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Winner Pays: The Limits of Unconscionable Arbitration Agreements

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In its important 2011 decision *AT&T Mobility v. Concepcion*, the United States Supreme Court sharply limited the grounds on which a court may invalidate an arbitration agreement. A recent ruling by the United States Court of Appeals for the Eleventh Circuit, *In re Checking Account Overdraft Litigation MDL No. 2036*, illustrates how lower courts are starting to find ways around the Supreme Court's strict enforcement of arbitration agreements. This is the first published, post-*Concepcion* case where a federal court of appeals has rejected an element of an arbitration agreement as unconscionable under state law. The decision also suggests how the drafters of arbitration agreements might avoid such judicial rejection.

Lacy Barras, a customer of BB&T, a commercial bank, sued the bank as part of a putative class of plaintiffs alleging the improper charging of overdraft fees. Page one of the customer agreement between Ms. Barras and the bank contained an arbitration clause providing for arbitration of any disputes under the AAA rules. Page fourteen of the agreement also had a separate provision stating the following:

> COSTS, DAMAGES, AND ATTORNEYS' FEES. You agree to be liable to the Bank for any loss, costs, or expenses, including, without limitation, reasonable attorneys' fees, the costs of litigation, and the costs to prepare or respond to subpoenas, depositions, child support enforcement matters, or other discovery that the Bank incurs as a result of any dispute involving your account.

Thus, strictly read, the customer was responsible for all of BB&T's costs and fees in any litigation or arbitration against the bank, *regardless of the outcome of the dispute*. Even if Ms. Barras sued BB&T and won, she still would have to reimburse the bank for its costs of defending the suit.

The case was consolidated into a larger multidistrict litigation based in the United States District Court for the Southern District of Florida. BB&T moved to compel arbitration of Ms. Barras's claims. Perhaps realizing that the cost-shifting provision was difficult to defend on the merits, the bank argued that the provision did not apply to proceedings brought under the arbitration clause and effectively promised not to try to enforce it. The bank also argued that the case should be submitted to arbitration even if the cost-shifting provision was invalidated.

The district court twice denied BB&T's motion to compel arbitration, holding the arbitration agreement was unconscionable under South Carolina state law, which governed the dispute. BB&T appealed to the United States Court of Appeals for the Eleventh Circuit, which considered the district court's ruling in light of the Supreme Court's *Concepcion* decision.

In *Concepcion*, the Supreme Court considered the "saving clause" in section 2 of the Federal Arbitration Act, which permits a court to refuse to enforce an arbitration agreement "upon such grounds as exist at law or in equity for the revocation of any contract." The Supreme Court explained that this clause leaves the door open to allowing arbitration agreements to be "invalidated by generally applicable contract defenses, such as fraud, duress, or unconscionability." But the Court effectively narrowed the potential grounds for invalidation, holding that a state rule against class action waivers in customer agreements was preempted by the FAA, because the rule "interferes with fundamental attributes of arbitration" – even though, on its face, the rule was generally applicable to both arbitration and litigation.

Reviewing Ms. Barras's case, the Eleventh Circuit reversed the lower court's ruling, but only insofar as it had denied effect to the arbitration clause in the customer contract. The Eleventh Circuit agreed with the district court that the cost-shifting provision in particular was unconscionable under state law, and held that *Concepcion* did not change this result. At the same time, the court of appeals ruled that the invalid provision could be severed from the arbitration clause, and therefore ordered arbitration of the claims.

The fact that BB&T's cost-shifting provision was buried in the middle of a long agreement of adhesion, coupled with its egregiously one-sided content, made this case a relatively straightforward application of state common law unconscionability. Left unanswered was what would have happened had BB&T's customer agreement been slightly different.

In particular, if BB&T had been a bit more careful in drafting its cost-shifting provision, *Concepcion* might have saved it. Specifically, a provision that required the customer *to pay the arbitrator's fees and administrative costs*, but not BB&T's attorney's fees, would have been an arbitration-specific clause that state law might not be able to touch.

Central to the Eleventh Circuit's ruling was its articulation of a longstanding principle – equally applicable to both litigation and arbitration – "that attorney's fees and costs generally are not recoverable by a non-prevailing party." Under *Concepcion*, the FAA preempts state rules against enforcement "that apply only to arbitration or that derive their meaning from the fact that an agreement to arbitrate is at issue." A state rule that singled out as invalid a provision that focused on *arbitrator's* fees would arguably have been just such a rule. After all, there is no analogue to such a rule in litigation; litigants do not (legally) pay the judge or jury.

True, a court might get out of this conundrum by arguing that a rule against requiring the customer to pay the arbitrator's fees is subsumed into the more general principle that a winning party should not be forced to pay the losing party's costs. But this might be hard to defend where the Supreme Court in *Concepcion* made clear that the FAA preempts any state law that "interferes with fundamental attributes of arbitration." The principle that the parties are responsible for paying an arbitrator is, if anything, more of a fundamental attribute of arbitration than the individual-action principles that led the Court to strike down the state rule against class-action waivers in *Concepcion*. And perhaps an even more fundamental attribute of arbitration is the notion that the terms of the parties' agreement to arbitrate – including any agreement on allocation of costs – will be given effect.

An aggrieved customer might also complain that the arbitrator's costs could exceed the value of the potential award, particularly for a small-scale consumer claim. However, again *Concepcion* forecloses this very argument. In striking down the state rule against class-action waivers, the *Concepcion* Court rejected the contention that class proceedings were "necessary to prosecute small-dollar claims that might otherwise slip through the legal system." Rather, the Court held that the FAA preempted such a rule "even if it is desirable for unrelated reasons."

Another variation on the facts here could also have led to a different result. The Eleventh Circuit observed that while the arbitration clause was prominently displayed on the first page of BB&T's customer agreement, the cost-shifting provision was far down in the fine print. The inconspicuous appearance of this provision "weigh[ed] heavily" in the court's finding that the provision was *procedurally* unconscionable. The court also separately found that the content of the provision was substantively unconscionable. Under the law of South Carolina and many other states, a contractual provision is invalid only if it is both procedurally *and* substantively unconscionable. The logical implication, then, is that a customer-pays provision, however one-sided it might appear, would still be legal under state law if it were adequately disclosed. Indeed, the Eleventh Circuit observed in a footnote that "[b]ecause arbitration is a matter of private contract, parties are of course free to agree that one party will bear the other party's costs and attorneys' fees, and, as in any contract, the parties are bound to this agreement so long as it is enforceable." If BB&T's cost-shifting provision had been – like the arbitration clause – displayed in bold writing, on the first page of the customer agreement, it might not have contained the "element of surprise" that led the court to find that "Barras lacked a meaningful choice in agreeing to the provision." Can an egregious cost-shifting provision survive judicial scrutiny, so long as it is prominent enough in the agreement? Eventually, perhaps an audacious company will put it to the test.

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