Department of Legislative Services

Maryland General Assembly
2011 Session

FISCAL AND POLICY NOTE
Revised

House Bill 729 (Delegate Simmons)
Judiciary Judicial Proceedings

Civil Actions - Class Action Waiver in a Written Agreement - Unenforceability

This bill prohibits a written agreement made between two parties before a dispute arises between the parties from waiving or having the practical effect of waiving the rights of a party to the agreement to resolve the dispute by obtaining relief as a representative or as a member of a class of similarly situated persons. Any such class action waiver is unenforceable.

The bill applies retroactively and must be applied to and interpreted to affect any written agreement in existence on or after the bill's October 1, 2011, effective date.

Fiscal Summary

State Effect: None. The bill is procedural and is not expected to materially affect State finances.

Local Effect: None. The bill is procedural and is not expected to materially affect local finances.

Small Business Effect: Potential meaningful impact on small businesses that currently use written agreements containing class action waivers. However, the bill is more likely to affect large businesses.

Analysis

Current Law: Under Maryland Rule 2-231, the prerequisites for a class action in the circuit courts are: (1) the class is so numerous that joinder of all members is impracticable; (2) there are questions of law or fact common to the class; (3) the claims

or defenses of the representative parties are typical of the claims or defenses of the class; and (4) the representative parties will fairly and adequately protect the interests of the class.

Background: A class action is a type of lawsuit in which a single person or a large group of people sue on behalf of the interests of a larger group of people or a group of defendants are sued on behalf of a larger group. Class action lawsuits typically occur when it is impractical or inconvenient for all of the members of a group of people with a common interest in the litigation to sue individually or appear personally. A representative is a person who sues on behalf of a group of plaintiffs in a class action.

Class action waivers are becoming a common feature in consumer contracts and are often accompanied by binding arbitration agreements. The Federal Arbitration Act (FAA) authorizes binding arbitration in contracts and generally requires that parties bound to arbitration submit to arbitration instead of litigation. The FAA has been viewed as "manifest[ing] a liberal federal policy in favoring arbitration agreements." *EEOC v. Waffle House, Inc.*, 534 U.S. 279 (2002). In general, the FAA preempts state law and requires courts to give "due regard to the federal policy favoring arbitration…." *Mastrobuono v. Shearson Lehman Hutton, Inc.*, 514 U.S. 52 (1995).

However, under Section 2 of the FAA, arbitration agreements are "valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract." Section 2 of the FAA is often referred to as the "savings clause." The U.S. Supreme Court has held that the savings clause allows states to "…regulate contracts, including arbitration clauses, under general contract law principles." *Allied-Bruce Terminix Cos. v. Dobson*, 513 U.S. 265, 281 (1995). This authority exists so long as a state court does not use state contract law to treat arbitration agreements "in a manner different from that in which it otherwise construes nonarbitration agreements." *Perry v. Thomas*, 482 U.S. 483, 492 n.9 (1987). Courts have interpreted the savings clause as meaning that a state law that limits the enforceability of an arbitration agreement is not preempted by the FAA so long as the state law applies equally to all contracts and does not discriminate against arbitration. This is consistent with the reasoning behind the enactment of the FAA in the 1920s, a time during which courts routinely favored litigation over arbitration in business agreements.

At issue in a case currently before the U.S. Supreme Court is whether the FAA's favorable attitude towards arbitration is so expansive that it prohibits a consumer from participating in a class action lawsuit under certain circumstances.

In *AT&T Mobility v. Concepcion* (U.S. Supreme Court No. 09-893), two consumers sued AT&T over a plan that was advertised as including free cellphones. The consumers alleged that they and numerous other Californians were defrauded because AT&T

charged significant sales tax on the "free" cellphones. AT&T sought to dismiss the case, citing the class action waiver in the contract's mandatory arbitration agreement. A federal district court ruled that the class action ban was unconscionable under California law and that the FAA did not preempt state law in this case because California's common law definition of unconscionability did not defeat the purposes of the FAA. The Ninth Circuit Court of Appeals upheld the lower court's ruling. The U.S. Supreme Court granted *certiorari* in the case to determine whether the FAA preempts state courts from striking down class action waivers contained in mandatory arbitration agreements.

While several state and federal lower courts have invalidated class action bans in contracts using principles of unconscionability under State contract law, the *Concepcion* case hinges on whether the inclusion of a class action waiver in a mandatory arbitration clause creates a situation in which: (1) the waiver falls under the purview of the FAA; (2) the FAA preempts state law pertaining to the waiver; and (3) the waiver is enforceable, regardless of the treatment of class action waivers located outside of mandatory arbitration clauses under state contract law.

AT&T contends that the lower courts discriminated against arbitration when they used state unconscionability law to invalidate a class action ban in a mandatory arbitration clause, because invalidating a class action ban in a mandatory arbitration clause is invalidating a valid form of arbitration that is preempted by the FAA and forces arbitration to operate like litigation. The Concepcions argue that (1) the lower courts did not discriminate against arbitration because they have invalidated class action bans as unconscionable in cases involving contracts that did not contain mandatory arbitration agreements; (2) state law is not preempted by the FAA simply because the class action ban was located in a mandatory arbitration agreement; and (3) preemption by the FAA would give special treatment to arbitration agreements, rather than prevent discrimination against arbitration.

The court heard oral arguments in the case on November 9, 2010. An opinion has not been issued. The case is being closely watched by the business community and consumer groups due to its potential to significantly limit consumer class action lawsuits.

Additional Information

Prior Introductions: None.

Cross File: None.

Information Source(s): Judiciary (Administrative Office of the Courts); *Los Angeles Times;* U.S. Supreme Court – SCOTUS Blog – Preview of U.S. Supreme Court Cases; Oral Arguments and Briefs for Petitioner and Respondent (*AT&T Mobility v. Concepcion*, No. 09-893); Amicus Brief for the States of Illinois, Maryland, Minnesota, Montana, New Mexico, Tennessee, Vermont, and the District of Columbia in Support of the Respondents; Public Citizen; Department of Legislative Services

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