

EXECUTIVE ALERT

April 28, 2011

SUPREME COURT UPHOLDS ARBITRATION AGREEMENT WITH CLASS ACTION WAIVER

Yesterday, the United States Supreme Court upheld an arbitration provision in an AT&T cellular telephone contract that required arbitration of all disputes, but required that the arbitration be brought in the parties' "individual capacity, and not as a plaintiff or class member in any purported class or representative proceeding." *AT&T Mobility LLC v. Concepcion*, ___ U.S. ___, 2011 U.S. LEXIS 3367 (Apr. 27, 2011). Both the district court and the Ninth Circuit had held the provision unconscionable under the California Supreme Court's decision in *Discover Bank v. Superior Court*, 36 Cal. 4th 148 (2005). In *Discover Bank*, the California Supreme Court held that class action waivers are unconscionable if the provision is contained in an adhesion contract, the dispute involves a relatively small amount of damages, and the party with inferior bargaining power alleges a scheme to defraud. Both the district court and the Ninth Circuit held that application of the rule in *Discover Bank* was not preempted by the Federal Arbitration Act.

In a 5-4 decision authored by Justice Scalia, the Supreme Court held that California's rule enunciated in *Discover Bank* 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." The plaintiffs argued that the *Discover Bank* rule is permissible under the FAA because it was rooted in California's unconscionability doctrine and policy against exculpation, and, thus, a finding that class action waiver provisions in arbitration agreements are unconscionable is not preempted by the FAA.

The Supreme Court rejected this argument. It found that the FAA's "principal purpose" is to "ensur[e] that private arbitration agreements are enforced according to their terms." It further found that although Section 2 of the FAA preserves generally applicable contract defenses, it does not suggest an intent to preserve state law rules that stand as an obstacle to the FAA's objectives. "The FAA's overarching purpose is to ensure the enforcement of arbitration agreements according to their terms, so as to facilitate informal, streamlined proceedings. Parties may agree to limit the issues subject to arbitration, to arbitrate according to specific rules, and to limit with whom they will arbitrate."

Noting that "the times in which consumer contracts were anything other than adhesive are long past," the Supreme Court found that class arbitration, to the extent it is manufactured by the decision in *Discover Bank* rather than resulting from agreement of the parties, is inconsistent with the purposes of the FAA. First, class arbitration sacrifices the arbitration's informality and makes the process slower and more costly. Second, class arbitration is more likely to generate a procedural mess. Third, class arbitration greatly increases the risk to defendants because defendants have fewer avenues for review and a greater risk of liability if damages are aggregated in a class arbitration. While the Court left states free to address concerns

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over class action waivers in arbitration agreements, such steps cannot conflict with the FAA's purpose to enforce the terms of arbitration agreements.

Enforceability of class action waivers in arbitration agreements will continue to require a case-by-case examination in the context of specific agreements. Nevertheless, the *AT&T* decision should breathe new life into carefully crafted class action waivers.

If you have any questions about this decision or how it may impact your business, please contact Mark Johnson (mjohnson@bakerlaw.com or 614.462.2698), Rodger Eckelberry (reckelberry@bakerlaw.com or 614.462.5189), Robert Tucker (rtucker@bakerlaw.com or 614.462.2680) or your regular Baker Hostetler contact.

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