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US Supreme Court Gives Green Light to Class Action Waivers in Consumer Contracts

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On April 27, 2011, the U.S. Supreme Court, ruling in a five-to-four decision, in AT&T Mobility LLC v. Concepcion et ux., *held that California's* Discover Bank *rule—a rule that largely invalidated class action waivers in arbitration provisions in consumer contracts in California and other states following similar rules—is preempted by the Federal Arbitration Act because it "stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress." The ruling clears the way for class arbitration waivers in consumer arbitration agreements within the FAA's scope.*

The U.S. Supreme Court, in *AT&T Mobility LLC v. Concepcion et ux.*, considered whether the Ninth Circuit correctly ruled that the class action waiver in the arbitration provision in the consumers' contract for the sale and servicing of cell phones was unconscionable, relying in part on the California Supreme Court's decision in *Discover Bank v. Superior Court*, 36 Cal. 4th 148 (2005).[1] In *Discover Bank*, the Court held that when a class action 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," the waiver is unconscionable under California law and should not be enforced. The Ninth Circuit, in *Concepcion*, affirmed the district court's finding that the arbitration provision in the contract was unconscionable under *Discover Bank* because it contained a class action waiver, and further that the *Discover Bank* rule was not preempted by the Federal Arbitration Act (FAA). Reversing the Ninth Circuit, and confirming that the *Discover Bank* rule is preempted, the U.S. Supreme Court recognized that "[a]rbitration is a matter of contract, and the FAA requires courts to honor parties' expectations," and that "[s]tates cannot require a procedure that is inconsistent with the FAA, even if it is desirable for unrelated reasons."

[1] The arbitration agreement provided that AT&T would pay claimants a minimum of $7,500 and twice their attorney's fees if they obtained an arbitration award greater than AT&T's last settlement offer. The district court found this "sufficient to provide incentive for the individual prosecution of meritorious claims that are not immediately settled," and "concluded that the Concepcions would have been **better off** under their arbitration agreement with AT&T than they would have been as participants in a class action." The Ninth Circuit "admitted that aggrieved customers who filed claims would be 'essentially guarantee[d]' to be made whole." Yet both lower courts found the arbitration agreement unenforceable under the *Discover Bank* rule.

The U.S. Supreme Court found that "[w]hen state law prohibits outright the arbitration of a particular type of claim the analysis is straightforward: The conflicting rule is displaced by the FAA." Addressing the *Discover Bank* rule, the Court noted that, although Section 2 of the FAA "preserves generally applicable contract defenses, nothing in it suggests an intent to preserve state-law rules that stand as an obstacle to the accomplishment of the FAA's objectives." The "overarching purpose" of Sections 2, 3, and 4 of the FAA is to "ensure the enforcement of arbitration agreements according to their terms so as to facilitate streamlined proceedings." The Court identified three obstacles to the FAA's objectives that result from the *Discover Bank* rule: (1) switching from bilateral to class arbitration "sacrifices the principal advantage of arbitration—its informality—and makes the process slower, more costly, and more likely to generate procedural morass than final judgment;" (2) class arbitrations require procedural formality to bind the class members, and (3) class arbitration "greatly increases risks to defendants," such that "defendants will be pressured into settling questionable claims."

Justice Thomas, concurring, agreed that Sections 2 and 4 of the FAA "would require enforcement of an agreement to arbitrate unless a party successfully asserts a defense concerning the formation of the agreement to arbitrate, such as fraud, duress, or mutual mistake." He also concluded that contract defenses, such as public policy, unrelated to the making of the agreement are not a basis for declining to enforce an arbitration clause.

Justice Breyer, in the dissenting opinion joined by Justices Ginsburg, Sotomayor and Kagan, argued that the *Discover Bank* rule is consistent with the FAA's language and primary objective, rejecting that it stands as an obstacle to the FAA's accomplishment and execution. He further argued that the Discover Bank rule "puts agreements to arbitrate and agreements to litigate 'upon the same footing.'"

California's *Discover Bank* rule no longer stands as an obstacle to enforcing class action waivers in the arbitration provision in consumer contracts governed by the FAA. By enforcing arbitration provisions according to their terms, *Concepcion* permits the parties to a consumer contract to avail themselves of all the benefits the arbitration procedure was designed to deliver. This opens up additional strategic options for litigants to consider in consumer class action litigation. Furthermore, companies that changed their consumer contracts after *Discover Bank* to eliminate class action waivers in their arbitration provisions or to eliminate arbitration provisions entirely may want to revisit those changes in light of *Concepcion*.

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