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High Court Holds Federal Arbitration Act Preempts California State Court Rule on Class Action Waivers

On April 27, 2011, the United States Supreme Court, in *AT&T Mobility v. Conception*, in a 5-4 decision, held that the Federal Arbitration Act preempts California's *Discover Bank* rule that class action waivers are generally unconscionable. Justice Scalia, writing for the majority, concluded that the *Discover Bank* rule "stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress."

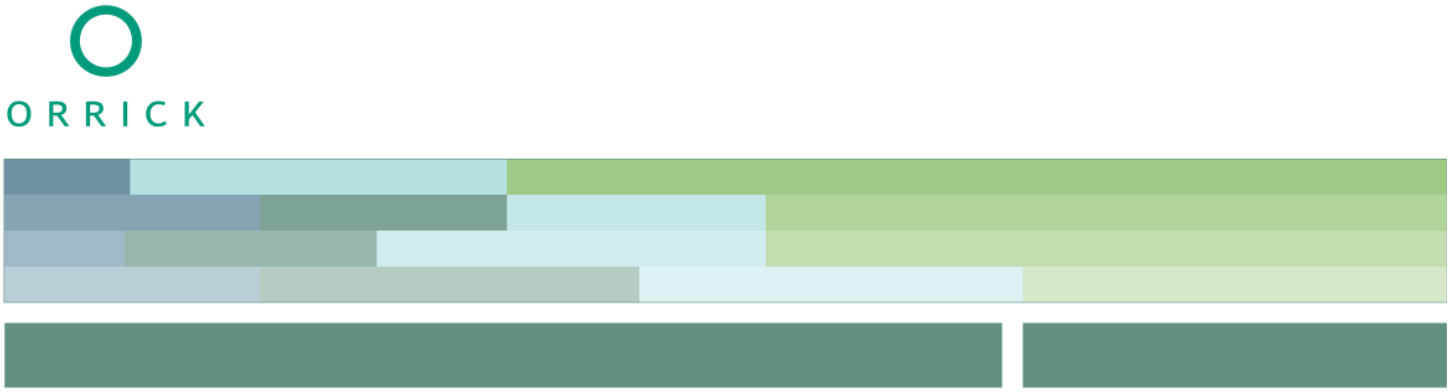
In *Discover Bank v. Superior Court*, the California Supreme Court held that class action waivers in consumer arbitration agreements are unconscionable if the agreement is in an adhesion contract, disputes between the parties are likely to involve small amounts of damages, and the party with the inferior bargaining power alleges a deliberate scheme to defraud. Following *Discover Bank*, class action waivers in consumer arbitration agreements were largely unenforceable.

In this case, the plaintiffs filed a class action complaint in federal court against AT&T alleging, among other things, that AT&T engaged in false advertising and fraud by charging sales tax on phones it advertised as free. AT&T moved to compel arbitration under the terms of an arbitration agreement with the plaintiffs that required claims to be brought in the parties' "individual capacity, and not as a plaintiff or class member in any purported class or representative proceeding."

Relying on the California Supreme Court's decision in *Discover Bank*, the District Court denied AT&T's motion on the ground that the arbitration provision requiring a class action waiver was unconscionable because AT&T had not shown that bilateral arbitration adequately substituted for the deterrent effects of class actions. The Ninth Circuit affirmed the lower court's decision, holding that the *Discover Bank* rule was not preempted by the Federal Arbitration Act because the rule was simply "a refinement of the unconscionability analysis applicable to contracts generally in California."

The U.S. Supreme Court reversed, holding that the *Discover Bank* rule is preempted by the Federal Arbitration Act because "[r]equiring the availability of classwide arbitration interferes with fundamental attributes of arbitration and thus creates a scheme inconsistent with the FAA." Class arbitration, the Court explained, sacrifices the informality of arbitration by making the process slower, more costly, and more procedurally complicated. Further, class arbitration greatly increases the risks to defendants. For example, arbitrators are not generally knowledgeable about the class certification process and the absence of multilayer review makes it more likely that errors will go uncorrected. The Court concluded that arbitration is poorly suited to the higher stakes of class litigation.

The majority acknowledged the dissenting justices' concern that class arbitrations are necessary to allow prosecution of "small-dollar claims that might otherwise slip through the legal system." Nevertheless, the majority concluded that "States cannot require a procedure that is inconsistent with the FAA, even if it is desirable for unrelated reasons."



Chief Justice Roberts and Justices Kennedy, Thomas, and Alito joined Justice Scalia in the majority opinion. Justice Thomas also wrote a concurring opinion. Justice Breyer wrote the dissenting opinion. Justices Ginsburg, Sotomayor and Kagan joined in the dissent.

What This Case Means for Employers

Even though the class action waiver in *Conception* related to a consumer arbitration agreement, the holding in this case is of equal applicability to the full range of employment class actions. Companies that want to avoid the possibility that employees can pursue claims in arbitration as a class action should consider similar language to that used by AT&T, which required claims to be brought in the parties' "individual capacity, and not as a plaintiff or class member in any purported class or representative proceeding." Any employer that is using or considering pre-dispute arbitration agreements as a condition of employment should carefully review their existing arbitration.

Orrick's Team

Orrick's Global Employment Law Group represents a broad range of companies in all forms of employment class action matters including wage-and-hour, systemic discrimination and pattern or practice cases brought by the EEOC. For more information about this alert or our capabilities, please contact any of our employment law lawyers.