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Second Circuit Decision Puts in Doubt Enforceability of Class Action Waivers in Arbitration Provisions

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Many consumer-facing companies use arbitration provisions in their standard contracts to avoid the costs and burdens of the judicial process. But some go further, requiring customers to not only arbitrate, but to forego any class action remedy. The Second Circuit's decision last week in *In Re: American Express Merchants' Litigation* casts doubt on this strategy – holding such provisions unenforceable in a wide swath of cases – and thereby reinforcing a Circuit split that may ultimately need to be resolved by the Supreme Court.

The Supreme Court most recently addressed the arbitrability of class actions last year in *Stolt-Nielsen v. AnimalFeeds Int'l Corp.,* 130 U.S. 1758 (2010). There, the Court held that plaintiffs may not pursue a class action in arbitration unless that right is *expressly* specified in the arbitration provision. For all practical purposes, this meant that companies could avoid class actions – and the financial exposure associated with them – simply by adopting a standard arbitration provision. Indeed, because many types of cases are only economically feasible if pursued as a class, *Stolt-Nielsen* was widely seen as a way to avoid liability, as a boon to large consumer-facing companies, and as a potentially mortal wound to the class action bar.

The Second Circuit's *Amex* decision, however, not only restores the world to its pre-*Stolt-Nielsen* state, it goes a step further. By concluding that a mandatory arbitration provision – even one that includes an express "class action waiver" – is unenforceable to the extent it "effectively precludes any action seeking to vindicate [plaintiff's] statutory rights," the court not only gives back to plaintiffs (and their counsel) the right to proceed as a class, but it restores their – expressly waived – right to proceed in court rather than through arbitration.

It remains to be seen, however, whether this decision will stand. While the Second Circuit now joins the First Circuit in invalidating these types of class action waivers, the Third Circuit has universally enforced such provisions in light of the Federal Arbitration Act's "congressional declaration of a liberal federal policy favoring arbitration." The tension between this policy and the policy favoring private enforcement of statutory rights makes this case ripe for Supreme Court resolution.

Background

This case was consolidated and filed in New York District Court in 2003 by merchants who accept American Express ("Amex") payment cards. The merchants alleged that Amex illegally tied together its charge and credit card services in violation of §1 of the Sherman Act. Specifically, the merchants claimed that Amex leveraged its market power in *charge cards* (which are typically associated with business expense accounts) to compel merchants to accept its new revolving *credit card* products (which were marketed to a broader range of consumers) at the same elevated fees – fees that vastly exceeded the rate for comparable Visa, MasterCard or Discover credit cards.

The merits of the antitrust claims have not yet been considered, as the proceedings thus far have focused solely on the enforceability of the following arbitration provision:

Neither [party] will have the right to litigate [any arbitrable] claim or have a jury trial on that claim. . . . Further, [the plaintiff merchants] will not have the right to participate in a representative capacity or as a member of any class of claimants pertaining to any claim subject to arbitration. . . . ***There shall be no right or authority for any claim to be arbitrated on a class-wide basis***.

The district court originally enforced this provision, and compelled arbitration. The Second Circuit reversed in a prior decision that was later vacated by the Supreme Court for further consideration in light of *Stolt-Nielsen*. In its recent decision, the Second Circuit reaffirmed and reinstated its prior decision invalidating the arbitration clause. Accordingly, barring further appeals, the case will now proceed as a federal court class action, notwithstanding the plaintiffs' unequivocal agreement to submit its claims to arbitration.

Stolt-Nielsen Does Not Prevent Invalidation of Arbitration Provisions

In *Stolt-Nielsen*, the Supreme Court considered whether parties could pursue a class action in arbitration in the absence of a provision expressly conferring that power. Because "arbitration is simply a matter of contract between the parties," the Court held that "a party may not be compelled . . . to submit to class arbitration unless . . . the party *agreed* to do so." Nor, in the Court's view, could such an agreement be implied from a standard arbitration clause that was otherwise silent on the issue.

Latching onto *Stolt-Nielsen*'s admonition that courts must give effect to the "intent of the parties," Amex argued that courts must enforce the arbitration agreements that merchants voluntarily and knowingly entered into, just as they would any other standard contractual provision. In Amex's view, if courts may not impose class *arbitration* on unwilling parties, they also cannot impose judicial class *litigation* on them, which surely represents a far departure from the intent of the parties.

The Second Circuit disagreed, noting that *Stolt-Nielsen* does not stand for the proposition that a contractual clause barring class arbitration is *per se* enforceable: As the court explained, the Amex case "focuse[s] not on whether the plaintiffs' contract provides for class arbitration, but on whether the class action waiver is enforceable when it would effectively strip plaintiffs of their ability to prosecute alleged antitrust violations." In the court's view, it was not a matter of contract at all. Rather, it was a matter of preventing parties from circumventing the congressionally established enforcement regime for laws that depend heavily on private party enforcement.

Embracing Supreme Court Dicta, the Second Circuit Reinforces a Circuit Split

The Second Circuit's decision demarcates the battle lines drawn by the other Circuits that addressed this issue. The Third Circuit has unequivocally held that arbitration provisions (and class action waivers) are enforceable, even if it means that meritorious suits will never be filed. In so ruling, the Third Circuit not only relied on the liberal congressional policy favoring arbitration, but also on the fact that the FAA was enacted "to reverse the longstanding judicial hostility to arbitration agreements . . . and to place arbitration agreements upon the same footing as other contracts." *Gilmer v. Interstate Johnson Lane Corp.,* 500 U.S. 24 (1991).

The Second Circuit, however, was not persuaded. It chose to side with the First Circuit, noting that the FAA expressly permits invalidation "upon such grounds as exist at law or in equity for the revocation of any contract." While the Second Circuit could not point to any Supreme Court precedent invalidating an arbitration provision on public policy grounds – indeed, many decisions uphold them – the court relied instead on dicta in *Green Tree Financial Corp. v. Randolph*, 531 U.S. 79 (2000).

In *Randolph*, the Supreme Court *upheld* an arbitration clause, and rejected the argument that expected arbitration costs rendered it unenforceable. As the Court held, there was no indication that "Congress intended to preclude arbitration of the statutory claims at issue" and, in any event, the plaintiff had not shown that litigation costs would be excessive. As to this latter reason, the court simply assumed – but did not hold – that a showing of excessive litigation costs would be a basis for invalidating an arbitration clause.

The Second Circuit found this dicta to be "controlling here," concluding that a plaintiff seeking to invalidate an arbitration agreement need only show that "arbitration would be prohibitively expensive." Based on an economist's affidavit, the court concluded that, notwithstanding the Clayton's Act treble damages and attorneys' fees provisions, "the record abundantly supports the plaintiffs' argument that they would incur prohibitive costs if compelled to arbitrate under the class action waiver."

Implications

The Second Circuit's *Amex* case is significant in the context of antitrust issues, but its outer boundaries are unclear. A broad reading of the decision may suggest that arbitration provisions are essentially void with respect to the types of cases currently brought as large class actions. But other interpretations are possible, including that the Second Circuit's decision cannot be extended beyond the antitrust context (where prospective waivers of rights have long been held to be unenforceable) to other types of cases, particularly those not based upon a federal statute.

In any event, until the Supreme Court resolves the conflict, companies will be faced with conflicting standards. Does this mean that companies should abandon their efforts to include class action waivers in regard to antitrust concerns? It depends.

To the extent companies had been on the fence about including such provisions for business reasons, *Amex* may tip the balance in favor of dropping the request for a waiver. Alternatively, companies can *expressly* provide for *class arbitration*. This middle-road approach preserves the benefits of arbitration over litigation, even if it does not completely eliminate exposure to representative actions. On the other hand, for consumer-facing companies wishing to do everything they can to reduce litigation expenses and avoid nettlesome class actions, there seems to be little downside to continuing to include these provisions.

Who knows, the Supreme Court might soon come down – as it has in the past – on the side of arbitrability.

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