Preempted? Class Actions and the Wireless Phone Industry

by Jonathan Scott, Esq.[1]

The advertisement: "XYZ Wireless – the only wireless phone you'll ever need. Unlimited calls, one cheap rate, service available everywhere in the state all the time." The consumer complaint: The billing practices of XYZ Wireless include rounding up airtime charges and other hidden costs, and they do not provide reliable service everywhere in the state. The lawsuit: plaintiffs file a putative class action in state court alleging state law claims for violations of the state consumer protection law, fraud, and breach of contract. The result?

The result under this fact pattern may not turn on the evidence or whether the requisites of a class action have been met. The case may be decided on an issue that might not appear, at first blush, to be significant – will any or all of the plaintiffs' claims be dismissed because they are preempted by federal law?

As federal legislation and regulation has increased, attorneys involved in class action litigation have inevitably found themselves faced with arguments regarding whether a

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[1]Jonathan C. Scott is the managing attorney of the Smithtown, New York office of Lawfinders Associates, Inc., a nationwide consulting firm offering litigation support services to attorneys. He earned his B.A. and Masters degrees from State University of New York at Stony Brook and his J.D. degree from Touro College School of Law. Mr. Scott is a member of the New York, New Jersey, Connecticut, Washington D.C., Florida, and Pennsylvania bars.

plaintiff's state law claims are preempted by federal law. By asserting a preemption defense, a defendant asks the court to find that even where a state cause of action exists, the state, by statute or through the courts, has no power to enforce its laws against the defendant. Preemption issues can arise anytime plaintiffs seek redress against an industry regulated by the federal government. The Supreme Court itself has weighed in on preemption claims involving a number of industries ranging from airlines to licensed grain warehouse operators. As the range and scope of federal regulation continues to expand, class action claims involving regulated industries will continue to be affected. And even when an industry has been substantially deregulated, defendants will often assert that claims against them are still preempted.

Pursuit of preemption defenses have become prevalent in consumer class action suits brought against wireless telephone service carriers. While Congress and the Federal Communications Commission ("FCC") have effectively deregulated most aspects of wireless telephone services, wireless carriers continue to assert that state law consumer protection, fraud, and breach of contract claims are preempted under the Federal Communications Act. The evolving case law in the wireless area provides guidance on how to avoid running afoul of the preemptive effect of federal law and serves as a cautionary tale regarding how, in class action claims against industries subject to any federal regulation, plaintiffs' counsel should consider how claims may be pled to avoid a preemption defense and defendants' counsel

should carefully research the possible scope and effect of federal statutes regulations on state law causes of action.

The Basics of Preemption

The issue of federal preemption of state law springs from the federal Constitution itself – specifically, the Supremacy Clause in Article VI. As Justice Souter recently explained, when federal law preempts state law, "on the subject covered, state law just drops out." *Nixon v. Missouri Municipal League*, 2004 WL 573799, *6 (U.S. 2004). If federal law preempts a state's ability to regulate conduct in an area, a party is only answerable for its conduct under federal law and is no longer answerable to state regulatory authorities or subject to suit in state court for causes of action based on state law.

A defendant's argument that a state law claim is eliminated under the doctrine of preemption may arise under several different circumstances. First, Congress may explicitly indicate its intent to preempt state law. *Schneidewind v. ANR Pipeline Co.*, 485 U.S. 293, 299 (1988). Preemption may also be inferred when federal legislation in a particular field is so comprehensive that it is reasonable to infer that Congress did not intend to leave any room for state regulation in the area. *Hillsborough County v. Automated Med. Labs., Inc.*, 471 U.S. 707, 713 (1985). Preemption may also exist when a state law or regulation actually conflicts with federal law. *California Fed. Sav. & Loan Ass'n v. Guerra*, 479 U.S. 272, 281 (1987). In determining whether Congress intended to preempt a particular state law or judicial act, a court focuses on what type of activity a state seeks to control or regulate, and

not the method by which the state chooses to regulate. Accordingly, in addition to prohibiting state statutory enactments or regulations, federal law may also preempt common law causes of action in state court. There is generally a presumption against preemption of state law claims in the absence of an express indication by Congress. The Supreme Court has stated that congressional intent to preempt must be "clear and manifest," particularly in areas traditionally reserved to the states such as the exercise of state police powers, including consumer protection against fraud, misrepresentation, and deceptive practices. *Medtronic, Inc.* v. *Lohr,* 518 U.S. 470, 485 (1996).

How Does a Court Determine if a Claim is Preempted

Complete preemption exists when Congress "so completely preempt[s] a particular area, that any civil complaint raising this select group of claims is necessarily federal in character." *Metropolitan Life Ins. Co. v. Taylor*, 481 U.S. 58, 63-64 (1987). Complete preemption is jurisdictional, and any claim in the area is necessarily federal in nature. To establish complete preemption, a defendant must show that: (1) the statute contains a civil enforcement provision that creates a cause of action that both replaces and protects the analogous area of state law; (2) there is a specific jurisdictional grant to the federal courts for enforcement of the right; and (3) there is a clear Congressional intent that claims brought under federal law be removable. Few federal statutes meet this high standard, and complete preemption has been clearly found only in the areas of federal labor relations, the Employee Retirement Income Security Act of 1974, and certain Indian land grant rights cases. *Oneida*

Indian Nation v. County of Oneida, 414 U.S. 661, 666-67 (1974); *Arana v. Ochsner Health Plan, Inc.*, 338 F.3d 433, 439 (5th Cir. 2003).

More commonly, a defendant will raise a claim of ordinary preemption as an affirmative defense to a state claim, asserting that federal law has eliminated the plaintiff's state law claim. This form of preemption does not create federal subject matter jurisdiction and only supports dismissal of the state court action, not removal to federal court. Preemption can found when a state attempts to regulate "in a field that Congress intended the Federal Government to occupy exclusively," and Congress's intent to do so may be inferred from a pervasive regulatory scheme or where federal interest in a particular field is so dominant that Congress's intent to preclude enforcement of state laws on the same subject may be presumed. *English v. General Elec. Co*. 496 U.S. 72, 79 (1990). State law may also be preempted when compliance with both federal and statute regulations is impossible, when a state law becomes an obstacle to accomplishing Congress's objectives and purposes, or when a state law would directly conflict with federal law. *Gade v. National Solid Wastes Mgmt. Ass'n*, 505 U.S. 88, 98 (1992). With respect to wireless telephone carriers, the preemption issue has arisen out of a Congressional enactment expressly prohibiting states from regulating the rates charged by the wireless service carriers or the entry of carriers into the marketplace.

Federal Regulation and Deregulation of the Wireless Phone Industry

The Federal Communications Act of 1934 ("FCA"), 47 U.S.C. § 151, *et seq*., governs, among other things, the licensing and regulation of "commercial mobile radio service providers" such as wireless telephone companies. Congress revised the statutory system of licensing and regulating wireless telecommunications services in 1993 to promote a rapid development of a wireless telecommunications infrastructure in the United States. To prevent the creation of a hodge podge of state and local regulations that might hamper the development of wireless communications systems, Congress amended Section 332 of the FCA to expressly prohibit state and local governments from "regulat[ing] the entry of or the rates charged by any commercial mobile service or any private mobile service . . .." 47 U.S.C. § 332(c)(3)(A). This narrow provision expressly preempts state and local regulation of the rates charged by wireless carriers and the terms under which a wireless carrier may enter the marketplace, reserving such regulatory authority to the FCC.

The FCC has also chosen not to regulate the rates charged by wireless carriers, as part of its effort to promote the development of the wireless phone industry. While other telephone-service providers have been required in the past to seek FCC approval for their service rates by filing a document known as a "tariff," wireless service carriers are specifically exempted from tariff filing requirements by the FCC. 47 C.F.R. § 20.15(a), (c) (1997); 47 C.F.R. § 20.3 (1997). Having been freed from the obligation imposed on other telephone-service providers to file their rates with the FCC, wireless carriers therefore cannot invoke the filed-rate doctrine, a judicial doctrine that eliminates any claims relating to a

defendant's rates when those rates are subject to regulatory approval. *See American Tel. and Tel. Co. v. Central Office Tel., Inc*., 524 U.S. 214, 222 (1998) (under the filed-rate doctrine, "even if a carrier intentionally misrepresents its rate and a customer relies on the misrepresentation, the carrier cannot be held to the promised rate if it conflicts with the published tariff.") Given the FCC's choice not to regulate wireless carrier rates, section 332 prevents a state from imposing its own regulatory scheme on wireless carrier rates.

But Section 332 does not eliminate all claims against a wireless carrier. Instead, section 332 also establishes that states are not prohibited "from regulating other terms and conditions of commercial mobile services." 47 U.S.C. § 332(c)(3)(A). According to the House Committee that considered this legislation, the phrase "terms and conditions" included matters such as customer billing information and practices, billing disputes, and other consumer protection matters. H.R.Rep. No. 103-111, 103d Cong., 1st Sess. 211, 261, reprinted in 1993 U.S.C.C.A.N. 378, 588. Wireless carriers have nevertheless asserted that under section 332, class action claims by consumers based on state consumer protection laws, as well as state tort and contract law, are preempted under section 332.

The Courts Reach Inconsistent Results on the Preemption of State Law Claims Against Wireless Carriers

After section 332 was enacted, the issue of preemption began to arise in class actions where consumers brought claims against wireless carriers under state consumer protection laws. The first courts to address the issue of preemption reached inconsistent results. For instance, in *Tenore v. AT&T Wireless Serv., Inc.*, 962 P.2d 104 (Wash. 1998), customers

brought a class action against cellular telephone service carriers alleging that the carriers failed to disclose in their advertising that they rounded up airtime charges to the nearest minute. The Washington Supreme Court held that section 332 did not preempt a fraud claim based on a wireless carrier's billing practices. In *Ball v. G.T.E. Mobilnet of California*, 96 Cal.Rptr.2d 801 (Cal. App. 2000), customers sued every major provider and owner of cellular phone services in California alleging that requiring them to pay for "non-talking" time, including the practice of rounding up airtime charges, constituted unfair and unlawful business practices under California law. The Court of Appeal held that the plaintiffs' claims for injunctive relief against the defendants' billing for non-communication time were preempted by section 332 because such claims constituted an attempt to regulate the carriers' rates. The court also determined, however, that claims of inadequate disclosure or misrepresentation were not preempted because states are still allowed to regulate "other terms and conditions" such as what information carriers did or did not disclose about their billing practices to their customers. The court concluded that claims regarding the carriers' failure to disclose that they were rounding up airtime charges were therefore not preempted.

The Seventh Circuit saw things quite differently in *Bastien v. AT&T Wireless Servs., Inc.*, 205 F.3d 983 (7th Cir. 2000). In *Bastien*, a dissatisfied customer sued a wireless service provider in state court for breach of contract and consumer fraud. The defendant removed the case to federal court, and the Seventh Circuit held that because section 332 completely preempted regulation of wireless telephone industry rates and market entry, the case was

properly in federal court. The court examined the plaintiff's complaint and concluded that while the plaintiff's allegations were couched in terms of consumer-protection claims, the allegations were, in substance, claims based on the rates being charged and, because they attacked the caliber of service provided by the defendant, the claims also constituted an attempt to use a state court proceeding to create a barrier to market entry.

The FCC Speaks

In the wake of these conflicting decisions, the FCC itself weighed in with its opinion regarding what claims, if any, could be brought in state court under section 332. In *In re Wireless Consumers Alliance, Inc.*, 2000 WL 1140570 (FCC August 14, 2000), the FCC sought to give guidance to state courts on the issue of whether section 332's language prohibiting rate regulation precluded state courts from considering consumer-protection, tort, and contract claims. In its *Wireless* decision, the FCC confirmed that state courts may adjudicate state-law claims against wireless carriers for violations of consumer protection, tort, and contract laws. The *Wireless* decision arose out of a California case involving consumer claims that a wireless carrier engaged in unfair business practices, falsely advertised that it provided a "seamless calling area," and made intentional and negligent misrepresentations about its services. In its decision, the FCC addressed whether section 332 preempts "state courts from awarding monetary relief against [wireless service carriers] (a) for violating state consumer protection laws prohibiting false advertising and other fraudulent

business practices, or (b) in the context of contractual disputes and tort actions adjudicated under state contract and tort laws." *Wireless* at ¶ 1.

The FCC concluded that "section 332 does not generally preempt the award of monetary damages by state courts based on state consumer protection, tort, or contract claims." *Wireless* at ¶¶ 2. The FCC, in essence, rejected the *Bastien* court's conclusion that even where state-law claims did not directly challenge the reasonableness of a carrier's rate, consumer protection, tort, and contract claims are, in substance, only disguised challenges to rates because in computing damages, a state court would necessarily be determining whether the price charged by the carrier was reasonable. Instead, the FCC stated that state non-disclosure and consumer fraud claims are not disguised attacks on the reasonableness of the rate charged for the service. *Wireless* at ¶ 26. The FCC made it plain that while section 332 prohibits state regulation of rates or market entry, a wireless carrier may be subject to damages for a non-disclosure or false advertising if it fails to inform consumers of material terms, conditions, or limitations on the service it provides, and that an award of damages based on the difference between the service provided and the service promised does not require a state court to determine the reasonableness of a carrier's rates. *Wireless* at ¶ 26. While the rates actually charged may become a part of a court's damages computation, "a consideration of the price originally charged, for the purposes of determining the extent of the harm or injury involved, is not necessarily an inquiry into the reasonableness of the original price and therefore is permissible." *Wireless* at ¶ 38. The FCC also stated the

reasonableness of a rate is not implicated by a complaint questioning a carrier's quality of service. *Wireless* at ¶ 25, n. 83 and 84. The FCC did caution, however, that a state claim may be preempted if, when determining a damages award, a state court engages in "a regulatory type of analysis that purports to determine the reasonableness of a prior rate or it sets a prospective charge for services." *Wireless* at ¶ 38.

After *Wireless*, Courts Hold That Most Consumer Claims Are Not Preempted

In the wake of *Wireless,* every state appellate court to have addressed the preemption issue has concluded that most state consumer protection and breach of contract claims are not preempted by section 332. In *Spielholz v. Superior Court*, 104 Cal.Rptr.2d 197 (Cal. App. 2001), which involved the same facts presented in *Wireless*, the plaintiff brought claims for unfair business practices, misrepresentation, and false advertising based on the carrier's conduct in falsely advertising a "seamless calling area" throughout Southern California and its failure to disclose gaps or "dead zones" where wireless telephone users were unable to connect calls. The court concluded that section 332 does not prohibit a state court from awarding damages based on false advertising. The court noted that while a state court was prohibited from making an outright determination regarding the reasonableness of a carrier's rates, computing a damages award based, in part, on the rates charged would not constitute such a determination. Similarly, in *Naevus Int'l, Inc. v. AT&T Corp.*, 724 N.Y.S.2d 721 (N.Y. App. 2001), the Supreme Court of the State of New York, Appellate Division, First Department relied on *Wireless* and held that while subscribers' claims for breach of contract,

unjust enrichment, and breach of warranty were preempted because they attacked the rates charged, claims based on a carrier's misrepresentations regarding its services would not be preempted. In *Union Ink Co., Inc. v. AT&T Corp.*, 801 A.2d 361 (N.J. App. 2002), and *Bryceland v. AT&T Corp.*, 114 S.W.3d 552 (Tex. App. – Dallas 2002, pet. filed), the plaintiffs' asserted common law fraud, negligent misrepresentation, and violations of the state consumer fraud statute based on a carrier's representations regarding its rate plan and services. The *Union Ink* and *Bryceland* courts, both following *Wireless,* concluded that the plaintiffs' claims were not preempted.

Even the Seventh Circuit has recently retreated from its *Bastien* decision. In *Fedor v. Cingular Wireless Corp.*, 355 F.3d 1069 (7th Cir. 2004), a cellular phone owner brought a putative class action in state court against a service provider, alleging that the provider breached its contract by deferring billing for calls into periods after the dates of the calls. The case was removed to federal court, relying on *Bastien*, but the Seventh Circuit held that the plaintiff's state law claims were not preempted by the FCA so as to permit removal. The Seventh Circuit rejected the carrier's argument that section 332 covered "any claim that touches on the rates charged in any manner" and cited *Wireless* as authority for its conclusion that the plaintiff's claims were not preempted. The *Fedor* court recognized that simply because a state court would reference the rates charged in assessing damages, by doing so, the court "would never examine the reasonableness of those rates" but only the question of whether the charges were consistent with the parties' contract or the carrier's representations.

The court also noted, however, that if a plaintiff's claims required a state court (1) to enter into a regulatory type of analysis purporting to determine the reasonableness of a carrier's rates or (2) to determine what wireless service infrastructure was appropriate or necessary for a carrier to enter the market, those claims would be preempted.

Preempted or not Preempted

The wireless cases provide an example of how even run-of-the-mill consumer fraud and breach of contract claims can potentially become federal issues if a federally-regulated industry is involved or Congress has otherwise indicated its intent to preempt state regulation. If claims against a wireless carrier are improperly pled and can be interpreted as attacks on a carrier's rates or their entry into the marketplace, the claims of a plaintiff class may be preempted. Both the FCC and recent court decisions indicate that when a court engages in a "regulatory type of analysis" with respect to a carrier's rates, a plaintiff's claims would be preempted. But neither the FCC nor recent opinions have defined what constitutes a regulatory type of analysis, leaving a great deal of uncertainty concerning what types of claims might be preempted. Given that the scope of federal preemption in the area remains, in many ways, unsettled, defendants are certain to raise preemption as an affirmative defense.

In any case where preemption may be an issue, the question of possible preemption must be addressed by the plaintiff before the case is even filed, and plaintiff's counsel should attempt to avoid having claims preempted through careful research regarding the relevant statutes and prudent pleading of claims. As in the wireless arena, how a claim is pled can be

determinative, and the complaint should be drafted from the beginning with an eye towards avoiding any preemption dispute. A defendant should similarly study any relevant statutory and regulatory scheme, as well as related legislative materials and the latest decisions, to determine if a preemption defense might be available and how best to characterize a plaintiff's claims so that they will fall within the scope of federal preemption.