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SECOND CIRCUIT REVIEW

Expert Analysis

Some Class Action Waivers In Arbitration Still Unenforceable

By **Martin Flumenbaum** | And **Brad S. Karp**

The Federal Arbitration Act (FAA) "is a congressional declaration of a liberal federal policy favoring arbitration agreements."[1] But parties may reach an agreement that a court finds unenforceable as a matter of public policy. In this column, we revisit *In re: American Express Merchants' Litigation*, a case that confronts such a situation and identifies an exception to the general enforceability of arbitration agreements.

In 2009, the U.S. Court of Appeals for the Second Circuit (*American Express I*) held that a class action waiver in the mandatory arbitration clause of a commercial contract is unenforceable under the FAA when a plaintiff can demonstrate that the costs of pursuing non-class arbitration are so high that they effectively foreclose any reasonably feasible means of recovery.[2] *American Express I* was the subject of our March 25, 2009, column.

In May 2010, the Supreme Court vacated that decision and remanded for reconsideration in light of *Stolt-Nielsen S.A. v. AnimalFeeds International Corp.*,[3] its 2010 decision holding that imposing class arbitration on parties who have not agreed to authorize class arbitration is inconsistent with the FAA and emphasizing that the primary role of a court confronting an arbitration agreement is to give effect to the intent of the parties.

On remand (*American Express II*), Judge Rosemary S. Pooler, joined by Judge Robert D. Sack, determined without oral argument that *American Express I's* reasoning was "unaffected" by the Supreme Court's decision in *Stolt-Nielsen* and reaffirmed its holding.[4]

As in that earlier case, the court was careful not to adopt a per se rule against the enforceability of class arbitration waivers. Instead, the Second Circuit held that the question whether a class action waiver is enforceable requires a case-by-case analysis of the totality of the circumstances.

MARTIN FLUMENBAUM *and* BRAD S. KARP *are members of Paul, Weiss, Rifkind, Wharton & Garrison LLP.* DAVID K. KESSLER, *a litigation associate at the firm, assisted in the preparation of this column.*

Background and History

The named plaintiffs—California and New York corporations that operate businesses that have contracted with American Express, as well as the National Supermarkets Association, Inc.—filed class action complaints against American Express in the Southern District of New York. They accused American Express of illegally "tying" various products in violation of Section 1 of the Sherman Act. They sought to represent a class consisting of all merchants that had accepted American Express charge cards and therefore been forced to accept American Express credit and debit cards as well.

In 'American Express II,' the Second Circuit reaffirmed its holding that a class action waiver in an arbitration agreement is unenforceable if the costs of non-class arbitration would be so high as to outweigh the possible recovery.

The District Court

American Express moved to compel arbitration under the terms of its contracts with the plaintiffs. The district court granted that motion and dismissed the plaintiffs' case, rejecting their argument that the class action waiver in the contract's mandatory arbitration provision effectively prevented them from asserting their statutory claims because the cost of pursuing each claim individually was prohibitively high.[5]

The court observed that the plaintiffs could recover treble damages and attorneys' fees under the Clayton Act in the context of the arbitration proceeding. Moreover, the court held that the question whether the class action waiver was enforceable was one for the arbitrators to resolve.

Second Circuit

In *American Express I*, the Second Circuit reversed the district court's decision, holding that the enforceability of the waiver provision was a question for the court, not for the arbitrators. First, the circuit addressed the Supreme Court's decision in *Gilmer v. Interstate/Johnson Lane Corp.*,[6] which held that an arbitration clause is enforceable absent a showing that Congress intended to preclude a waiver of judicial remedies.

Gilmer involved the application of a mandatory arbitration rule of the New York Stock Exchange to a lawsuit brought by a manager at a brokerage firm under the Age Discrimination in Employment Act (ADEA). The Court rejected the argument that the arbitration procedures in the NYSE rules did not adequately further the purposes of the ADEA—which explicitly permits class actions—because those rules did not allow for class actions.

The circuit did not find *Gilmer* controlling. It explained that the NYSE rules at issue there allowed for collective actions, and possibly even class actions, and that in any event the plaintiffs in *American Express I* did not argue the class waiver was void merely because the antitrust laws allowed for class actions. Rather, they raised the "more nuanced" question "whether the mandatory class action waiver…is enforceable even if the plaintiffs are able to demonstrate that the practical effect of enforcement of the waiver would be to preclude their bringing Sherman Act claims against Amex in either an individual or collective capacity."[7]

The Second Circuit then concluded that the Supreme Court's decision in *Green Tree Financial Corp.-Alabama v. Randolph* was controlling.[8]

In *Randolph*, the Court addressed the question whether "an arbitration agreement that does not mention arbitration costs and fees is unenforceable because it fails to affirmatively protect a party

from potentially steep arbitration costs."[9] It held that "a party seek[ing] to invalidate an arbitration agreement on the ground that arbitration would be prohibitively expensive…bears the burden of showing the likelihood of incurring such costs" but concluded that the plaintiff had not demonstrated costs of that magnitude.[10]

Although *Randolph* did not consider the effects of its holding on an arbitration agreement that banned class arbitration, several circuit courts had relied upon *Randolph* to uphold arbitration agreements that banned class actions based upon the plaintiffs' failure to present sufficient evidence of prohibitive costs.

Applying *Randolph*, the circuit concluded that the plaintiffs had demonstrated the prohibitive costs of individual arbitration of their claims. The record "abundantly" supported their argument that they would face such costs if forced to arbitrate each claim separately.[11] The court relied on a "compelling[]" affidavit from the plaintiffs' expert, who explained that the out-of-pocket cost of pursuing an antitrust case would be at least several hundred thousand dollars but that the median plaintiff could expect to recover only about $5,000 in damages.[12] In addition, under the fee-shifting rules for federal antitrust cases, a prevailing plaintiff would be reimbursed at most $40 per day for its expert witness expenses, a fraction of the likely costs.

Because the plaintiffs had shown they could pursue their claims only if those claims were aggregated, the court concluded that, were the arbitration clause enforced, it could deprive the plaintiffs of the statutory protections of the antitrust laws. The class waiver clause therefore acted as a waiver of future liability under the federal antitrust statutes and was void as a matter of public policy.

The court added two "caveats."[13] First, it did not hold that class action waivers in arbitration agreements are per se unenforceable, instead requiring a case-by-case analysis of the totality of the circumstances. Second, it did not limit its decision to plaintiffs who are "small merchants."

U.S. Supreme Court

In May 2010, the Supreme Court vacated *American Express I* and remanded the case for reconsideration in light of its recent decision in *Stolt-Nielsen*.[14] In that case, AnimalFeeds and a group of other companies that chartered space in cargo ships sued Stolt-Nielsen for illegal price-fixing and demanded class arbitration. The parties agreed that the arbitration clause was "silent" as to whether class arbitration was permissible—the contract did not address class arbitration, and the parties had not agreed whether class arbitration was permissible.[15]

The arbitration panel concluded that the contract allowed class arbitration, reasoning that a wide range of arbitration clauses have been construed as allowing class arbitration and that the petitioners had not established that the parties intended to preclude class arbitration. After proceedings in the lower courts, the Supreme Court granted certiorari to address the question whether imposing class arbitration upon parties whose arbitration clause was "silent" on that issue is consistent with the FAA.

In a 5-3 decision, the Court reversed the decision of the Second Circuit.[16] It held that under the FAA, a "basic precept" is that arbitration is a "matter of consent, not coercion."[17] As a result, courts and arbitrators are required to construe arbitration clauses to "give effect to the intent of the parties,"[18] and "a party may not be compelled under the FAA to submit to class arbitration unless there is a contractual basis for concluding that the party *agreed* to do so."[19]

Moreover, class arbitration differs significantly enough from bilateral arbitration that an arbitrator could not infer consent to class arbitration merely from the agreement to submit to arbitration generally.

Justice Ruth Bader Ginsburg, joined by Justice John Paul Stevens and Justice Stephen Breyer, dissented, arguing that the Court erred by substituting its judgment for that of the arbitrators.

'American Express II'

Upon reconsideration of *American Express I*, the Second Circuit considered the implications of *Stolt-Nielsen* and held, as it had in its original decision, that the class action waiver was unenforceable. First, it rejected American Express's argument that *Stolt-Nielsen* "repeatedly emphasiz[ed] [a] courts' obligation to faithfully enforce (not just construe) the parties' arbitration agreement."[20]

It concluded that *Stolt-Nielsen* held only that a party cannot be forced to engage in class arbitration absent a contractual agreement to do so. "It does not follow," the circuit explained, that "a contractual clause barring class arbitration is per se enforceable."[21] That was the question before the *American Express II* court.

Turning to that question, the court largely reiterated its analysis in *American Express I*. It found *Randolph* controlling and held that the evidence established, as a matter of law, that the cost of non-class arbitration to each individual plaintiff was prohibitive. As a result, the class action waiver was unenforceable because it "preclude[d] plaintiffs from enforcing their statutory rights."[22]

As in *American Express I*, the court limited the scope of its holding, which did not constitute a per se ban on class arbitration waivers and did not depend upon the plaintiffs' status as "small" merchants.

Finally, the court considered American Express's argument that *Stolt-Nielsen* expressly rejected the use of public policy as a basis for finding contractual language void. It held that although *Stolt-Nielsen* "plainly rejects using public policy as a means for divining the parties' intent, nothing in *Stolt-Nielsen* bars a court from using public policy to find contractual language void."[23]

Conclusion

In *American Express II*, the Second Circuit reaffirmed its holding that a class action waiver in an arbitration agreement is unenforceable if the costs of non-class arbitration would be so high as to outweigh the possible recovery, effectively prohibiting plaintiffs from vindicating their statutory rights.

The court also provided guidance about what showing was necessary to establish prohibitively high costs.

In reaching its decision, the circuit considered *Stolt-Nielsen* at the direction of the Supreme Court and found that case inapplicable, rejecting the contention that *Stolt-Nielsen* required courts to enforce arbitration agreements solely as they are written, without regard for public policy. On April 11, 2011, the circuit granted American Express's motion to stay the court's mandate, so it is possible the Supreme Court will soon have the opportunity to consider for itself the implications of *Stolt-Nielsen* for class action waivers in arbitration provisions.

1. *In re Am. Express Merchs. Litig.*, 634 F.3d 187, 199 (2d Cir. 2011) (quoting *Moses H. Cone Mem'l Hosp. v. Mercury Const. Corp.*, 460 U.S. 1, 24 (1983)).
2. *In re Am. Express Merchs. Litig.*, 554 F.3d 300, 320 (2d Cir. 2009).
3. 130 S. Ct. 1758 (2010).
4. *In re Am. Express Merchs. Litig.,* 634 F.3d 187, 188 (2d Cir. 2011). Then-Judge Sonia M. Sotomayor was the third judge on the panel in *American Express I*.
5. *In re Am. Express Merchs. Litig.*, No. 03-cv-9592, 2006 WL 662341 (S.D.N.Y. Mar. 16, 2006).
6. 500 U.S. 20 (1991).
7. *In re Am. Express Merchs. Litig.*, 554 F.3d at 314.
8. 531 U.S. 79 (2000).
9. Id. at 82.
10. Id. at 92.
11. *In re Am. Express Merchs. Litig.*, 554 F.3d at 315.
12. Id. at 316-17.
13. Id. at 320.
14. *Am. Express Co. v. Italian Colors Rest.*, 130 S. Ct. 2401 (2010).
15. *Stolt-Nielsen*, 130 S. Ct. at 1764.
16. Justice Sotomayor took no part in the decision.
17. 130 S. Ct. at 1773.
18. Id. at 1774-75.
19. Id. at 1775 (emphasis in original).
20. *In re Am. Express Merchs. Litig.*, 634 F.3d at 193.
21. Id. at 193.
22. Id. at 199.
23. Id.