

April 28, 2011

## Supreme Court Holds That the Federal Arbitration Act Preempts State Law Limitations on Arbitration Agreements

***“Arbitration is a matter of contract, and the FAA requires courts to honor parties’ expectations.”***

In a much-anticipated decision regarding class actions and arbitration, the U.S. Supreme Court held on April 27, 2011, that the Federal Arbitration Act (FAA) preempts state contract law limitations on the enforceability of arbitration agreements. In a 5-4 opinion by Justice Scalia in *AT&T Mobility v. Concepcion*, No. 09-893, 563 U.S. \_\_\_\_ (April 27, 2011), the Court held that California’s *Discover Bank* rule, which classified most collective-arbitration waivers in consumer contracts as unconscionable, stood as “an obstacle” to Congressional purpose and is, therefore, preempted by the FAA.

The decision represents a significant victory for businesses seeking to enforce individual arbitration agreements in contracts with consumers, employees, and others. The sweeping language of the Court’s opinion is likely to expand significantly the enforceability of arbitration provisions and class action waivers in consumer and employment contracts.

In *Concepcion*, a husband and wife filed a class action against AT&T Mobility LLC alleging various violations of California’s consumer protection statutes. AT&T moved to compel individual arbitration pursuant to the wireless service contract’s arbitration agreement, which contained an express class action waiver. The district court and the Ninth Circuit held that the class action waiver was unconscionable under California’s *Discover Bank* rule because: (1) it was contained within a contract of adhesion; (2) the dispute involved small amounts of damages; and (3) the plaintiffs alleged a scheme to deliberately cheat large numbers of consumers out of small amounts of money. *Laster v. AT&T Mobility LLC*, 584 F.3d 849, 854-55 (9th Cir. 2009). Like the district court, the Ninth Circuit held that “[t]he FAA does not bar federal or state courts from applying generally applicable state contract law principles and refusing to enforce an unconscionable class action waiver in an arbitration clause.” *Id.* at 856-57 (internal quotation omitted).

The Supreme Court reversed, holding that a state may not condition the enforceability of arbitration agreements on the availability of classwide arbitration procedures. Although generally applicable contract defenses are preserved under the FAA, the Court held that the FAA preempted California’s *Discover Bank* unconscionability rule because “nothing in [the FAA] suggests an intent to preserve state-law rules that stand as an obstacle to the accomplishment of the FAA’s objectives.” Slip Opinion at 9.

The decision reinforces that “[t]he overarching purpose of the FAA . . . is to ensure the enforcement of arbitration agreements *according to their terms*” and that “the FAA was designed to promote arbitration.” *Id.* at 9, 11 (emphasis added). “Arbitration is a matter of contract,” the Court stated, “and the FAA requires courts to honor parties’ expectations.” *Id.* at 17. The California *Discover Bank* rule interfered with the purpose of the FAA, because it essentially allowed any party to a consumer contract to demand a right to class arbitration as a prerequisite for an enforceable arbitration provision. The Court stated that “[r]equiring the availability of classwide arbitration interferes with fundamental attributes of arbitration and thus creates a scheme inconsistent with the FAA.” *Id.* It was inconsistent with the FAA, the majority

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stated, for class arbitration to be “manufactured” by state law rather than brought about through a consensual agreement.

Of particular interest, the majority brushed aside the concerns of the dissent and of consumer advocates that class proceedings are necessary to prosecute small-dollar claims. The majority stated only that “[s]tates cannot require a procedure that is inconsistent with the FAA, even if it is desirable for unrelated reasons.” *Id.* 17.

Because courts in many states have held that class action waivers may be found unconscionable under state contract unconscionability principles, the Supreme Court’s decision has the potential to mark a significant shift in the arbitration arena.



*If you have any questions about this Legal Alert, please feel free to contact any of the attorneys listed below or the Sutherland attorney with whom you regularly work.*

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