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Arbitrations 1, Class Actions 0: Supreme Court Breathes New Life Into Consumer Arbitrations

By David Curcio and Nick Nicholas

The Supreme Court may have dealt a death blow to the arbitration of consumer class actions in the 5-4 decision in *AT&T Mobility LLC v. Concepcion*, 563 U.S. _____ (April 27, 2011). The Court held that the Federal Arbitration Act pre-empted the California rule that arbitration clauses banning class actions were unconscionable. By reversing the Ninth Circuit, the Supreme Court has reopened a seemingly locked door and businesses may wish to consider resurrecting their arbitration clauses and modeling them on the *AT&T* opinion.

The case arose out of a cell phone contract in which the consumers were promised "free phones" by AT&T, but were charged $30.22 sales tax for the full retail value of the phones. They sued AT&T for deceptive advertising. AT&T moved to compel an individual arbitration proceeding under the arbitration clause in the cell phone contract. Under the contract, "all disputes" between the parties were subject to arbitration, which must be brought in the parties' "individual capacity, and not as a plaintiff or class member in any purported class or representative proceeding." The clause went on to provide that "the arbitrator may not consolidate more than one person's claims, and may not otherwise preside over any form of a representative or class proceeding."

The District Court found the arbitration clause to be favorable to the consumer in many respects, but still ruled it unconscionable under *Discover Bank v. Superior Court*, 36 Cal. 4th 148, 113 P. 3d 1100 (2005). The arbitration clause's pro-consumer language included a requirement that AT&T bear the cost of a non-frivolous arbitration, and that the proceeding would be held in the consumer's venue. Most significantly, the agreement provided that, "in the event that a customer receives an arbitration award greater than AT&T's last written settlement offer, . . . AT&T [would] pay a $7,500 minimum recovery and twice the amount of the claimant's attorney's fees." The District Court concluded that the informal dispute resolution process was "quick, easy to use" and that "consumers who were members of a class would likely be worse off." *Laster v. T-Mobile USA, Inc.*, 2008 WL 5216255, *11–*12 (SD Cal., Aug. 11, 2008). These consumer-friendly terms can serve as a road map for drafters of new arbitration clauses.

Nevertheless, the District Court, and the Ninth Circuit, citing the *Discover Bank* rule, found the prohibition of class arbitration to be unconscionable "because AT&T had not shown that bilateral arbitration adequately substituted for the deterrent effects of class actions." The Ninth Circuit stated that it was merely refining "the unconscionability analysis applicable to contracts generally in California." *Laster v. AT&T Mobility LLC*, 584 F. 3d 849, 857 (2009). Thus, it believed that it put "arbitration agreements with class action

waivers on the *exact same footing* as contracts that bar class action litigation outside the context of arbitration." *Id*. at 858.

Justice Scalia and the majority disagreed and held that *Discover Bank* was an obstacle to the purposes of the Federal Arbitration Act. Specifically, the Act reflected an intent to favor arbitration and established the fundamental principle that arbitration was a matter of contract. "In line with these principles, courts must place arbitration agreements on an equal footing with other contracts…" Thus, while arbitration agreements can be invalidated by general contract principles, including unconscionability, they cannot be invalidated by "defenses that apply only to arbitration or that derive their meaning from the fact that an agreement to arbitrate is at issue."

Applying this analysis, the majority held that *Discover Bank*'s unconscionability rule disproportionately disfavored arbitration. By manufacturing classwide arbitrations where the agreements specifically prohibited them, the rule obstructed the Federal Arbitration Act's objective to streamline legal proceedings and, therefore, was pre-empted. "Requiring the availability of classwide arbitration interferes with fundamental attributes of arbitration and thus creates a scheme inconsistent with the FAA." Justice Scalia dismissed the argument that the contract at issue was forced on the consumer by noting that "the times in which consumer contracts were anything other than adhesive are long past." As a result, new life has been breathed into arbitration clauses with class action waivers.

The dissent agreed with the Ninth Circuit that *Discover Bank* merely interpreted a statute to disfavor class action waivers in general, and then applied that general rule to block class action waivers for arbitrations involving small damage amounts and a "scheme" to cheat a large number of consumers. To the majority, however, the relative desirability of class arbitrations was irrelevant to the issue of whether or not *Discover Bank* was inconsistent with the Federal Arbitration Act. Both the majority and the dissent asserted that the relative merits of class arbitration and class litigation should not be a factor, although both the majority and the dissent discussed them at length. The majority also noted that the Act was intended to overcome "judicial hostility" to arbitration.

Since the 1990s, when the Supreme Court held that the Federal Arbitration Act pre-empted inconsistent state laws, federal courts have repeatedly grappled with the interaction between the Act and state laws protecting consumers. The turn of the century and the downturn in the economy brought a new series of attacks from Congress and state legislatures. Two of the toughest anti-arbitration bills were the 2009 Arbitration Fairness Act ("AFA"), which did not pass, and the 2010 Dodd-Frank Wall Street Reform and Consumer Protection Act, which did pass. The AFA would have prohibited mandatory pre-dispute arbitration in consumer, employee and franchise disputes. The Dodd-Frank Act not only contains strong anti-arbitration language in its text, it also creates a new Consumer Financial Protection Bureau which is expected to disfavor mandatory consumer arbitration.

As a result of the strong anti-arbitration legislative and regulatory environment, coupled with rising arbitration costs, many businesses stopped including arbitration provisions in their consumer contracts. In addition, some arbitration providers left the business of consumer arbitration. These and other factors, such as the perceived unfairness of arbitration to consumers, still weigh against re-inserting arbitration clauses into consumer contracts. However, the Supreme Court's preference for arbitration, particularly to preclude arbitration of class actions, could tip the scales for some businesses in the other direction. If they do decide to carefully craft new arbitration clauses, the Court's opinion in the *AT&T Mobility* case will be an essential guide and could allow businesses to enforce them with renewed vigor.

If you have any questions regarding this e-Alert, please contact **David Curcio** at **dcurcio@jw.com** or 713.752.4441 or **Nick Nicholas** at 713.752.4443 or **nnicholas@jw.com**.

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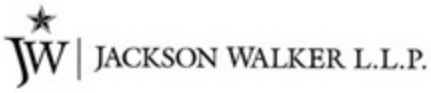

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