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U.S. Supreme Court Further Limits Class Arbitration

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Introduction

On April 27, 2011, in *AT&T Mobility LLC v. Concepcion*, a sharply divided U.S. Supreme Court ruled that the Federal Arbitration Act ("FAA") preempted California's judicially created *Discover Bank* rule, which found waivers of class arbitration in most consumer contracts to be unconscionable and therefore unenforceable. Specifically, the Supreme Court held that the FAA prohibits states from conditioning the enforceability of certain arbitration agreements on the availability of classwide arbitration procedures. *AT&T Mobility* reflects the ongoing commitment of the Supreme Court to ensure that the FAA preempts state laws or court rulings that are perceived to present an "obstacle" to the enforcement of private parties' mutual consent to arbitrate in accordance with the terms of their written agreements.

The *AT&T Mobility* decision is not surprising. It was foreshadowed by the Supreme Court's decision last year in *Stolt-Nielsen S.A. v. AnimalFeeds International Corp.*, 599 U.S. ___, 130 S.Ct. 1758 (2010), in which the Court held that where an arbitration agreement is silent on the question of whether class action proceedings are authorized, the parties' consent to class arbitration may not be inferred absent evidence of the parties' intent or a governing rule of law authorizing that inference. Taken together, *Stolt-Nielsen* and *AT&T Mobility* may well lead to the effective demise of class arbitrations unless those decisions are abrogated by federal legislation or subsequent Supreme Court decisions. For companies that seek to avoid the risk of class action lawsuits or arbitrations, *AT&T Mobility* and *Stolt-Nielsen* indicate that properly drafted arbitration clauses can minimize, and perhaps even eliminate, that risk in many circumstances.[1]

The Lawsuit

Vincent and Liza Concepcion (the "Concepcions") purchased cellular phone service from AT&T Mobility ("AT&T"), which advertised that it would provide consumers who agreed to a two-year contract term with a free cellular phone. Although AT&T did not charge the Concepcions for the cell phones, it did charge them $32.22 in sales tax based on the phones' retail value. The Concepcions filed suit against AT&T in the Southern District of California alleging that the practice of charging sales tax on a cell phone advertised as "free" was fraudulent and constituted false advertising. Later, the district court consolidated the Concepcion's action with a putative class action making the same allegations.

In purchasing the phone service that included the free new cell phones, the Concepcions signed an agreement that contained an arbitration clause. The arbitration clause required that any disputes be submitted to arbitration, but also required that claims be brought in a party's "individual capacity, and not as a plaintiff or class member in any purported class or representative proceeding." The arbitration

clause further provided that "the arbitrator may not consolidate more than one person's claims, and may not otherwise preside over any form of a representative or class proceeding." AT&T moved to compel the Concepcions to submit their claims to individual arbitration in accordance with the arbitration clause. Relying on the California Supreme Court's decision in *Discover Bank v. Superior Court*, 36 Cal. 4th 148 (2005), the district court held that the class arbitration waiver was unconscionable and that California unconscionability law is not preempted by the FAA. On appeal the Ninth Circuit affirmed.

The California Supreme Court Decision in Discover Bank

Under California law, courts may refuse to enforce any unconscionable contract or may "limit the application of any unconscionable clause." Cal. Civ. Code § 1670.5(a). In *AT&T Mobility*, the Supreme Court characterized the California Supreme Court's decision in *Discover Bank* as establishing a rule that most class arbitration waivers in consumer contracts are unconscionable and therefore unenforceable.

In *Discover Bank*, the plaintiff credit card holder alleged that Discover Bank engaged in certain deceptive practices regarding assessment of late fees. The plaintiff filed a complaint in state court, but Discover Bank moved to compel arbitration based on an arbitration agreement in the cardholder agreement. The arbitration agreement contained a clause forbidding classwide arbitration. The trial court ruled that the class arbitration waiver was unconscionable, but enforced the arbitration agreement with the proviso that plaintiff could seek classwide arbitration. Ultimately, the California Supreme Court held that the FAA did not preempt California law that class arbitration waivers may be unconscionable. It held:

> [W]hen the waiver is found in a consumer contract of adhesion in a setting in which disputes between the contracting parties predictably involve small amounts of damages, and when 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, then, at least to the extent the obligation at issue is governed by California law, the waiver becomes in practice the exemption of the party "from responsibility for [its] own fraud, or willful injury to the person or property of another." ([Cal.] Civ. Code § 1668.) Under these circumstances, such waivers are unconscionable under California law and should not be enforced.

Discover Bank, 36 Cal. 4th at 162.

In *AT&T Mobility*, the Ninth Circuit construed *Discover Bank* as creating a three-part test to determine whether class waivers are unconscionable: "(1) is the agreement a contract of adhesion; (2) are disputes between the contracting parties likely to involve small amounts of damages; and (3) is it alleged that the party with superior bargaining power has carried out a scheme deliberately to cheat large numbers of consumers out of individually small sums of money." 584 F.3d at 854.

The Supreme Court's Reasoning in AT&T Mobility

Section 2 of the FAA provides that arbitration clauses "shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for revocation of any contract." The Concepcions argued that "unconcionability" is a ground that exists at law or in equity for the revocation of a contract in general and that it may therefore be used to invalidate class arbitration waivers without contravening the FAA. The Supreme Court, however, concluded that the FAA may preempt generally

applicable doctrines or state law rules – such as unconscionability – if they are applied in a fashion that disfavors arbitration.

As "an obvious illustration of this point," the Supreme Court mentioned a hypothetical "case finding unconscionable or unenforceable . . . consumer arbitration agreements that fail to provide for judicially monitored discovery." The Supreme Court set forth other examples of state law rules "classifying as unconscionable arbitration agreements that fail to abide by the Federal Rules of Evidence, or that disallow an ultimate disposition by a jury." Concluding that these examples were not farfetched but rather similar to California's rule invalidating class arbitration waivers, the Supreme Court determined that the FAA preempts state law rules mandating certain arbitration procedures such as class arbitration: "The overarching purpose of the FAA . . . is to ensure the enforcement of arbitration agreements *according to their terms* so as to facilitate streamlined proceedings. Requiring the availability of classwide arbitration interferes with fundamental attributes of arbitration and thus creates a scheme inconsistent with the FAA." (emphasis added)

Echoing its decision last year in *Stolt-Nielsen*, the Supreme Court stated that the fundamental purpose of the FAA is to "ensur[e] that private arbitration agreements are enforced according to their terms." The Supreme Court also emphasized that the FAA was designed to promote speedy dispute resolution and observed that California's *Discover Bank* rule interferes with arbitration in a number of ways: (a) it allows any party to a consumer contract to demand arbitration *ex post* even though the parties agreed that claims would not be asserted on a classwide basis; (b) class arbitration sacrifices the informality of arbitration and makes the process slower and more costly; (c) class arbitration requires procedural formality in order to bind absentee class members; (d) class arbitration greatly increases risks to defendants (risks to which they had not agreed); and (e) arbitration "is poorly suited to the higher stakes of class litigation," noting in particular the lack of appellate review for class certification as well as the final award.

Four justices dissented in *AT&T Mobility*. Writing the dissent, Justice Breyer asserted that the *Discover Bank* rule "cannot be characterized as a targeted attack on arbitration" because it applies to contract waivers of class action litigation as well. The dissent noted that class arbitration is "well-known in California and followed elsewhere" and rejected as without basis the majority's conclusion that individual, rather than class, arbitration is a "fundamental attribute of arbitration." On the contrary, the dissent stated that "neither history nor present practice suggests that class arbitration is fundamentally incompatible with arbitration itself." Finally, while disagreeing with the majority's analysis of the merits of class arbitration, the dissent argued that the perceived advantages or disadvantages of class arbitration "should not factor into our decision."

The Future of Class Arbitration in the United States

AT&T Mobility's holding that the FAA preempts state law rules invalidating class arbitration waivers does not expressly prohibit class arbitration. Parties can still agree to class arbitration. As a practical matter, however, few companies – which are the likely targets of class action arbitrations – are likely to perceive any advantage to class arbitration. To the contrary, most companies likely want to avoid class arbitration just as they want to avoid class action litigation, particularly in the areas of consumer and employment contracts. For those companies that want to avoid class action litigation or arbitration, *AT&T Mobility* and *Stolt-Nielsen* establish at least for now that an appropriately drafted arbitration clause can, in most if not all circumstances, preclude class arbitration arising out of those contracts.

Because the Court's ruling in *AT&T Mobility* is a decision interpreting a statute (as opposed to a constitutional ruling), Congress could amend the FAA to overrule the Court's holding. The decision is almost sure to prompt consumer advocates to urge Congress to do so; and while there have been movements in Congress in the recent past to minimize companies' ability to force consumers to arbitrate their claims,[2] we believe that the current composition of Congress makes it unlikely that Congress will overturn the Court's decision in *AT&T Mobility* immediately. Given political interests, however, we think at least some proposals for further Congressional action will be made, including specifically the introduction of legislation that would incorporate a rule similar to that created by the California Supreme Court in *Discover Bank* into the FAA. Further, we anticipate that the Plaintiffs' bar will not accept *AT&T Mobility* quietly and will continue to litigate the class arbitration question in the hopes of finding some ways to "work around" *AT&T Mobility*. *AT&T Mobility*, particularly when combined with *Stolt-Nielsen*, would seem to foreclose those anticipated efforts by the Plaintiffs' bar, but we will continue to monitor developments in this area and report on them in future issues of Stay*Current*.[3]

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[1] It seems at least possible that, because companies that have not previously included mandatory arbitration agreements in their consumer contracts (because such agreements could not preclude the likelihood of being subjected to class-action arbitration) may, in the wake of *AT&T Mobility*, begin to include such provisions, the decision may result in a significant reduction in the number of class action lawsuits as well as the likely huge reduction in the number of class arbitrations.

[2] *See* "Congress Considers Arbitration Fairness Act," discussing H.R. 1020, a bill that would have prohibited mandatory arbitration provisions included in various types of agreements, including consumer contracts. http://www.paulhastings.com/publicationdetail.aspx?publicationId=1255.

[3] On May 2, 2011, the Supreme Court granted *certiorari* on the Ninth Circuit's decision in *CompuCredit Corp. v. Greenwood*, 615 F.3d 1204 (9th Cir. 2010). In *CompuCredit*, the Plaintiffs contended that a federal statute, the Credit Repair Organizations Act, 15 U.S.C. § 1679c ("CROA"), confers a private right of action that impliedly carves out from the FAA claims arising under that statute. The Ninth Circuit held that the CROA includes a non-waivable right to sue, and that the inclusion of that right in that federal statute precludes any mandatory arbitration of claims arising under it. The Ninth Circuit's decision is in conflict with decisions of the Third and Eleventh Circuits on the same question and raises broader questions regarding conflicts between the FAA and claims arising under other federal statutes. (*AT&T Mobility,* by contrast, involved a state-law claim). The Supreme Court's decision in *CompuCredit* will necessarily address the tension inherent between Supreme Court decisions that place paramount value on enforcing arbitration agreements as written, and Congressional attempts to assure certain classes of plaintiffs a judicial forum for their disputes.

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