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# States May Not Prohibit Class Action Waivers as Part of Pre-Dispute Arbitration Agreements

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In a decision with broad implications for the use of pre-dispute arbitration agreements in a variety of contexts, the Supreme Court has held that courts cannot refuse to enforce an arbitration agreement because it does not permit the class-based arbitration of claims. In the decision, *AT&T Mobility LLC v. Concepcion*, No. 09-893, 2011 WL 1561956, the Court held that states may not use state contract law principles as a means to impose limitations or requirements that "stand[] as an obstacle" to the unfettered use of arbitration agreements. Under *Concepcion,* obstacles of this sort will be suspect and ripe for challenge on Federal Arbitration Act preemption grounds. Paul Hastings will be sponsoring a teleconference in the coming weeks to discuss more fully the breadth of the decision and the steps employers should take as a consequence.

*Concepcion* arose when a California couple entered into a contract to purchase cellular telephone service from AT&T only to learn that they would be charged sales tax on the "free" phones that were supposed to be included with their service plan. The Concepcions, feeling they had been deceived, filed a lawsuit in federal court and later consolidated their case with a class action making the same claims on behalf of a larger group of AT&T customers. When AT&T argued that their contract with the Concepcions required them to submit their claim to an arbitrator rather than a judge, the Concepcions responded that their arbitration agreement was unenforceable under California law. Specifically, the Concepcions argued that because their arbitration agreement did not allow for a class-based arbitration, it was "unconscionable" under California law. Both the district court and the Ninth Circuit agreed. The Supreme Court, however, reversed in a 5-4 decision.

The Federal Arbitration Act was enacted to overturn many years of judicial hostility to arbitration agreements and embodies a strong federal policy in favor of arbitration. The Act provides, in part, that courts are obliged to enforce arbitration agreements as they are written unless the agreement is otherwise defective "on such grounds as exist at law or in equity for the revocation of any contract." That is, arbitration agreements are to be treated like any other agreement, and states are not permitted to invent special grounds for invalidating them that do not apply to contracts generally.

The Concepcions argued that by precluding class claims, their arbitration agreement was so substantively and procedurally one-sided and unfair that it should be considered "unconscionable" under California law. The Concepcions noted that the amount at issue in their claim against AT&T was rather small, and that attorneys are unlikely to pursue such small potatoes claims one-by-one. As a practical matter then, an agreement that required arbitration but precluded class claims effectively

meant that they could never recover the money they claimed to be owed — that their right to recover was illusory.

Moreover, the Concepcions pointed out that the "unconscionability" doctrine under California law is not unique to arbitration agreements. All kinds of contracts can be held unenforceable under California law if they are deemed to be unconscionable. And because the unconscionability doctrine applies across all types of contracts, they argued, the California rule that prohibits the enforcement of arbitration agreements that preclude class litigation should survive FAA preemption.

The Court disagreed. The California rule "stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress" — that is, the national policy favoring arbitration and the speedy dispute resolution it promises. Arbitration, the Court observed, is attractive because it tends to be relatively cheap, expeditious, and free of the cumbersome formalities and technicalities of court litigation. By its very nature, the Court reasoned, a class case is none of those things. A primary concern in the administration of class litigation procedures is fairness to absent parties, and the procedures that must be followed to ensure that those absent parties are treated fairly are antithetical to the things that make arbitration worthwhile. If the state can require that parties permit class arbitrations, it would sacrifice the informality and speed that are the principal advantages of that type of dispute resolution, and would pressure defendants into settling even frivolous claims because of the higher stakes involved.

The Court recognized that there may be some claims so small that they cannot efficiently be pursued if the class mechanism cannot be used, but this problem does not change the preemption analysis. The Court held: "states cannot require a procedure that is inconsistent with the FAA, even if it is desirable for unrelated reasons."

Although *Concepcion* concerned a consumer contract and not an employment case, there is no reason to doubt that it will be applied to future claims of preemption in employment cases. The touchstone for the majority opinion in *Concepcion* was its belief that California law frustrated Congress's objectives in passing the FAA — namely the unfettered use of arbitration agreements as embodied in the FAA.

Moreover, this standard could be applied to *other* state-imposed requirements on arbitration agreements, especially those that tend to formalize or increase the cost of arbitration. For example, the continuing validity of the California Supreme Court's 2000 decision in *Armendariz v. Foundation Health Psychcare Services* — which held that mandatory pre-dispute arbitration agreements must meet certain standards with respect to items like discovery, judicial review, and allocation of costs of arbitration — may have to be reevaluated. Although the full reach of *Concepcion* will only become known as the lower courts apply it in varied factual circumstances, there is no doubt that the decision remakes the landscape and will require courts to reevaluate issues long thought to be settled.

*Concepcion* also reaffirms the central teaching of last Term's *Stolt-Nielsen v, Animalfeeds International Corp.*, 130 S.Ct. 1758 (2010), in which the Court held that a party can be compelled to engage in class-based arbitration only if the agreement explicitly provides for it. Together, *Concepcion* and *Stolt-Nielsen* give vigilant employers powerful tools for avoiding expensive and cumbersome class litigation.

Accordingly, we believe that employers should closely reexamine the subject of arbitration. Those employers that previously have been skeptical of such agreements may well want to reevaluate, as *Concepcion* makes the process more user friendly and in some respects less risky. Arbitration

agreements may be more attractive than they were before this decision, inasmuch as they now seem to provide a more flexible vehicle for employers and employees to resolve their disputes quickly, fairly, and less expensively. Those that currently use arbitration agreements with their employees will want to consider whether their current form remains consistent with the state of the law and the employer's needs.

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Paul Hastings will be exploring the practical and legal ramifications of this landmark decision in a teleconference in the coming weeks. We invite you to join us. Check your inbox soon for our invite with the event details.

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