State Law May No Longer Prohibit Class Action Waivers in Arbitration Agreements

The Federal Arbitration Act ("FAA") makes agreements to arbitrate "valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract." (9 U.S.C. § 2). However, under California state law's *Discover Bank*-rule class action waivers in consumer contracts are held unconscionable and thus such contracts are unenforceable (*Discover Bank v. Superior Court*, 36 Cal.4th 148, 153 (2005) ("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 class-wide arbitration"); *Laster v. AT&T Mobility LLC*, 584 F.3d 849, 855 (9th Cir. 2009) ("arbitration agreements with class action waivers are on the *exact same footing* as contracts that bar class action litigation")). As a result, arbitration clauses in consumer contracts that prevent consumers from participating in class actions, be it class arbitration or litigation, have routinely been held by both State and federal courts in California to be unenforceable.

On April 27, 2011, the U.S. Supreme Court held in *AT&T Mobility v. Concepcion*, 563 U.S. __ (2011), that the FAA preempts California's *Discover Bank*-rule prohibiting such class action waiver, holding that the FAA does not allow courts to invalidate or ignore arbitration clauses containing such a waiver on that basis.

In *Concepcion*, the plaintiffs had entered into a mobile phone sale and servicing contract with AT&T that provided all disputes between the parties would be arbitrated but prohibited class arbitration. The plaintiffs argued this was unconscionable under California law. Disagreeing, the Court held that while the *Discover Bank*-rule applied to contracts generally, its application and effect particularly disfavor arbitration. The Court reasoned that requiring the observation of state law rules that disfavor arbitration such as "[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 pointed out that "[a]lthough the rule does not require classwide arbitration, it allows any party to a consumer contract to demand it *ex post*" (*Id*. at 12, emphasis in original). The Court highlighted three issues related to California's state law rule that undermine arbitration. First, classwide arbitration "sacrifices the principal advantage of arbitration – its informality – and makes the process slower, more costly and more likely to generate a procedural morass than final judgment." (*Id*. at 14). Second, classwide arbitration "*requires* procedural formality" (e.g., notice to class members, opportunity to be heard and to opt out, etc.) to ensure that "absent parties…be bound by the results of arbitration." (*Id*. at 15). The Court found it unlikely that Congress intended to empower arbitrators with such procedural powers when it passed the FAA. (*Id*.) Third, "class arbitration greatly increases the risks to defendants" that often results in the "in terrorem" settling of questionable class-claims without any available recourse for procedural and appellate safeguards as exists in litigation. (*Id*. at 15-16). The Court concluded that "[a]rbitration is poorly suited to the higher stakes of class litigation." (*Id*. at 16). Above all, the Court emphasized, "[t]he overarching purpose of the FAA . . . is to ensure the enforcement of arbitration agreements according to their terms so as to facilitate streamlined proceedings" and the Court held that California's *Discover Bank*-rule interferes with this intent. (*Id*. at 9).

The Court's *Concepcion* decision provides further support and predictability in having arbitration clauses enforced even in the face of state law challenges based on unconscionability or other local public policy concerns inconsistent with the FAA. That said, it should be kept in mind that the FAA, § 2's savings clause, which provides general contract defenses such as fraud, duress, and mutual mistake, may still be used to invalidate an arbitration clause.

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