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U.S. SUPREME COURT FINDS THAT CLASS ACTION WAIVERS IN ARBITRATION AGREEMENTS ARE ENFORCEABLE UNDER THE FEDERAL ARBITRATION ACT

To Our Clients and Friends:

Today, the United States Supreme Court issued its opinion in *AT&T Mobility LLC v. Concepcion*, No. 09-893, addressing whether the Federal Arbitration Act ("FAA") prohibits States from conditioning the enforceability of arbitration agreements on the availability of class arbitration procedures, or otherwise requiring class actions regardless of prohibitions in an arbitration agreement. In a 5-4 decision, the Court held that the FAA preempts State rules that purport to classify class action waivers in consumer arbitration agreements as unconscionable. In so doing, it reinforced the importance of enforcing arbitration agreements and their terms, as recognized by the FAA. This decision affects a wide range of consumer and employee arbitration contracts in almost every industry.

In *AT&T Mobility*, Vincent and Lisa Concepcion entered into an agreement for the sale and servicing of cellular telephones with AT&T Mobility LLC ("AT&T"). The contract provided for the arbitration of all disputes between the parties, including that any claims be brought in the parties' individual capacity and not as a plaintiff or class member in any purported class or representative proceeding. Slip op. at 1. The Concepcions later sued AT&T in federal court for false advertising and fraud by charging $30.22 in sales tax on phones that were advertised as free. *Id*. at 2-3. Their complaint was consolidated in a putative class proceeding.

AT&T moved to compel arbitration under the terms of its agreement. The Concepcions opposed the motion on the ground that the agreement was unconscionable and unlawful under California law because it disallowed class actions, relying on the California Supreme Court's decision in *Discover Bank v. Superior Court*, 36 Cal. 4th 148, 113 P. 3d 1100 (2005). The district court found that the arbitration provision was unconscionable under California law, and the Ninth Circuit affirmed. *See Laster v. AT&T Mobility LLC*, 584 F. 3d 849 (2009).

The Supreme Court reversed and held that California's *Discover Bank* rule is preempted by the FAA. Slip op. at 18. Writing for the Court, Justice Scalia reaffirmed the liberal federal policy favoring arbitration manifested in the FAA, and noted that the FAA was enacted in 1925 in response to widespread hostility to arbitration agreements and that class arbitration was not envisioned by Congress at that time. *Id*. at 4, 15. Although the FAA preserves generally applicable contract defenses (through the "savings clause" in the FAA which provides that arbitration agreements "shall be 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), the FAA "cannot be held to destroy itself." *Id*. at 9. Nothing in the FAA's savings clause suggests an intent to preserve state laws or rules that are an obstacle to the FAA's objectives. *Id*. The principal purpose of the FAA is to "[e]nsure that private arbitration agreements are enforced according to their terms." *Id*. at 9-10 (citation omitted).

The Court reiterated that the "point of affording parties discretion in designing arbitration processes is to allow for efficient, streamlined procedures tailored to the type of dispute," and that proceedings may be agreed to be confidential. Slip op. at 10. The informality of arbitration is "desirable, reducing the cost and increasing the speed of dispute resolution." *Id*.

California's *Discover Bank* rule permitting a consumer to demand a class action in lieu of an individual arbitration, regardless of the terms in an arbitration agreement to the contrary, improperly interferes with arbitration as provided under the FAA. *Id*. at 11-12. The Court rejected the justification that the rule was limited only to adhesion contracts, since "the times in which consumer contracts were anything but adhesive are long past." *Id*. at 12. Agreements to arbitrate where parties are in positions of unequal bargaining power (such as investors in securities cases or employees in discrimination cases) have been held to be enforceable. *Id*. at 12 n.5. While States remain free to take steps to address concerns attendant to contracts of adhesion, for example by requiring that class action waiver provisions be highlighted in arbitration agreements, they cannot take steps that "conflict with the FAA or frustrate its purpose to ensure that private arbitration agreements are enforced according to their terms." *Id*. at 12 n. 6.

The Court relied in part on its prior decision in *Stolt-Nielson S.A. v. AnimalFeeds Int'l Corp.*, 559 U.S. ___ (2010) (the subject of a Gibson Dunn Client Letter dated May 3, 2010). Slip op. at 13. There, the Court held that arbitrators had exceeded their powers by ordering class arbitration where the parties had not expressly agreed to it, and where the arbitration agreement was otherwise silent. Likewise, the Court in *AT&T Mobility* reiterated, "The conclusion follows that class arbitration, to the extent it is manufactured by *Discover Bank* rather than consensual, is inconsistent with the FAA." *Id*. The shift from individual to class arbitration sacrifices the principal advantages of arbitration, its informality, and makes the process slower, more costly, and more likely to generate a procedural morass. *Id*. at 14.

Moreover, explained the Court, class arbitration lacks the procedural protections captured in Federal Rule of Civil Procedure 23 and necessary to protect the rights of absent class members. "For a class-action money judgment to bind absentees in litigation, class representatives must at all times adequately represent absent class members, and absent members must be afforded notice, an opportunity to be heard, and a right to opt out of the class." Slip op. 15 (citing *Phillips Petroleum Co. v. Shutts*, 472 U. S. 797, 811–812 (1985)).

The principles behind the FAA conflict with State requirements for class actions and class arbitrations for other reasons. For example, in the absence of a class action or arbitration, a defendant is more willing to accept the risk of error of an individual arbitration since the impact is limited to the size of the individual dispute. Slip op. at 15-16. But in a class proceeding, the risk of error can become unacceptable to a defendant, "since with even a small chance of a devastating loss, defendants will be pressured into settling questionable claims." *Id*. at 16. In rejecting class arbitration as a viable option, the Court stated, "We find it hard to believe that defendants would bet the company with no effective means of review . . . ." *Id*.

In short, "Arbitration is a matter of contract, and the FAA requires courts to honor parties' expectations." *Id*. at 17. The Court specifically rejected the argument by the Concepcions that class proceedings are necessary to prosecute small dollar claims that might otherwise slip through the legal

system. *Id*. at 9, 17. "But States cannot require a procedure that is inconsistent with the FAA, even if it desirable for unrelated reasons." *Id*. The Court also noted that AT&T's arbitration agreement had provisions that make it unlikely that that the matter would go unresolved, including a provision for a minimum payment of $7,500 and attorney's fees if the Concepcions obtained an arbitration award greater than AT&T's last settlement offer before the arbitrator is selected. *Id*. at 17-18.

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The *AT&T Mobility* decision is significant for a number of reasons. Class action waivers in arbitration agreements likely will be held enforceable, even in the adhesive context of consumer contracts, thereby requiring individual resolution of disputes if desired by companies. The Court suggested that the same will be true of employers who enter into arbitration agreements with their employees. Slip op. at 12 n.5 (specifically referencing the enforceability of arbitration agreements in the employment context "despite allegations of unequal bargaining power between employers and employees"). Moreover, States will not be permitted to circumvent the FAA and arbitration contracts by requiring or permitting plaintiffs to choose to litigate in a class action or class arbitration in the absence of consent by the defendant. The decision underscores the importance of arbitration in general and the enforcement of agreed-upon contractual rules governing arbitration.

That AT&T had a clear, class action waiver provision in its arbitration agreement was instrumental to the Court's decision. AT&T's agreement provided not only that claims be brought in the parties' individual capacity and not as a plaintiff or class member in any purported class or representative proceeding, but it also stated 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.

AT&T also benefitted from several pro-consumer provisions in its arbitration agreement--a judge in another case described the arbitration provision as "perhaps the most fair and consumer-friendly provisions this Court has ever seen," despite the presence of a class arbitration waiver. In AT&T's agreement:

- Any dispute could be initiated easily by completing a one-page form available on AT&T's website;
- If the matter was not resolved informally within 30 days, the customer could demand arbitration by completing another form available on the website;
- The arbitration was to take place in the county in which the customer was billed;
- The customer could choose whether the arbitration should proceed in person, by telephone, or based on submissions for claims of $10,000 or less;
- The arbitration was to be conducted pursuant to the AAA Commercial Dispute Resolution Procedures and the Supplementary Procedures for Consumer-Related Disputes;

- The arbitrator could award any form of individual relief, including an injunction and potentially punitive damages; and,

- AT&T relinquished any claim to reimbursement of its attorney's fees in an arbitration.

The AT&T agreement went farther than many consumer arbitration agreements by guaranteeing a significant recovery of at least $7,500 (later increased in 2009 to $10,000) and twice the claimant's attorney's fees if the award was greater than the last settlement offer made by AT&T before an arbitrator was selected. It also provided that a claimant could opt for a small claims court proceeding in lieu of an arbitration, and that the arbitration was not considered confidential. The wording of the majority decision in *AT&T Mobility* does not seem to require similar provisions in an arbitration agreement, although the Court did observe that the district court concluded that the guaranteed amounts would put the Concepcions in a better position than if they were participants in a class action.

Although not addressed expressly in the Court's decision, arbitration provisions that are substantially one-sided in favor of the company or employer likely are still subject to scrutiny. While the dicta and holding are broad, the Court was addressing the specific question of whether class actions or arbitrations could be imposed on a company regardless of the terms of the arbitration agreement to the contrary. Whether the type of financial guarantees in AT&T's agreement are essential seems doubtful based on the decision, although there also remains some uncertainty in this respect.

The bottom line is that companies and employers should review the terms in their consumer and employment contracts promptly and make any necessary modifications to maximize the holding in *AT&T Mobility*. There may be circumstances where a class proceeding is preferable to an individual action for business or expense reasons (such as the potential benefits of a class settlement), but the parties could always consent in writing to any class procedure later depending on the nature of the claims involved, if there is an interest in doing so.

Gibson Dunn lawyers are available to assist in addressing any questions you may have about these developments. Please contact the Gibson Dunn attorney with whom you work, or any of the following members of the Class Actions Group, the International Arbitration Group, or the Labor and Employment Group:

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