Class Action Alert

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U.S. Supreme Court Overturns California Rule that Prohibited Waivers of Class Action Relief in Arbitration Agreements

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On April 27, 2011, in *AT&T Mobility LLC v. Concepcion*[1] (*AT&T Mobility*), the United States Supreme Court, in a 5–4 decision, ruled that federal law preempts California's so-called *Discover Bank* rule, which had classified most purported class action waivers in consumer arbitration contracts as unconscionable and unenforceable. The *AT&T Mobility* decision breathes life into the ability of businesses across the country that regularly contract with consumers to demand, as part of that contract, arbitration of disputes and waiver of any right to pursue a class action or other aggregate or representative action against the business. As a result of this decision, the mere presence of a class action waiver, without more, will be legally insufficient to establish that a consumer arbitration agreement is unconscionable. There remains a risk, however, that class action waivers could still be found to be unconscionable on other grounds, particularly where the arbitration agreement lacks provisions that would make it feasible for customers to seek resolution of small claims.

The *Discover Bank* rule had its genesis in a 2005 decision by the California Supreme Court addressing a consumer challenge to credit card late fees, which the consumer challenged through a class action law suit. Discover Bank pointed to a clause in the plaintiff's credit card agreement that required arbitration and prohibited class or representative claims. The California Supreme Court held that, where 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 individual sums of money," the waiver is unconscionable and unenforceable under California law.[2]

In *AT&T Mobility*, the Supreme Court reviewed similar facts and claims. The plaintiff brought a class action suit alleging that AT&T unlawfully charged sales tax on the retail value of mobile phones that AT&T advertised as "free" under certain contract plans. The plaintiff's cell phone plan was governed by AT&T's standard agreement, which contained a mandatory arbitration clause that required arbitration of all disputes in the subscriber's "individual capacity, and not as a plaintiff or class member in any purported class or representative proceeding." AT&T Mobility sought to enforce this class action prohibition. The plaintiff argued that the class action waiver was unenforceable under the *Discover Bank* rule.

Both the trial court and the U.S. Court of Appeals for the Ninth Circuit, relying on the *Discover Bank* rule, found the class action waiver unenforceable. The Supreme Court, however, held that Section 2 of the Federal Arbitration Act (FAA)[3]—which states that a written agreement to arbitrate is "valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of

any contract"—preempts the *Discover Bank* rule. Specifically, the Court reasoned, "[t]he overarching purpose of the FAA ... is to ensure the enforcement of arbitration agreements according to their terms so as to facilitate streamlined proceedings," and that "[r]equiring the availability of classwide arbitration interferes with fundamental attributes of arbitration and thus creates a scheme inconsistent with the FAA."

The Court cautioned, however, that "states remain free to take steps addressing the concerns that attend contracts of adhesion—for example, requiring class-action-waiver provisions in adhesive arbitration agreements to be highlighted." Additionally, while the arbitration clause in *AT&T Mobility* did include a class action waiver, in many other respects, as the Supreme Court noted, the arbitration clause was very favorable to the consumer. For example:

- AT&T was required to pay all costs of nonfrivolous claims;
- The arbitration was required to take place in the county in which the customer was billed;
- For small claims, the customer could choose how the arbitration proceeded, i.e., whether in person, by telephone, or based solely on written submissions;
- Either party could bring a claim in small claims court in lieu of arbitration;
- AT&T could not seek reimbursement of its attorney's fees; and
- If a customer was awarded an arbitration award greater than AT&T's last written settlement offer (if any), AT&T was required to pay a $7,500 minimum recovery (which amount, by the time of the *AT&T Mobility* decision, had been increased to $10,000 by subsequent amendments to the AT&T arbitration clause) and twice the amount of the customer's attorney's fees.

If an adhesion contract with a consumer has an arbitration clause with a class action waiver, but does not include consumer-friendly provisions like those in *AT&T Mobility*, it is uncertain whether a lower court will distinguish *AT&T Mobility*. The decision observed the consumer-favorable terms but did not limit its holding to such facts. Nonetheless, a plaintiff seeking to pursue a class action will likely point to any such difference as a critical and distinguishing factor, and the *AT&T Mobility* provisions provide the best safe harbor available under the decision.

Class action plaintiffs may also shift their focus to procedural unconscionability arguments, based on how a particular contract is communicated to, and agreed to, by a consumer. For example, to the extent that shrink-wrap contracts, click-through contracts, or other contracts that are not delivered before a consumer purchases a product include an arbitration clause with a class action waiver, renewed scrutiny may be directed towards such contracts as procedurally unconscionable.

Thus, while *AT&T Mobility* overturns the *Discover Bank* rule against class action waivers in arbitration agreements, to maximize the chances that their own arbitration clauses with class action waivers will be enforced, businesses should be attuned to other potential issues regarding both the substance of an arbitration provision and how it is ultimately delivered and agreed to by the customer.

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Endnotes

1 563 US ___, 2011 WL 1561956 (2011)

2 *Discover Bank v. Super. Ct.* 36 Cal.4th 148, 162 (2005)

3 9 U.S.C. § 2.
