SUPREME COURT HOLDS THAT AGREEMENTS WITH ARBITRATION CLAUSES CAN PROPERLY WAIVE CLASS ACTION RIGHTS

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On Wednesday, April 27, 2011, the Supreme Court issued a 5-4 decision in *AT&T Mobility v. Concepcion*, ruling that the Federal Arbitration Act ("FAA") protects the rights of companies to require arbitration and to preclude individuals from pursuing such arbitration on a classwide basis, even in consumer contracts. That decision, authored by Justice Scalia, will likely reduce the prevalence of classwide arbitrations, and makes arbitration clauses more attractive to companies seeking to protect themselves against consumer or other types of class actions.

The case arose out of the purchase of cellular telephones and service by Vincent and Liza Concepcion ("Plaintiffs" and "Respondents") in February 2002. At that time, the Plaintiffs entered into a service agreement with AT&T Mobility LLC ("Defendant" and "Petitioner"), which was advertised as including "free" phones, but were charged $30.22 in sales tax based on the phones' retail value. Plaintiffs subsequently filed a lawsuit in a California federal district court alleging that charging sales tax on "free" phones was an unfair and deceptive practice in violation of California's Unfair Competition Law.[1]

The Concepcions' cellular service agreement "provided for arbitration of all disputes between the parties, but required that claims be brought in the parties' 'individual capacity, and not as a plaintiff or class member in any purported class or representative proceeding.'"[2] Defendant moved to compel arbitration under the terms of the arbitration agreement.[3] The District Court, relying on the California Supreme Court decision *Discover Bank v. Superior Court*, 36 Cal.4th 148 (2005),[4] found the arbitration provision unconscionable because it prohibited classwide treatment.[5] Defendant appealed to the Ninth Circuit Court of Appeals, which agreed that the provision was unconscionable under California law, and that the Federal Arbitration Act did not preempt California's unconscionability law found in *Discover Bank*.[6]

In reversing the Ninth Circuit, the Supreme Court relied upon its interpretation of the language of Section 2 of the FAA, which states in relevant part: "A written provision in any maritime transaction or a contract evidencing a transaction involving commerce to settle by arbitration a controversy thereafter arising out of such contract or transaction . . . shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract."[7] The Court stated that that section reflects both "a liberal federal policy favoring

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[1] *Laster v. T-Mobile USA, Inc.*, No. 05cv1167 DMS, 2008 WL 5216255, at *1-2 (S.D. Cal. Aug. 11, 2008).
[2] *AT& T Mobility LLC v. Concepcion*, --U.S.--, No. 09-893, 2011 WL 1561956, at *3 (U.S. Apr. 27, 2011). The provision further states that the arbitrator may not consolidate multiple claims "and may not otherwise preside over any form of a representative or class proceeding." *Id*. at n.2.
[3] 2008 WL 5216255, at *5.
[4] The *Discover Bank* rule provides a three-part inquiry to determine whether a class waiver in a consumer contract is unconscionable: (1) whether the agreement is a consumer contract of adhesion drafted by a party of superior bargaining power; (2) whether the agreement occurs in a setting in which disputes between the contracting parties predictably involve small amounts of damages; and (3) whether it is alleged that the party with the superior bargaining power has carried out a scheme to deliberately cheat large numbers of consumers out of individually small sums of money. *Id*. at *8. The Supreme Court describes the rule as "California's rule classifying most collective-arbitration waivers in consumer contracts as unconscionable." 2011 WL 1561956, at *5.
[5] 2008 WL 5216255, at *5-14.
[6] *Laster v. AT&T Mobility LLC*, 584 F.3d 849, 853, 857-59 (9th Cir. 2009).
[7] 9 U.S.C. § 2.

arbitration" and the "fundamental principle that arbitration is a matter of contract."[8] Thus, the Court stated, "courts must place arbitration agreements on an equal footing with other contracts, and enforce them according to their terms."[9] Ultimately, the Court concluded that "[r]equiring the availability of classwide arbitration interferes with fundamental attributes of arbitration and thus creates a scheme inconsistent with the FAA," such that such a requirement cannot constitute a "ground . . . for the revocation of any contract" as is permitted under Section 2 of the FAA.[10]

Specifically, the Court found that arbitration was much less attractive to companies if done on a classwide basis, stating that "[a]rbitration is poorly suited to the higher stakes of class litigation."[11] For example, the Court noted that "[w]e find it hard to believe that defendants would bet the company with no effective means of review, and even harder to believe that Congress would have intended to allow state courts to force such a decision."[12] In response to the dissent, which the Court characterized as "claim[ing] that class proceedings are necessary to prosecute small-dollar claims that might otherwise slip through the legal system," the Court held that "States cannot require a procedure that is inconsistent with the FAA, even if it is desirable for unrelated reasons."[13] Accordingly, the Court held that "[b]ecause it 'stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress,' California's *Discover Bank* rule is preempted by the FAA."[14]

Justice Thomas concurred separately to note that he "reluctantly join[ed] the Court's opinion,"[15] because his reading of the FAA would require that "an agreement to arbitrate be enforced unless a party successfully challenges the formation of the arbitration agreement, such as by proving fraud or duress."[16] He noted, however, that "the Court's test will often lead to the same outcome as my textual interpretation . . . ."[17]

Justice Breyer, writing for the four-justice dissent, asserted that the Court's decision violated principles of federalism, and misread the FAA.[18] The dissent noted that California law set forth certain circumstances under which class action waivers in <u>any</u> contract were unenforceable, and thus, as the California law was not limited to arbitration agreements, it constituted "such grounds as exist at law or in equity for the revocation of any contract" and accordingly the California law was not preempted by Section 2 of the FAA, but was to the contrary therefore expressly permitted by it.[19] The dissent also took issue with the Court's conclusion that class arbitration was inconsistent with the use of arbitration, noting that it is a "form of arbitration that is well known in California and followed elsewhere," and also that is provided for in the rules of the American Arbitration Association ("AAA").[20] The dissent added that the California law helped

[8] 2011 WL 1561956, at *5.
[9] *Id.*
[10] *Id.* at *6-8.
[11] *Id.* at *12.
[12] *Id.*
[13] *Id.* at *13.
[14] *Id.* (citation omitted).
[15] *Id.* at *14.
[16] *Id.* at *15.
[17] *Id.* at *14.
[18] *Id.* at *16, 23.
[19] *Id.* at *16-18.
[20] *Id.* at *19.

prevent companies from effectively insulating themselves from liability to consumers, noting in that connection, "[w]hat rational lawyer would have signed on to represent the Concepcions in litigation for the possibility of fees stemming from a $30.22 claim?"[21]

Finally, the dissent set forth its view that the language selected by Congress in Section 2 of the FAA had retained an important role for states "incident to agreements to arbitrate," and that principles of federalism, "embodied in specific language in this particular statute," should have led the Court to uphold the California law.[22] The dissent concluded by stating "[w]e do not honor federalist principles in their breach."[23]

[21] *Id.* at *21.
[22] *Id.* at *23.
[23] *Id.*