WSGR ALERT

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U.S. SUPREME COURT ISSUES SIGNIFICANT NEW DECISION REGARDING CLASS ACTION LITIGATION

Ruling Rejects California Decision Prohibiting Class Action Waivers in Arbitration Agreements

On April 27, 2011, the United States Supreme Court issued an opinion in *AT&T Mobility LLC v. Concepcion* that will have far-reaching implications for class action lawsuits and arbitration agreements. Indeed, many commentators have described *AT&T Mobility* as the Supreme Court's most important decision regarding class action suits, and two U.S. senators already have announced their intention to introduce legislation to amend the federal law upon which the Supreme Court relied.

As explained below, the *AT&T Mobility* decision will be especially significant to companies that transact with consumers pursuant to agreed-upon terms of use or similar agreements, or that have pre-dispute arbitration agreements with employees, because it may allow those companies to avoid class action litigation through properly drafted arbitration clauses.

Background

In recent years, many states—including California—largely have prohibited arbitration agreements that contain "no class action" provisions. Most notably, in *Discover Bank v. Superior Court*,[1] the California Supreme Court held that arbitration agreements prohibiting class actions are, for the most part, unconscionable under California law and therefore unenforceable in its courts. In yesterday's decision, the United States Supreme Court held that this "*Discover Bank* rule" is preempted by the Federal Arbitration Act (FAA) because it "stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress" in enacting the FAA, namely, ensuring the enforcement of arbitration agreements according to their terms so as to facilitate streamlined, efficient proceedings.

Discover Bank v. Superior Court

In *Discover Bank*, a California resident filed suit against Discover Bank alleging that the bank had a practice of representing to cardholders that late payment fees would not be assessed if the payment was received by a certain date, whereas in actuality the fees were assessed if payment was received after 1:00 p.m. on the due date. Although the plaintiff's personal damages were small, Discover Bank's potential liability would be significant if the potential damages of all of its customers were aggregated in a class action lawsuit.

Discover moved to compel arbitration pursuant to the arbitration clause in its standard form agreement with its customers. The arbitration agreement mandated that all disputes be arbitrated and expressly precluded consumers from bringing class claims in arbitration. The trial court granted Discover's motion, but ruled that the class arbitration waiver was "unconscionable" under California law. The trial court therefore allowed the plaintiff to pursue class claims in the arbitration. Discover successfully appealed; the appellate court held that the FAA preempts the state law rule that class arbitration waivers are unconscionable. Discover's victory was short lived, however. The California Supreme Court reversed, holding that the FAA does not preempt California's law and that "under some circumstances, the law in California is that class action waivers in consumer contracts of adhesion are unenforceable, whether the consumer is being asked to waive the right to class action litigation or the right to classwide arbitration."

Discover Bank established a three-part test to determine whether a class action waiver is unenforceable: (1) the contract was one of "adhesion"; (2) the disputes between the parties were likely to involve small amounts of damages; and (3) the party with inferior bargaining power alleged a deliberate scheme to defraud. If these three factors are met, the class action waiver is deemed unconscionable under California law and is not enforceable. Under this test, class action waivers in arbitration agreements with

[1] See *Discover Bank v. Superior Court*, 36 Cal. 4th 148 (2005).

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consumers almost always would be unenforceable in California.

In the years since *Discover Bank* was decided, California courts—and courts throughout the country applying the laws of other states—have refused to enforce class action waivers in a variety of contexts. For example, in *Gentry v. Superior Court*,[2] the California Supreme Court adopted a stringent set of requirements that would need to be met before it would enforce a class action waiver in an employment arbitration agreement.

AT&T Mobility v. Concepcion

In February 2002, Vincent and Liza Concepcion (the plaintiff-respondents) purchased cellular phone service from AT&T Mobility LLC, which was advertised as including a free phone. After the Concepcions were charged $30.22 in sales tax on the retail value of the phones, they sued AT&T in federal district court in California, alleging that it was deceptive for AT&T to advertise the wireless phone as "free" without disclosing that a $30.22 fee would appear on their first bill.

In March 2008, AT&T moved to compel arbitration, pursuant to a clause in its service agreement requiring arbitration of all disputes between the parties. The clause 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." The district court denied AT&T's motion after concluding that AT&T's arbitration provision was unconscionable under *Discover Bank*. The Ninth Circuit affirmed, agreeing that the provision was unconscionable under California law and holding that the FAA did not preempt its ruling. On April 27, 2011, the Supreme Court reversed.

The Supreme Court's Analysis

In a 5-4 decision, the Supreme Court held that California's *Discover Bank* rule is preempted by the FAA. Justice Antonin Scalia's opinion for the majority explained that the "principal purpose" of the FAA is to "ensur[e] that private arbitration agreements are enforced according to their terms" and emphasized that "[t]he point of affording parties discretion in designing arbitration processes is to allow for efficient, streamlined procedures tailored to the type of dispute. It can be specified, for example, that the decision-maker be a specialist in the relevant field, or that proceedings be kept confidential to protect trade secrets. And the informality of arbitral proceedings is itself desirable, reducing the cost and in-creasing the speed of dispute resolution."

The Court recognized that many advantages of arbitration are lost when it is conducted on a classwide basis. "Classwide 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." At the same time, according to the opinion, classwide arbitration "greatly increases risks to defendants" because the "absence of multilayered review makes it more likely that errors will go uncorrected. Defendants are willing to accept the costs of these errors in arbitration, since their impact is limited to the size of individual disputes, and presumably outweighed by savings from avoiding the courts. But when damages allegedly owed to tens of thousands of potential claimants are aggregated and decided at once, the risk of an error will often become unacceptable."

Because California's *Discover Bank* rule undermines the principal advantages of arbitration and is "an obstacle to the accomplishment and execution of the full purposes and objectives" of the FAA, the Supreme Court concluded that the *Discover Bank* rule was preempted as a matter of federal law.

Implications of the *AT&T Mobility* Decision

The Supreme Court's decision in *AT&T Mobility* has significant implications for companies that transact with their customers pursuant to agreed-upon terms of use or similar agreements, or that have arbitration agreements with employees. While class waivers outside of arbitration agreements are likely not valid in California[3] and many other states, yesterday's decision provides powerful ammunition to companies that would prefer to resolve claims through individual arbitration rather than through the court system. Indeed, requiring consumers to pursue claims through arbitration on an individual basis, rather than classwide arbitration or litigation, may significantly decrease the "chance of a devastating loss" and "'in terrorem' settlements" described in the majority's opinion.

In light of *AT&T Mobility*, companies that already have agreements in place with consumers should consider whether to include provisions requiring arbitration with a class action waiver, and how to do so in a way that would ensure that such agreements are enforceable. In addition, companies that do not already form agreements with consumers, employees, or others should consider implementing agreements that include carefully drafted arbitration clauses in order to avail themselves of individual arbitration claim resolution. While arbitration may have significant drawbacks such as the lack of appellate review of an arbitrator's decision—indeed, the district court recognized that AT&T's arbitration clause puts

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[2] See *Gentry v. Superior Court*, 42 Cal. 4th 443 (2007).

[3] See *America Online, Inc. v. Superior Court*, 90 Cal. App. 4th 1 (2001).

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plaintiffs in a better position than they would be in if they were members of a class—companies should consider whether those drawbacks outweigh the burden and risk of defending against a class action lawsuit.

For more information about the *AT&T Mobility* decision, arbitration, or class action litigation, please contact a member of Wilson Sonsini Goodrich & Rosati's litigation practice.

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