

Class Action Defense Strategy Blog

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Discover Bank Is Dead: The U.S. Supreme Court Rules That Federal Law Preempts State Laws That Obstruct The Enforcement Of Class Action Waivers In Arbitration Agreements

On April 27, 2011, the Supreme Court held that the Federal Arbitration Act "preempts California's rule classifying most collective arbitration waivers in consumer contracts as unconscionable." *AT&T v. Concepcion*, 563 U.S. ____, majority at 5, 18 (2011). The Court referred to this rule as the "*Discover Bank* rule," after the California Supreme Court's decision in *Discover Bank v. Superior Court*, 36 Cal.4th 148 (2005), though variations of this public policy-based rule have been articulated by many other court decisions in California and elsewhere. Writing for the majority in a 5 to 4 opinion, Justice Scalia concluded that state laws that undermine the enforceability of class action waivers in consumer arbitration agreements improperly obstruct the FAA.

The plaintiff in *Concepcion* brought a class action against AT&T for false advertising in violation of California law for charging \$30.22 in sales tax for a cell phone advertised as free. AT&T moved to compel arbitration and enforce a class action waiver. The federal trial court in San Diego denied the motion based on the three prongs of *Discover Bank*, finding that the class action waiver was unconscionable because 1) the contract was a non-negotiable contract of adhesion, 2) the damages at issue were small, and 3) the plaintiff alleged a scheme to cheat consumers of small sums of money. The Ninth Circuit affirmed, holding that the FAA did not preempt *Discover Bank*. The Supreme Court reversed.

The Court was unpersuaded by the rationale of *Discover Bank*: that enforcing class action waivers in cases involving small sums of money will essentially kill any such claim. As the dissent argued: "The *realistic* alternative to a class action is not 17 million individual suits, but zero individual suits, as only a lunatic or a fanatic sues for \$30." *Id.*, dissent at 9. The majority was untroubled: "The dissent claims that class proceedings are necessary to prosecute small-dollar claims that might otherwise slip through the legal system. But States cannot require a procedure that is inconsistent with the FAA, even if it is desirable for unrelated reasons." *Id.*, majority at 17.

Given its broad reasoning, *Concepcion* should apply beyond *Discover Bank* to other

judicially-constructed obstacles to the enforcement of consumer arbitration clauses in California. For example, some courts have held that there is an unwaivable right to a class action under California's Consumers Legal Remedies Act (the "CLRA"). Some courts have held that there is an unwaivable right to a class action in the context of employment disputes. Some courts have held that claims for public injunctions under the CLRA and California's Unfair Competition Law cannot be arbitrated.

Under *Concepcion*, the FAA now preempts all these judicial attacks on arbitration. According to the Court, "When state law prohibits outright the arbitration of a particular type of claim, the analysis is straightforward: The conflicting rule is displaced by the FAA." *Id.*, majority at 7. In his concurring opinion, Justice Thomas writes: if the FAA, "means anything, it is that courts cannot refuse to enforce arbitration agreements because of a state public policy against arbitration, even if the policy nominally applies to 'any contract.'" *Id.*, concurring at 1. "Contract defenses unrelated to the making of an agreement—such as public policy—could not be the basis for declining to enforce an arbitration clause." *Id.*, concurring at 4.

The majority recognizes that the FAA does not preempt "generally applicable contract defenses." *Id.*, majority at 9. *Discover Bank*, which purports to apply the generally applicable defense of unconscionability, went too far by refusing to enforce class action waivers in cases involving small sums of money. As an example of what the FAA does not preempt, in a footnote, the majority writes that, "Of course States remain free to take steps addressing the concerns that attend contracts of adhesion—for example, requiring class action-waiver provisions in adhesive arbitration agreements to be highlighted. Such steps cannot, however, conflict with the FAA or frustrate its purpose to ensure that private arbitration agreements are enforced according to their terms." *Id.*, majority at 12, n. 6. State legislatures, presumably, will have to craft such rules without singling out arbitration in a way that imposes obstacles not imposed on the enforcement of other contract terms.

Businesses should consult with Sheppard Mullin or similarly qualified counsel on how best to draft an arbitration provision with a class action waiver enforceable under *Concepcion*.

Authored By:

Shannon Z. Petersen
(619) 338-6656
SPetersen@sheppardmullin.com