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Financial Services Alert

U.S. Supreme Court Upholds Class Action Waivers (For Now)

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On April 27, in a 5-4 decision, the United States Supreme Court held that "[b]ecause it 'stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress,' California's *Discover Bank* rule [which invalidated many "class action waivers" in consumer contracts] is preempted by the [Federal Arbitration Act ("FAA")]. *AT&T Mobility v. Concepcion*, __ U.S. __, 2011 WL 1561956, at *13 (2011).

The Majority's Reasoning

The FAA's savings clause allows states to invalidate arbitration clauses, "upon such grounds as exist at law or in equity for the revocation of any contract." 9 U.S.C. § 2. But, Justice Scalia's majority opinion says, "nothing in it suggests an intent to preserve state-law rules that stand as an obstacle to the accomplishment of the FAA's objectives." *Id.* at *7.

The FAA's principal purpose was to ensure that private arbitration agreements are enforced according to their terms, leaving the contracting parties free to choose an arbitration procedure allowing for efficient, streamlined proceedings tailored to the type of dispute they anticipate. *Id.* at *8.

California's *Discover Bank* rule invalidated arbitration clauses in many consumer contracts as unconscionable unless they permitted classwide arbitration. By requiring classwide arbitration, the *Discover Bank* rule posed an obstacle to the FAA's purposes and objectives. *Id.* at *9, 13.

Classwide arbitration is fundamentally different from bilateral arbitration. *Id.* at *10-12.) Classwide arbitration sacrifices arbitration's principal advantages. Class arbitration requires formality of proceedings. It slows arbitration and makes it more costly. It greatly increases the defendant's risks.

Even if enforcing class action waivers in arbitration clauses effectively grants a defendant immunity from some claims that are uneconomic to prosecute individually, "States cannot require a procedure that is inconsistent with the FAA, even if it is desirable for unrelated reasons." *Id.* at 13.

The Immediate Impact:
More Arbitration, Fewer Class Actions

For defendants who have arbitration clauses with class action waivers in their current consumer contracts, *Concepcion* will prove an immediate godsend, moving putative class action litigation out of court and into individual arbitration. *Concepcion's* impact will not be limited to California. Many other states, such as New Jersey, New York, and Georgia, have also refused to enforce arbitration clauses containing class action waivers. *In re American Express Merchants' Litig.*, 634 F.3d 187 (2d Cir. 2011); *Homa v. American Express Co.*, 558 F.3d 225 (3d Cir. 2009); *Dale v. Comcast Corp.*, 498 F.3d 1216 (11th Cir. 2007).

Likely, defendants will now be able to successfully compel individual arbitration even in cases which have been prosecuted in court for some time, and even if the defendant earlier decided not to move to compel arbitration. After an earlier Supreme Court reversal of arbitration-unfriendly precedent, the Ninth

Circuit held the defendant had not waived arbitration by not moving to compel earlier since an earlier motion would have been futile given then-existing precedent. Also, the plaintiffs were not prejudiced by the delay. They obtained discovery they would not have gotten in arbitration, and the greater expense of court litigation was a self-inflicted wound. *Fisher v. A.G. Becker Paribas, Inc.*, 791 F.2d 691 (9th Cir. 1986).

The Medium Term Outlook: Other Barriers Likely To Fall

In the mid-term, other courts are likely to follow *Concepcion* in striking down other state-law barriers to arbitration.

Fisher v. DCH Temecula Imports, LLC, 187 Cal.App.4th 601 (2010) likely will not survive *Concepcion*. *Fisher* refused to enforce the arbitration clause found in most California car dealers' contract forms, finding it void as against the public policy implicit in the California Consumer Legal Remedies Act's ("CLRA's") class action and anti-waiver provisions. After *Concepcion*, states cannot force classwide arbitration on unwilling parties by invoking state public policies any more than they can by invoking unconscionability.

Next to fall may be decisions such as *Cruz v. Pacificare Health Systems, Inc.*, 30 Cal.4th 303 (2003) and *Broughton v. Cigna Healthplan of Cal.*, 21 Cal.4th 1066 (1999) which held that claims for injunctive relief under Business & Professions Code § 17200 and the CLRA to be non-arbitrable because they enforce public, not private rights.

As interpreted in *Concepcion*, the FAA forbids states from refusing to allow arbitration of particular sorts of claims. "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." 2011 WL 1561956, at *6.

Also likely to face renewed challenge under *Concepcion* are *Armendariz v. Foundation Health Psychcare Services, Inc.*, 24 Cal.4th 83 (2000) and *Gentry v. Superior Court*, 42 Cal.4th 443 (2007) which held employers' arbitration clauses unenforceable unless they allowed classwide arbitration, discovery, and other state-favored procedures.

The Long-Term Outlook: Continued Turmoil And The CFPB

The long-term outlook is for continued turmoil on this subject. It will not take long for consumer attorneys to turn their initial howls of outrage into intense efforts to persuade Congress to overturn *Concepcion*.

Already, the Dodd-Frank Act forbade lenders from including arbitration clauses in residential mortgage loans or home equity loans. 15 U.S.C. § 1639c(e)(1). The same act also authorized the new Consumer Finance Protection Bureau ("CFPB") to adopt regulations prohibiting or imposing conditions or limitations on arbitration clauses in contracts for consumer financial products or services. 12 U.S.C. § 5518(b).

With Republicans now in control of the House, Congressional action is less likely. The CFPB is supposed to become operational on July 21, however. Undoubtedly limitations on consumer arbitration clauses will be high on the CFPB's agenda. This issue is likely to make confirmation of the CFPB's as-yet unnominated director even more contentious. The new bureau's continued funding may also be threatened as a means of pressuring it on this issue.

There is certain to be much lobbying and politicking for some time on the issue with the ultimate outcome uncertain.

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