U.S. Supreme Court Rules Arbitration Clauses May Waive Class Action Rights

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The Supreme Court of the United States ruled on April 27, 2011, that state laws and court decisions that prohibit arbitration clauses from containing class action waivers are preempted by the Federal Arbitration Act, and that such clauses are not necessarily unconscionable.

The Supreme Court of the United States recently handed down a decision in *AT&T Mobility LLC v. Concepcion*, 562 U.S. ___ (2011), which will have a major impact on the enforceability of class action waivers in arbitration clauses. The court held that the Federal Arbitration Act (FAA) preempts state statutory and decisional authority that treats arbitral class action waivers as unconscionable, as a matter of law. The Supreme Court also specifically disapproved of a California Supreme Court decision that had held that class action waivers in consumer contracts were unconscionable, and thus unenforceable. The AT&T decision could provide a road map for companies desiring to avoid consumer class action claims.

Section 2 of the FAA makes agreements to arbitrate "valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract." 9 U.S.C. §2. The California decision had held that class action waivers are, as a matter of law, unconscionable in consumer contracts of adhesion involving small amounts at issue. Based on its finding that unconscionability may provide grounds to revoke any contract, the California court found the FAA did not prohibit it from refusing to enforce an arbitral class action waiver.

In *AT&T*, the Supreme Court held that this rule interferes with the clear intent of the FAA to promote arbitration, noting "[t]he 'principal purpose' of the FAA is to 'ensur[e] that private arbitration agreements are enforced according to their terms.'" *AT&T* slip op., at 9–10 (quoting *Volt Information Sciences, Inc. v. Board of Trustees of Leland Stanford Junior Univ.*, 489 U.S. 468, 478 (1989)). The court found that the California rule would disallow enforcement of any arbitration agreement that included a class action waiver in a consumer contract. While the California court reasoned that its rule should only apply to adhesion contracts, the Supreme Court noted that "the times in which consumer contracts were anything other than adhesive are long past." *AT&T* slip op., at 12. The Supreme Court also noted that the other requirements for the California rule to be applied—that the case involve small dollar amounts and involve schemes to cheat consumers—were too flexible and would only require basic allegations to be made to defeat the terms of an arbitration agreement. The Supreme Court held that when a state law would

impair the purpose of the FAA to the extent that the California rule would, the FAA must preempt the conflicting state law.

Importantly, the Supreme Court *did not* rule that *all* arbitral class action waivers are enforceable. Rather, the Supreme Court held only that arbitral class action waivers are not, in and of themselves, unconscionable. Courts still must evaluate the particular arbitration agreement at issue on a case-by-case basis to determine whether the terms are fair. The arbitration agreement at issue in the *AT&T* decision, however, provides an example of an arbitration agreement that courts have held to be fair and enforceable. The highlights of that arbitration agreement include the following:

- Venue in the county where the consumer resides
- Consumer election to have the arbitration be in-person, telephonic or decided based on written submissions
- AT&T agreed to pay all costs for nonfrivolous claims
- Arbitrators had the power to award any form of individual relief, including issuing injunctions and presumably awarding punitive damages
- AT&T waived any right to seek reimbursement of its fees and costs
- In the event that a consumer received an award greater than AT&T's last written settlement offer, AT&T was to pay a $7,500 minimum recovery and double the amount of the consumer's attorney's fees

In finding AT&T's terms fair, the Supreme Court relied on the District Court's finding that consumers "were better off under their arbitration agreement with AT&T than they would have been as participants in a class action, which 'could take months, if not years, and which may merely yield an opportunity to submit a claim for recovery of a small percentage of a few dollars.'"

Businesses at risk for consumer class actions should consider whether the cost of a generous arbitration provision like AT&T's may outweigh the risk of consumer class actions. The key to this analysis is the difference between the number of consumers who are likely to pursue individual claims to their conclusion and the likelihood that a plaintiff's attorney will assert claims on behalf of a large number of consumers without their active participation.

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McDermott Will & Emery's Trial Practice Group is continuing to monitor this matter, and will report on new developments as they arise. With our extensive consumer class action experience, McDermott is well-suited to help you evaluate these risks and, if warranted, help you construct and apply a defensible class action waiver. For more information, please contact your regular McDermott lawyer or:

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