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# California's "Unconscionability" Rule Against Many Class Action Arbitration Waiver Clauses Preempted

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For several years businesses that enter into contracts with consumers have witnessed the tension between courts in California and the Federal Arbitration Act's (the FAA) stated preference for arbitration over litigation. In cases like *Moses H. Cone Memorial Hospital v. Mercury Constr. Corp.*, 460 U.S. 1 (1983), *Green Tree Financial Corp. v. Bazzle*, 539 U.S. 444 (2003), and *Stolt-Nielsen S.A. v. AnimalFeeds Int'l Corp.*, 559 U.S.__ (2010), the Supreme Court has reiterated federal law's encouragement of arbitration. Yet the California courts and the Ninth Circuit have repeatedly invalidated arbitration provisions. In *Discover Bank v. Superior Court*, 36 Cal. 4th 148 (2008), the California Supreme Court held that an arbitration provision that waived a consumer's ability to participate in classwide arbitration was unconscionable under California law. Under *Discover Bank*, class action waivers in many arbitration provisions were unenforceable.

On April 27, 2011, the United States Supreme Court held that the FAA preempts the holding in *Discover Bank*. *AT&T Mobility LLC v. Concepcion*, No. 09-893, 563 U.S. ___ (Apr. 27, 2011). The Court has once again emphasized the federal policy in favor of arbitration as a means of resolving disputes.

The Concepcions entered into a mobile phone sale and servicing contract with AT&T. The contract provided that all disputes between the parties would be arbitrated but prohibited class arbitration by requiring "that 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 sued AT&T for false advertising and fraud. (AT&T had advertised free phones but charged the Concepcions sales tax based on the phones' retail value.) AT&T moved to compel arbitration under the terms of the parties' contract. The Concepcions argued that the class action waiver in the contract's arbitration clause rendered the clause unconscionable under California law. The district court agreed, finding the arbitration clause unconscionable and thus unenforceable under *Discover Bank*. *Laster v. T-Mobile USA, Inc.*, No. 05cv1167 DMS (AJB), 2008 WL 5216255, at *14 (S.D. Cal. Aug. 11, 2008).

The Ninth Circuit affirmed the denial of AT&T's motion to compel arbitration. *Laster v. AT&T Mobility LLC*, 584 F.3d 849, 855 (9th Cir. 2009). It further held that the FAA did not preempt the *Discover Bank* rule because that rule merely refined "the unconscionability analysis applicable to contracts generally in California." *Id.* at 857.

Writing for the majority (joined by Chief Justice Roberts and Justices Kennedy, Thomas and Alito), Justice Scalia began his analysis with the FAA, which provides: "A written provision in … a contract evidencing a transaction involving commerce to settle by arbitration a controversy thereafter arising out of such contract or transaction … 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 Court previously has "described this provision

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as reflecting both a 'liberal federal policy favoring arbitration' and the 'fundamental principle that arbitration is a matter of contract.'" Slip op. at 4 (citations omitted).

The Court noted that, like other contracts, arbitration agreements must be enforced according to their terms. Under section 2's final phrase (the "savings clause"), however, arbitration agreements can be declared unenforceable by "'generally applicable contract defenses, such as fraud, duress, or unconscionability,' but not by defenses that apply only to arbitration or that derive their meaning from the fact that an agreement to arbitrate is at issue." Slip. op. at 5 (citation omitted). The question before the Court was whether the FAA's section 2 preempts California's *Discover Bank* rule. Slip op. at 5. The majority answered "yes."

Noting that the FAA's "overarching purpose" is "to ensure the enforcement of arbitration agreements according to their terms so as to facilitate streamlined proceedings," the majority opinion concluded that "[r]equiring the availability of classwide arbitration interferes with fundamental attributes of arbitration and thus creates a scheme inconsistent with the FAA." Slip op. at 9. In addition, California's *Discover Bank* rule interferes with arbitration agreements by "allow[ing] any party to a consumer contract to demand [classwide arbitration] *ex post*." Slip op. at 12. In his analysis, Justice Scalia examined the differences between bilateral and classwide arbitration, noting that class arbitration includes absent parties, necessitating more formal and costly procedures, and involves higher stakes. Slip op. at 13-16. These differences demonstrated that arbitration is "poorly suited to the higher stakes of class litigation." Slip op. at 16. As for the limited judicial review of arbitral awards, the majority opinion commented, "We find it hard to believe that defendants would bet the company with no effective means of review, and even harder to believe that Congress would have intended to allow state courts to force such a decision." Slip op. at 16-17.

Public policy reasons could not justify a state court procedure that conflicts with the FAA. Slip op. at 17. Concluding that class arbitration "manufactured by *Discover Bank* rather than consensual" is inconsistent with the FAA," slip op. at 13, the Court held that California's *Discover Bank* rule is preempted. Slip op. at 18.

Although he joined the majority opinion, Justice Thomas also wrote a concurrence explaining that he would reach the same result based solely on the language of section 2. Justice Breyer, joined by Justices Ginsburg, Sotomayor and Kagan, dissented, finding that California law treats arbitration agreements like all other contracts, so the *Discover Bank* rule is consistent with, and not preempted by, the FAA. Dissenting op. at 3, 5.

With the Court's opinion in *AT&T Mobility*, the business community can breathe a sigh of relief. Class action waivers, often found in not only mobile phone contracts but many other consumer contracts as well, will be enforced. Companies will not be forced into classwide arbitrations which they did not agree to and which may impede a faster resolution of the individual consumer claims. However, under section 2's "savings clause," arbitration clauses in general, and class action waivers provisions in particular, still may be subject to challenge on the basis of general contract defenses such as fraud, duress and mutual mistake, so business defendants still should expect to see oppositions to their motions to compel arbitration.

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