

E-ALERT | Litigation

May 2, 2011

SUPREME COURT ISSUES IMPORTANT DECISION IN *AT&T MOBILITY LLC v. CONCEPCION*

The Supreme Court holds that arbitration clauses with class action waivers in standard form consumer contracts are enforceable.

In a decision with broad application, the United States Supreme Court held last Wednesday that the Federal Arbitration Act preempts (and thus invalidates) state law rules that classify class action waivers in consumer contracts as unconscionable and therefore unenforceable. *AT&T Mobility LLC v. Concepcion*, No. 09-893 (April 27, 2011). This holding sweeps away a major barrier to enforcing arbitration agreements between businesses and consumers that had been erected by judicial decisions in California and several other states. The Supreme Court has made clear that where a consumer has entered into a contract that contains an arbitration provision, that consumer must submit to arbitration any dispute that falls within the scope of that agreement – even where the arbitration provision contains the type of class action waiver that many states had previously disfavored as unconscionable.

Background

Many standard consumer contracts, including those governing cellular phone service, bank products, and other goods and services, include clauses that require the contracting parties to submit any disputes to binding arbitration. These arbitration clauses often include a “class waiver,” which prohibits the customer from pursuing his or her claim as part of a class proceeding.

The Federal Arbitration Act (“FAA”) provides that arbitration agreements are presumptively valid and enforceable “save upon such grounds as exist at law or in equity for the revocation of any contract.” 9 U.S.C. § 2. Many courts had interpreted this saving clause as permitting courts to apply state contract law to invalidate arbitration provisions on grounds of “unconscionability.” Applying this principle, some state courts, including California’s Supreme Court, had established a rule that class waivers in consumer agreements were almost always unconscionable when included in consumer contracts under which disputes were likely to involve relatively small sums. In those states, therefore, such arbitration agreements became unenforceable unless the business was willing to agree to class arbitration, which typically has been considered an unpalatable alternative.

The Supreme Court’s Decision in *AT&T Mobility v. Concepcion*

In a 5 to 4 vote, the Supreme Court invalidated California’s rule against class action waivers in consumer arbitration agreements – and, by implication, similar rules in other states. The Court reasoned that states are not free to create new restrictions on arbitration based on the doctrine of “unconscionability” where those restrictions impede the purpose of the FAA. And the Court concluded that classifying class waivers as unconscionable – in other words, *requiring* that customers be allowed to pursue their claims in a class proceeding – “interferes with fundamental

attributes of arbitration and thus creates a scheme inconsistent with the FAA.” *Concepcion*, No. 09-893, at 9.

Class proceedings, according to the Court, conflict with several “fundamental attributes” of arbitration. They are slower, more costly, and necessarily require a more formal procedure than individual arbitrations. Class proceedings also involve greater risks for defendants, because in class arbitration there is less opportunity for review of errors, and the cost of those errors may be substantial where a defendant is dealing with tens of thousands of claimants in one proceeding. The Court suggested, moreover, that many consumers will be better off resolving their disputes through individual arbitration rather than participating in a prolonged class proceeding.

In short, because requiring class proceedings plainly conflicts with the FAA’s goal of promoting streamlined arbitration, arbitration agreements containing class waivers are enforceable as a matter of federal law, and state rules classifying such waivers as unconscionable and thus unenforceable are preempted.

Consumer advocates and plaintiffs’ counsel may try to cabin this holding, arguing that it applies only to arbitration provisions that contain certain pro-consumer provisions that were in the actual AT&T Mobility contract at issue. However, the Court seemed to foreclose this argument by suggesting the states could not condition the enforcement of arbitration clauses on their inclusion of certain provisions. Simply put, “States cannot require a procedure that is inconsistent with the FAA, even if it is desirable for unrelated reasons.” *Id.* at 17.

Conclusion

Concepcion is a highly favorable decision for consumer-facing businesses that include arbitration agreements in their standardized contracts. Businesses that do not have arbitration clauses in their agreements, or that do not include class waivers as part of such clauses, may wish to consider whether it would be advantageous to do so. The Supreme Court has made it clear that, assuming that the contract as a whole is not subject to attack under ordinary contract principles, arbitration clauses will be enforceable. This may portend a substantial reduction in the number of consumer class action cases. And *Concepcion* would seem to limit severely the ability of states to adopt any restrictions on arbitration where those rules would hinder the enforcement of arbitration agreements on their plain terms. Only direct legislative action or a change to the FAA itself, upon which the Court’s decision rested, would likely alter these conclusions. Although some Senators and Representatives have stated their desire to legislatively override *Concepcion*, the near-term viability of these efforts seems dubious.

If you have any questions concerning the material discussed in this client alert, please contact the following members of our firm:

Sonya Winner
Anita Stork
Robert Wick
Sarah Wilson

415.591.7072
415.591.7050
202.662.5487
202.662.5397

swinner@cov.com
astork@cov.com
rwick@cov.com
swilson@cov.com

This information is not intended as legal advice. Readers should seek specific legal advice before acting with regard to the subjects mentioned herein.

Covington & Burling LLP, an international law firm, provides corporate, litigation and regulatory expertise to enable clients to achieve their goals. This communication is intended to bring relevant developments to our clients and other interested colleagues. Please send an email to unsubscribe@cov.com if you do not wish to receive future emails or electronic alerts.

© 2011 Covington & Burling LLP, One Front Street, San Francisco, CA 94111-5356. All rights reserved.