Litigation Alert: U.S. Supreme Court Enforces Class Action Waivers in Consumer Arbitration Agreements

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AT&T Mobility v. Concepcion, No. 09-893, Argued November 9, 2010 – Decided April 27, 2011.

Summary

On Wednesday April 27, 2011, the Supreme Court, by a 5-4 decision, overturned California's refusal to enforce waivers of class action rights in consumer arbitration agreements, holding that the Federal Arbitration Act ("FAA") preempted California's rule. The Court's holding calls into question state rules finding arbitration provisions unconscionable based on the purported unfairness to claimants of contractual arbitration procedures. The decision further underscores the strong federal policy in favor of arbitration agreements and indicates consumers (and likely other groups) will be less able to avoid contractual arbitration provisions resulting in the survival of far fewer class actions.

Background of the Case

In *AT&T Mobility*, plaintiffs filed a putative class action in the Southern District of California alleging false advertising and fraud based on AT&T charging sales tax on cellular telephones that were advertised as "free." After the suit had been filed, AT&T amended the Wireless Services Agreement ("WSA") it had with customers to include a payment by AT&T of $7,500 should the customer prevail in an arbitration at an amount greater that AT&T's last written settlement offer before the arbitration had commenced. After this amendment, AT&T moved to compel the plaintiffs to submit their claims to individual arbitration under the revised WSA, which contained a waiver of rights to proceed by class action.

Although noting the generally consumer-friendly terms of the arbitration provision at issue, the district court denied AT&T's motion to compel arbitration, citing *Discover Bank v. Superior Court,* 26 Cal.App. 4th 148 (2005). The so-called *Discover Bank* rule had held that class action waivers in most consumer arbitration agreements are unconscionable (and therefore not preempted by the FAA).

The Ninth Circuit affirmed the district court's opinion. Considering whether the FAA expressly or impliedly preempts California's *Discover Bank* rule, the Ninth Circuit followed its prior decision in *Shroyer v. New Cingular Wireless Services, Inc.*, 498 F.3d 976 (9th Cir. 2007). *Shroyer* held that invalidating arbitration agreements banning class actions would not contradict the FAA's dual policies of (1) reversing judicial hostility to arbitration agreements by placing them on the same footing as any other contract, and (2) promoting the efficient and expeditious resolution of claims. The Ninth Circuit also interpreted the holding in *Discover Bank* to create a three-part test to determine whether a class action waiver in a consumer contract is unconscionable: (1) is the agreement a contract of adhesion; (2) are disputes between the parties likely to involve small amounts of damages; and (3) is it alleged that the party with superior bargaining power carried out a plan to deliberately "cheat large numbers of consumers out of individually small sums of money." *Id.* at 983. While the Court recognized that AT&T's addition of the $7,500 premium payment in the revised WSA added a "new

wrinkle" under the second prong of the *Discover Bank* rule, it found that this did not distinguish the case from *Shroyer* and that "under California law, the present arbitration clause is unconscionable and unenforceable" and that the FAA did not preempt California unconscionability law.

The Supreme Court's Decision

Before the Supreme Court, AT&T again emphasized the consumer-friendly terms of the WSA, including the potential recovery of double attorney's fees in addition to the $7,500 premium payment. Additionally, AT&T argued that California's unconscionability doctrine as articulated in *Discover Bank* was applied in a discriminatory way to disfavor arbitration. In response, Conception argued that California has a policy against allowing a party, here AT&T, from exempting itself from responsibility for its own fraud, and that this policy constitutes sufficient grounds for the revocation of a contract under FAA's Section 2. That section states that arbitration agreements "shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract" – often referred to as the "savings clause." According to Conception, preventing a corporation from immunizing itself from class action litigation is a basis to invalidate an arbitration agreement contemplated and consistent with Section 2 of the FAA.

In a decision authored by Justice Scalia, the Supreme Court held that state-imposed rules mandating procedures incompatible with those contained in arbitration agreements were contrary to the FAA's intention to promote arbitration and enforce agreements to arbitrate. The procedure at issue here was the availability of class actions in arbitration, but the Court also included specific discovery or evidentiary requirements as other illustrations.

Turning then to the specifics of the case, the Court held that "requiring the availability of class-wide arbitration interferes with fundamental attributes of arbitration and thus creates a scheme inconsistent with the FAA." Slip op at 9. Specifically, the Court held that such requirements would impose delay, formality, and added risk to defendants (who could not seek fulsome judicial review of large class awards), and that "arbitration is poorly suited to the higher stakes of class litigation." *Id.* at 16.

Notably, the Court did not purport to determine whether the arbitration provision before it was unconscionable under California law. It rejected *Discovery Bank* and other state rules requiring that, in the absence of certain procedural, evidentiary, or other safeguards, arbitration agreements are necessarily unconscionable. Accordingly, it held that "California's *Discover Bank* rule is preempted by the FAA" because it "stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress" (*Id.* at 18 (citation omitted)), namely the "national policy favoring arbitration. *Id*. at 11.

The dissent, led by Justice Breyer (joined by Justices Ginsburg, Sotomayor and Kagan) was of the view that the majority misinterpreted the history and reach of federal arbitration law, which the dissent interpreted as allowing class actions to co-exist with the Federal Arbitration Act's protections for arbitration. The dissent also projected that under this rule, "small-dollar claimants" might be more likely to abandon their claims rather than press a case.

Implications

Wednesday's decision should significantly decrease the number of class actions that will survive. This decision sounds the death knell for state prohibitions on class action waivers in arbitration agreements and other rules that require certain arbitration procedures in order to avoid a finding of unconscionability. Previously, these rules had provided consumers (and other groups) with a way to avoid arbitration and pursue class action claims. Now more consumers will be required to arbitrate their disputes and be unable to seek class-based relief. The impact of *AT&T Mobility* will also likely extend far beyond arbitration

agreements in consumer contracts. For example, employees will likely find it far more difficult to pursue class action claims or otherwise challenge the validity of arbitration clauses.

Although the outcome may have been influenced by the perceived fairness of the underlying AT&T agreement, as framed by Justice Scalia, the decision did not turn on an analysis of fairness. Moreover, the decision expressed doubt about additional arguments where they "rely on the uniqueness of an agreement to arbitrate as a basis for a state-law holding that enforcement would be unconscionable." *Id.* at 7. For example, the Court expressed intolerance for state rules that would require particular forms of discovery and for other procedural constraints that might undermine the parties' arbitral bargain.

Nevertheless, while *Discover Bank* and other cases of its ilk are clearly overruled, other decisions such as *Armendariz v. Foundation Health Pyschcare Servs., Inc.*, 24 Cal. 4th 83, 113-114 (2000), which found a unilateral arbitration agreement in an employment contract to be unconscionable, are still in force. In *Armendariz*, the California Supreme Court found that arbitration agreements may be unconscionable when they are 'overly harsh' or cause 'one-sided' results." *Id.* at 114 (internal citations omitted). Unlike *Discover Bank*, the *Armendariz* provision was not found to be unfair because of a procedural shortcoming, but instead because it only applied to claims brought by employees while still allowing employers a choice of forum.

Accordingly, in drafting and seeking to enforce future consumer agreements, businesses should understand that imbalanced arbitration clauses may still be found unconscionable in their entirety, especially where the purported unconscionability is not derivative of the use of an arbitration procedure itself, but rather an imbalance of rights as between the parties within the arbitration forum.

This decision also limits the general availability of class-based arbitration as it comes in the wake of the Supreme Court's decision in *Stolt-Nielsen v. AnimalFeeds International Corp.*, 130 S.Ct. 1758 (2010). There the Court addressed the availability of class arbitration where a bilateral arbitration agreement between two commercial entities was silent on whether one party could initiate class arbitration against the other. After one party did so over the protest of the other, the Supreme Court held that such an agreement could not be deemed to support class arbitration in the absence of a specific class arbitration provision. Taken together, these decisions effectively mandate that unless both sides otherwise agree, class action arbitration will only be allowed where the contract at issue specifically requires that form of alternative dispute resolution.

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