THOMPSON HINE

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PRODUCT LIABILITY UPDATE

Supreme Court Upholds Consumer Arbitration Agreements That Bar Classwide Arbitration

In a major win for companies doing business with consumers, on April 27, the Supreme Court held that the Federal Arbitration Act (FAA) preempts a California rule of law, announced in *Discover Bank v. Superior Court*, 36 Cal. 4th 148, 113 P. 3d 1100 (2005), that arbitration agreements are unconscionable and unenforceable unless they provide for classwide arbitration. *AT&T Mobility LLC v. Concepcion*, 563 U. S. ____ (2011).

BACKGROUND

In *Laster v. AT&T Mobility*, 584 F.3d 849 (9th Cir. 2009), *cert. granted sub. nom AT&T Mobility v. Concepcion*, 130 S. Ct. 3322 (2010), the plaintiffs had sought to maintain a class action on behalf of AT&T consumers who entered into agreements entitling them to "free" cell phones but who were subsequently charged sales taxes. *Id.* at 852. AT&T moved to compel arbitration based on the arbitration clause contained in its sales and service agreement with the Concepcions. The arbitration clause provided that AT&T would pay the costs of nonfrivolous arbitration, which could be initiated simply by submitting a demand on AT&T's website, and provided for a minimum recovery of $7,500, plus double attorneys' fees, if the arbitrator awarded a consumer more than AT&T's last settlement offer.

The District Court specifically found that the arbitration agreement "sufficiently incentivizes consumers" to pursue "small dollar" claims and prompts AT&T to make generous settlement offers "even for claims of questionable merit," and that "consumers who were members of a class would likely be worse off" than if they had arbitrated their claims subject to the agreement. *Laster v. T-Mobile USA, Inc.*, 2008 U.S. Dist. LEXIS 103712 at *32, 33-34 (S.D. Cal. 2008). Nonetheless, the District Court found the arbitration clause unconscionable under California law because it precluded classwide arbitration.

The Ninth Circuit affirmed and also held that the *Discover Bank* rule requiring the availability of classwide arbitration was not preempted by the FAA. It agreed with the plaintiffs that the *Discover Bank* rule was protected by the FAA's saving clause, which provides that arbitration agreements may be declared unenforceable "upon such grounds as exist at law or in equity for the revocation or any contract." *Laster v. T-Mobile USA, Inc.*, 584 F.3d 849, 857 (9th Cir. 2009). The saving clause permits nonenforcement of arbitration agreements based on "'generally applicable contract defenses, such as fraud, duress, or unconscionability,'" but not based on defenses uniquely applicable to arbitration agreements. *Concepcion*, slip op. at 5 (quoting *Doctor's Associates, Inc. v. Casarotto*, 517 U.S. 681, 687 (1996). The Ninth Circuit rejected AT&T's argument that class proceedings would reduce the efficiency of arbitration, and found the *Discover Bank* rule

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consistent with the FAA because it "placed arbitration agreements with class action waivers on the *exact same footing* as contracts that bar class action litigation outside the context of arbitration." *Laster*, 584 F.3d at 858.

THE MAJORITY'S ANALYSIS

The Supreme Court reversed the judgment of the Ninth Circuit, holding that the FAA preempts the *Discover Bank* rule. Writing for a five-justice majority, Justice Scalia first noted that, where state law outright prohibits arbitration, the FAA displaces that state law. In *Concepcion*, however, the inquiry was "more complex" because the Court was asked to consider whether "a doctrine [*i.e.*, unconscionability] normally thought to be generally applicable" and thus excepted from the FAA's broad preemption by Section 2 of that Act was being applied in a manner that disfavored arbitration.

To answer this question, the Court considered the effect of the *Discover Bank* rule on the "overarching purpose of the FAA," which is "to ensure the enforcement of arbitration agreements according to their terms so as to facilitate streamlined proceedings." It concluded that "[r]equiring the availability of classwide arbitration interferes with fundamental attributes of arbitration and thus creates a scheme inconsistent with the FAA." *Concepcion*, slip op. at 9. The Court described three ways in which the rule fundamentally undermines arbitration. First, classwide arbitration sacrifices the primary advantage of arbitration – informality – and makes it slower, more costly and more likely to generate a procedural morass than final judgment. Statistics on classwide arbitration confirm this. Second, classwide arbitration "*requires* procedural formality" to ensure that absent members are bound, and it is unlikely that Congress intended to leave such due process and class-related decisions in the hands of arbitrators when it passed the FAA. Third, because of its designed informality, "class arbitration greatly increases the risks to defendants" and results in the "in terrorem" settling of questionable claims. Classwide proceedings raise the stakes of arbitration, which is designed not to provide all the procedural and appellate safeguards that litigation provides. The Court concluded that "[a]rbitration is poorly suited to the higher stakes of class litigation." *Id.* at 16. Because California's *Discover Bank* rule "'stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress,'" the Court held that it was preempted by the FAA. *Concepcion*, slip op. at 18 (quoting *Hines v. Davidowitz*, 312 U.S. 52, 67 (1941)).

Concepcion thus establishes that the FAA prevents courts from refusing to enforce arbitration agreements merely because they preclude plaintiffs from proceeding as a class. More broadly, it shows that rules of state law that condition enforceability of arbitration agreements on requirements that arbitration include procedures paralleling those of litigation may also be preempted. The more exactingly that states seek to apply unconscionability doctrines to force arbitration to approximate litigation, the more likely such applications are to be preempted by Section 2 of the FAA.

For More Information

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