiffs made several arguments, including that the "blow-up" clause in the arbitration agreement rendered it unenforceable. That clause provided that if the law of the customer's state would find the class-action prohibition to be unenforceable, then the entire arbitration agreement was unenforceable. The plaintiffs argued that because class action prohibitions were unenforceable in California at the time the parties contracted, the mutual intention of the parties was that their claims would be litigated. The court disagreed, holding that *Concepcion* clarifies what the FAA has always meant and must be applied retroactively.

The plaintiffs additionally argued that, pursuant to *Gentry v. Superior Court*, 42 Cal. 4th 443 (Cal. 2007), their claims under California's Consumer Legal Remedies Act (CLRA) were not arbitrable. As further discussed below, *Gentry* was an employment case in which the court held that class-action prohibitions may impermissibly undermine the enforcement of unwaivable California Labor Code claims. The plaintiffs argued that, as the court found in *Arguelles-Romero v. Superior Court*, 184 Cal. App. 4th 825 (2010), *Gentry* articulates a "vindication of statutory rights" test that is distinct from an unconscionability analysis. Because the CLRA has an anti-waiver provision, the plaintiffs in *Murphy* argued that requiring individual arbitration of their CLRA claims would undermine their ability to vindicate their unwaivable statutory rights under *Gentry*. The court disagreed, holding without analysis that *Concepcion* overruled *Gentry*.

The plaintiffs also argued that DirecTV waived its right to move to compel arbitration. The court was not persuaded, finding that because DirecTV took action immediately after the *Concepcion* ruling, there was no waiver. Thus far, courts have nearly universally agreed that because it would have been "futile" for defendants to move to compel in certain states prior to *Concepcion*, they could not have voluntarily "waived" any known right. *See, e.g., Swift*, 2011 WL 3419499, at *10; *Sakalowski v. Metron Servs., Inc.*, No. 4:10CV02052 AGF, 2011 WL 4007982, at *3 (E.D. Miss. Sept. 8, 2011). At least one state court, however, has ruled to the contrary. *Natalini v. Import Motors, Inc.*, No. CIV500678 (San Mateo Sup. Ct. June 30, 2011).

In contrast to either of the other DirecTV cases, the court in the third DirecTV case, *In re DirecTV Early Cancellation Marketing and Sales Practice Litig.*, No. ML 09-2093 AG (ANx), 2011 WL 4090774 (C.D. Cal. Sept. 6, 2011), granted DirecTV's motion to compel individual arbitration in part and denied it in part. Like *Murray*, this case involved early cancellation fees. The plaintiffs made many of the same arguments asserted in the *Murray* and *Murphy* cases, most of which the court rejected. The court did, however, hold that the plaintiffs' CLRA and Unfair

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Competition Law (UCL) claims for injunctive relief were not arbitrable. The court based its decision on two California Supreme Court decisions, *Broughton v. Cigna Healthplans of California*, 21 Cal. 4th 1066, 1080 (Cal. 1999) and *Cruz v. PacificCare Health Systems, Inc.*, 30 Cal. 4th 303, 320 (Cal. 2003), which hold that arbitration is not suitable to CLRA and UCL claims where the plaintiff is seeking injunctive relief as a “private attorney general.” Some federal courts sitting in diversity jurisdiction have found *Broughton* and *Cruz* to be overruled by *Concepcion*. See, e.g., *Arellano v. T-Mobile USA, Inc.*, 2011 WL 1842712, at *1 (N.D. Cal. May 16, 2011). The court expressly rejected *Arellano*, finding that *Cruz* and *Broughton* do not outright prohibit the arbitration of all UCL and CLRA claims, only those seeking injunctive relief for the good of the public. Moreover, the court found “compelling reasons” as to why arbitration is not appropriate for vindicating broad public rights, including the fact that arbitrators are not bound by earlier arbitration decisions that could cause inconsistency.

These three DirecTV cases demonstrate that the impact of *Concepcion* on consumer protection cases is by no means certain. Although it is true that a majority of courts have broadly applied *Concepcion* to completely foreclose class litigation of state consumer protection claims, a steadily growing minority of courts are nevertheless declining to force consumers into individual arbitration for reasons purportedly unrelated to the “fact of a class action waiver.”

The Impact of *Concepcion* on Employment Cases

As with consumer-protection cases, courts have grappled with what impact *Concepcion* has on employment cases and have been just as varied in their opinions.

As discussed above, *Concepcion* overruled California’s *Discover Bank* rule. Although *Discover Bank* was squarely a consumer case, *Gentry v. Superior Court* arguably applied similar logic to employment cases in California. Under *Gentry*, an agreement that requires the arbitration of employment disputes but disallows class or collective actions cannot be enforced if class adjudication would be a significantly more effective way for employees to vindicate their unwaivable statutory rights. 42 Cal. 4th 443 (Cal. 2007). The question, then, is this: After *Concepcion*, is *Gentry* still good law?

A few California courts that have addressed this issue have concluded that *Concepcion* effectively overruled *Gentry*. In *Valle v. Lowe’s HIW, Inc.*, for example, the court granted an employer’s motion to compel individual overtime claims, concluding that *Gentry* is no longer valid law because it, just like *Discover Bank*, provided an unconscionability rule that applied only to arbitration provisions and was therefore preempted by the FAA. 11-1489 SC, 2011 WL 3667441 (N.D. Cal., Aug. 22, 2011); see also *Morse v. ServiceMaster Global Holdings, Inc.*, C 10-00628 SI, 2011 WL 3203919 (N.D. Cal., July 27, 2011) (stating, in a footnote, that *Concepcion* rejected the reasoning and precedent behind *Gentry*).

However, other courts have concluded the exact opposite, holding that *Gentry* is distinguishable from *Discover Bank* and remains good law. For example, in *Anderson v. Apple American Group, LLC*, the court found that while *Discover Bank* addressed whether a class-action prohibition in a



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consumer arbitration agreement was unconscionable, the question in *Gentry* was whether a class-action prohibition would undermine the statutory rights of employees. No. 2010-0009375 (Sacramento Cal. Sup. Ct. Aug. 16, 2011). The court then applied the *Gentry* factors to the facts of the case and determined that the employees' California Labor Code rights must be addressed on a class-wide basis, notwithstanding the class-action prohibition, so as to allow the employees to vindicate such rights. Similarly, in *Plows v. Rockwell Collins, Inc.*, the court found that *Gentry* is still valid law after *Concepcion* and permitted further discovery for the parties to brief the issue of whether the arbitration agreement, which prohibited class actions, was enforceable under *Gentry*. No. SACV 10-01936, 2011 WL 3501872 (C.D. Cal. Aug. 9, 2011).

In addition to deciding whether *Gentry* remains good law, courts have addressed other arguments plaintiffs have made in urging courts to narrowly construe *Concepcion* in employment cases. In *Brown v. Ralphs Grocery Co.*, the court declined to reach the issue of whether *Concepcion* overruled *Gentry* (although it suggested that it did not), but then it held that *Concepcion* did not apply to representative actions brought under California's Private Attorney General Act (PAGA). 197 Cal. App. 4th 489 (Cal. Ct. App. 2011). Under PAGA, an aggrieved employee can act as a private attorney general by suing to recover civil penalties against an employer for violations of the California Labor Code. The individual can collect penalties not only for himself, but also for other current and former employees, with 75 percent of the recovery going to the Labor and Workforce Development Agency for Enforcement of Labor Laws and Education. In *Brown*, the court found that regardless of the effect of *Concepcion* on *Gentry*, the Supreme Court did not address whether state laws applicable to waivers of statutory representative actions are preempted by the FAA. The court distinguished PAGA cases, indicating that a representative action under PAGA is "fundamentally a law enforcement action designed to protect the public and not to benefit private parties." *Id.* at 502. PAGA claims, the court held, do not conflict with the purposes of the FAA, and so *Concepcion* is simply inapposite. Several other courts have followed *Brown* for this proposition. *See, e.g., Teimouri v. Macy's, Inc.*, 37-2010-00093577 (San Diego Cal. Super. Ct. Aug. 19, 2011). *But see Valle, supra*, 2011 WL 3667441 (rejecting the plaintiffs' argument that a PAGA claim is inarbitrable and finding it preempted by the FAA).

Looking outside of California, courts have struggled with how to apply the unconscionability defense—which the Supreme Court in *Concepcion* specifically held remains a permissible ground for challenging an arbitration agreement (131 S. Ct. at 1746)—in a manner that does not "disfavor arbitration." In *Green v. SuperShuttle Int'l, Inc.*, the Eighth Circuit summarily rejected the plaintiffs' challenge to the enforceability of a class-action prohibition under Minnesota law simply because it was a state-law-based unconscionability challenge to a class-action prohibition without considering whether Minnesota's unconscionability law impermissibly disfavored arbitration. No. 10-3310, 2011 WL 3890326 (8th Cir., Sept. 6, 2011). In cases that do not involve class-action prohibitions, several courts have concluded that the analysis of unconscionability under state laws remains unchanged. *See, e.g., Kanbar v. O'Melveny & Myers*, No. C-11-0892, 2011 WL 2940690 (N.D. Cal., July 21, 2011) (a class-action, sex-discrimination case where the court found a shortened statute of limitations and overly broad confidentiality provisions are

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unconscionable); *Carrell v. L&S Plumbing P'ship, Ltd.*, No. H-10-2523, 2011 WL 3300067 (S.D. Tex., Aug. 1, 2011) (a Fair Labor Standards Act collective action where the court acknowledged that the Texas unconscionability law is unchanged, but found that cost sharing where there were minimal costs is not unconscionable). In contrast, in another case that did not involve a class-action prohibition, the court altered its application of Colorado's unconscionability law in light of the Supreme Court's "clear message" in *Concepcion*, rejecting the argument that the adhesive nature of the contract was unconscionable. *Daugherty v. Encana Oil & Gas (USA), Inc.*, No. 20-CV-02272, 2011 WL 2791338 (D. Colo., July 15, 2011). In fact, the court stated outright that although it likely would have found the arbitration agreement at issue to be unconscionable pre-*Concepcion*, the altered legal landscape post-*Concepcion* necessitated a different decision. These cases are of great concern because they suggest a trend of courts interpreting *Concepcion* as frowning upon unconscionability defenses to arbitration agreements generally.

At least one court has addressed a different question regarding the effect of *Concepcion* on employment cases: Is an arbitration agreement precluding class claims enforceable if it would preclude a plaintiff from enforcing a federal statutory right? In *Chen-Oster v. Goldman, Sachs & Co.*, the court refused to enforce an arbitration agreement in a class case where the plaintiffs alleged that the defendants had engaged in a pattern or practice of gender discrimination in violation of Title VII. 2011 WL 2671813 (S.D.N.Y. July 7, 2011). The court reasoned that mandating individual arbitration would preclude the plaintiff from bringing a pattern or practice case at all because in that circuit, as is the case in the majority of circuit courts, pattern or practice claims may only be brought as class claims. Title VII is a federal statute, and the court held that the FAA cannot preclude an individual from enforcing a federal statutory right.

As the above demonstrates, the application of *Concepcion* to employment cases, much like its application to consumer protection cases, is by no means certain.

Strategies for Avoiding Non-Class Arbitration

As case law develops, the impact of *Concepcion* in consumer and employment cases will no doubt become clearer. In the meantime, we offer the following suggestions as ways in which counsel for consumers and employees may attempt to avoid forced non-class arbitration.

- Limit the holding of *Concepcion*. In the employment context, consider arguing that *Gentry* remains good law, that it is inapplicable to a potential PAGA claim, or that applying *Concepcion* would unlawfully forbid "concerted action" as meant by the National Labor Relations Act. Additionally, in the consumer-protection context, consider arguing that claims for injunctive relief are made on behalf of the general public and are therefore inarbitrable.
- Consider whether an arbitration agreement might be unconscionable for reasons unrelated to class-action prohibition, including requirements that consumers or employees pay the costs of arbitration, limitations on recoverable damages, a shortened statute of limitations,

or confusing or misleading terms. If multiple terms are unconscionable, consider an argument that the entire arbitration agreement should be stricken.

- Consider other contract defenses, such as lack of mutuality or fraudulent inducement, that may void an arbitration clause.
- A motion to compel arbitration may fail due to a defendant's inability to put forth good evidence showing an agreement to arbitrate.
- The FAA is not applicable in state court. Justice Thomas has repeatedly asserted that the FAA sets procedural rules and is therefore not applicable in state court. *See, e.g., Preston v. Ferrer*, 552 U.S. 346, 363 (Thomas, J., dissenting). Some courts have accordingly suggested that *Concepcion* has no effect on actions brought in state court.
- The FAA is not applicable when it conflicts with federal law. Where a federal statute or regulation bars arbitration of federal claims, the statute or regulation may override the FAA.
- The scope of the arbitration clause does not cover claims. Closely analyze the agreement to determine if the alleged claims arguably fall outside of its scope.
- A party seeking to enforce is not a party to the agreement. A third party may attempt to enforce an arbitration clause as an "agent" or "beneficiary" of a contracting party. Such arguments are often not tenable.

One additional approach is to pursue tens, hundreds, or even thousands of individual arbitrations simultaneously. Although this effort may be cost-prohibitive, it is also costly and time-consuming for defendants and could encourage companies to reconsider class-action prohibitions in arbitration agreements. To illustrate, after succeeding in forcing customers into arbitration through *Concepcion*, AT&T is now suing customers that filed multiple arbitration demands seeking to stop AT&T's merger with T-Mobile, accusing the customers' law firms of encouraging the arbitrations and "taking a thousand bites at the apple." *See AT&T Mobility, LLC v. Gonnello*, No. 11-cv-05636-PKC (S.D.N.Y.).

As the case law develops, the most successful approaches will become clearer. Ultimately, however, the best hope for allowing consumers and workers to vindicate their rights may be reinvigorated legislative efforts, such as the proposed Arbitration Fairness Act, which seeks to ban arbitration clauses in consumer and employment contracts, and the successful Franken Amendment to the 2010 Defense Appropriations Act, which withholds money from government contractors who require their employees to arbitrate disputes.

*Editor's Note: After this article was submitted for publication, the Court of Appeal for the Fourth Appellate District of California disagreed that a defendant could wait to compel arbitration until after the Supreme Court ruled in *Concepcion*. In [Roberts v. El Cahon Motors, Inc.](#), ___ Cal.App.4th ___ (Nov. 8, 2011), the Court of Appeal held that regardless of whether the defendant's arbitration provision was valid and enforceable under *Concepcion*, the defendant had waived its right to compel such arbitration by waiting five months and actively engaging in discovery before doing so.*



Keywords: litigation, class actions, derivative suits, arbitration clauses, consumer protection, employment

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NEWS & DEVELOPMENTS

Answer Not Due Before Motion to Compel Arbitration

In [Lamkin v. Morinda Properties Weight Parcel, LLC](#) [PDF], No. 11-4022 (10th Cir. Sept. 19, 2011), an appeal of a breach-of-contract suit, the U.S. Court of Appeals for the Tenth Circuit concluded that a defendant seeking to compel arbitration is not required to file its answer before it can move to compel arbitration and that the contract's exclusive remedy for contract rescission and the return of the plaintiffs' earnest money did not nullify the contract's separate arbitration provision. In doing so, the court rejected the federal district court's "novel" contrary conclusion on both points.

First, the court concluded that requiring a defendant to file its answer before moving to compel arbitration is a "non-sequitur"; a defendant should not be required to "formally and substantively *engage in the merits of the litigation*" before it can "enforce its right *not to litigate*." Further, no authority was cited to the court (or by the district court) supporting the proposition that an arbitrable dispute does not exist until the defendant's answer is filed.

Second, the court determined that the contract's exclusive remedy did not nullify the contract's arbitration provision. Although arbitration is a remedy, the court explained it is a remedy in the sense of providing a remedial mechanism, not in the sense of remedying the alleged legal violation. Even though the exclusive remedy (contract rescission and the return of the plaintiffs' earnest money) resolved the issue of damages, an arbitrator could still determine the separate issue of liability, and "it is no answer to this to say that the court can make that determination," when that determination is for the arbitrator to make. In addition, here, too, no authority was cited to the court supporting the proposition that an exclusive remedy provision nullified an arbitration provision in the same contract, nor could the court "discern any persuasive reason" for that proposition.

Keywords: litigation, class actions, derivative suits, motion to compel arbitration, breach of contract

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