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Class Action Arbitration Waiver Rejected by Federal Appellate Court

Second Circuit sidesteps Concepcion *and holds that the ability to enforce federal statutory rights mandates that a plaintiff be allowed to pursue a class action in court notwithstanding the parties' agreement to mandatory arbitration.*

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Just when it appeared that the U.S. Supreme Court's recent series of arbitration decisions had firmly established that class action waivers in arbitration clauses are enforceable, in a closely watched case the U.S. Court of Appeals for the Second Circuit held on February 1 that an arbitration clause is void if individual arbitration would make it financially unfeasible for a plaintiff to vindicate federal statutory rights. The decision in *In re American Express Merchants' Litigation*, No. 06-1871, — F.3d — (2d Cir. Feb. 1, 2012)—the Second Circuit's third rejection of the arbitration clause in this case in just over three years—is in marked contrast to the series of recent decisions by the Supreme Court enforcing the express terms of arbitration agreements consistent with the Federal Arbitration Act's liberal policy favoring arbitration. The decision in *American Express* will likely be reviewed by the Supreme Court and raises a number of important questions for businesses that have attempted to reduce their litigation expense though mandatory arbitration programs.

Background

In 2003, several California- and New York-based merchants, as well as a national trade association representing independently owned supermarkets, brought a series of class action lawsuits contending that American Express charged exorbitant "merchant discount fees" for new credit card products, forcing merchants to pay the same fees for credit card purchases as for purchases made with the more traditional (and allegedly more profitable) charge cards. The plaintiffs alleged that, because of American Express's market power, the requirement that merchants pay the same fees for all American Express card transactions was an illegal "tying arrangement" in violation of Section 1 of the Sherman Act, 15 U.S.C. § 1.

Each member of the proposed class had previously executed a Card Acceptance Agreement with American Express containing a mandatory arbitration clause. The arbitration clause precluded a merchant from litigating in court or participating as a representative or member of any class of claimants pertaining to claims against American Express.

The district court granted American Express's motion to compel arbitration, holding that the issue of enforcing the class action waiver was for the arbitrator to resolve. In dicta, the district court also rejected the plaintiffs' contention that the costs of bringing individual claims would effectively strip the plaintiffs of their ability to bring small dollar-value claims (averaging only $5,000 in this case). Notably, the plaintiffs submitted an affidavit from an expert witness that the cost of performing an economic study of the type needed to support the plaintiffs' antitrust claims would be at least hundreds of thousands of dollars.

Prior Rulings of the Second Circuit

Following the district court's order compelling arbitration, the plaintiffs appealed. The Second Circuit reversed, holding that the plaintiffs' challenge to the enforcement of the arbitration clause raised a question of arbitrability, which under Supreme Court precedent was to be resolved by the court as opposed to by the arbitrator. *In re American Express Merchants' Litig.*, 554 F.3d 300, 311 (2d Cir. 2009) (*Amex I*). Relying on the plaintiffs' expert testimony comparing the significant costs of bringing an individual antitrust claim to the small compensatory damages to be recovered, the court further held that, consistent with dicta in the Supreme Court's decisions in *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*, 473 U.S. 614 (1985), and *Green Tree Financial Corp.-Alabama v. Randolph*, 531 U.S. 79 (2000), the plaintiffs' rights against American Express under the antitrust laws could only be vindicated by aggregated claims, "either in class action litigation or in class arbitration." *Amex I*, 554 F.3d at 317.

The Supreme Court granted American Express's petition for a writ of certiorari. However, rather than deciding the case on the merits, the Supreme Court remanded *Amex I* for reconsideration in light of the Court's then-new decision in *Stolt-Nielsen S.A. v. AnimalFeeds Int'l Corp.*, 130 S. Ct. 1758 (2010), which held that when an arbitration agreement is silent on class arbitration, the parties cannot be compelled to submit to class arbitration. On remand, in March 2011, the Second Circuit held that *Amex I* was unaffected by *Stolt-Nielsen*, except to clarify that American Express could not be ordered to class arbitration. *In re American Express Merchants' Litig.*, 634 F.3d 187, 200 (2d Cir. 2011) (*Amex II*). While the mandate in *Amex II* was on hold, the Supreme Court issued its decision in *AT&T Mobility LLC v. Concepcion*, 131 S. Ct. 1740 (2011). The parties submitted supplemental briefing on the applicability of *Concepcion* to the Second Circuit's analysis. Without entertaining oral argument, the Second Circuit reaffirmed its prior rulings and ordered the district court to deny American Express's motion to compel arbitration. *In re American Express Merchants' Litig.*, No. 06-1871, — F.3d — (2d Cir. Feb. 1, 2012) (*Amex III*).

The Ruling in *Amex III*

The Second Circuit's opinion in *Amex III* began by distinguishing the issues addressed in recent, pro-arbitration decisions by the Supreme Court: "What *Stolt-Nielsen* and *Concepcion* do not do is require that all class-action waivers be deemed per se enforceable. That leaves open the question presented on this appeal: whether a mandatory class action waiver clause is enforceable even if the plaintiffs are able to demonstrate that the practical effect of enforcement would be to preclude their ability to bring federal antitrust claims." *Amex III*, slip op. at 15. In a footnote, the court also distinguished the Supreme Court's recent decision in *CompuCredit Corporation v. Greenwood*, No. 10-948, 565 U.S. — (Jan. 10, 2012), which reaffirmed that Congress must be "explicit" when prohibiting arbitration of federal statutory claims. By contrast, the Second Circuit held that, although the Sherman Act does not expressly require that antitrust claims be brought as a class in court, "forcing plaintiffs to bring their claims individually

here would make it impossible to enforce their rights under the Sherman Act and thus conflict with congressional purposes manifested in the provision of a private right of action in the statute." *Amex III*, slip op. at 15 n.5.

In *Amex III*, the Second Circuit largely reiterated the analysis from its prior opinions regarding the suitability of class action lawsuits to vindicate statutory rights. Again citing the dicta in *Mitsubishi Motors* and *Green Tree Financial Corp.-Alabama* that large arbitration costs could preclude a litigant from effectively vindicating federal statutory rights in arbitration, the court observed: "Neither *Stolt-Nielsen* nor *Concepcion* overrules *Mitsubishi*, and neither makes mention of *Green Tree*." Slip op. at 20. The Second Circuit frankly acknowledged that no other federal circuit has permitted a plaintiff to avoid an arbitration clause on this ground solely because of the expense of arbitration. But the plaintiffs' failures in other cases, the court held, "speak to the quality of the evidence presented, not the viability of the legal theory." *Id.* at 21.

In reaffirming that the plaintiffs in *Amex III* had met their burden of challenging arbitration, the Second Circuit once again relied heavily on the affidavit submitted by the plaintiffs' economist stating that median volume merchant among the named plaintiffs suffered damages of approximately $5,000, and the named plaintiff processing the largest volume of American Express charges suffered damages of only about $38,000—both over a four-year period, and after trebling. *Amex III*, slip op. at 22. The court also relied on the economist's opinion that it would cost an individual plaintiff between $300,000 and $2 million to pay for an expert economic study and testimony regarding antitrust liability and damages issues. *Id.* Notably, the court had previously found the expert's evidence was "essentially uncontested." *Amex I*, 554 F.3d at 317. In view of the expense of maintaining an antitrust claim, compared to the small compensatory damages, the court held only aggregate claims would vindicate the plaintiffs' rights under the antitrust laws—notwithstanding the availability of attorney's fees and expenses under section 4 of the Clayton Act (15 U.S.C. § 15(a).) *Amex III*, slip op. at 23.

Finally, the opinion in *Amex III* reemphasized important caveats from the Second Circuit's earlier rulings. The holding that the plaintiffs were unable to vindicate their rights effectively under the Sherman Act in arbitration did not rely on their status as "small" merchants. *Amex III*, slip op. at 23. Nor did the court hold that class action waivers in arbitration agreements were per se unenforceable either generally or in antitrust actions specifically. The issue of enforceability of a class action waiver is instead to be "considered on its own merits, based on its own record," and in view of a liberal federal policy favoring arbitration. *Id.* Because the court found these plaintiffs could effectively pursue their antitrust claims only in a judicial class action, and not in an individual arbitration, the court held the arbitration clause was unenforceable. *Id.* at 25.

It is important to note that *Amex III* does not alter the enforcement of arbitration clauses with regard to *state* statutory and common law claims, the issue decided in *Concepcion*. The Second Circuit took pains to emphasize that it was analyzing the arbitration agreement not under state contract law, but instead under the "'vindication of statutory rights analysis, which is part of the federal substantive law of arbitrability.'" *Amex III*, slip op. at 14 (quoting *Amex I*, 554 F.3d at 320). Nonetheless, *Amex III* is the most recent and the most important of a growing number of federal and state court decisions attempting to distinguish and limit *Concepcion*. Some of those decisions involve issues of contract formation or mutual assent (*NAACP of Camden County East, et al. v. Foulke Mgmt. Corp.*, 421 N.J. Super. 404 (2011)); unconscionability in the form of unequal bargaining power and one-sided terms (*Sanchez v. Valencia Holding Co.*, 201 Cal. App. 4th 74 (2011); *Rivera v. Am. Gen. Fin. Servs., Inc.*, 259 P.3d 803 (N.M. 2011)); claims under California's Private Attorney General Act (*Brown v. Ralph's Grocery Co.*,

197 Cal. App. 4th 489 (2011); *Urbino v. Orkin Servs. of Cal., Inc.*, 2011 WL 4595249 (C.D. Cal. 2011)); and claims for public injunctive relief under state unfair competition law (*Ferguson v. Corinthian Colleges*, 2011 WL 4852339 (C.D. Cal. 2011)).

Possible Review of, and Open Questions Regarding, *Amex III*

The *Amex III* decision, although framed as a narrow ruling based on "uncontested" evidence about the cost of individual arbitrations, again puts the Second Circuit into at least indirect conflict with the Supreme Court's recent decisions in *Stolt-Nielsen*, *Concepcion*, and *CompuCredit*—all of which acknowledged the expediency of arbitration in enforcing claims. For example, in *Concepcion*, the Supreme Court rejected California's *Discover Bank* rule, which required that class arbitration be available when, *inter alia*, the plaintiff's damages were "predictably small." *Concepcion*, 131 S. Ct. at 1750. This requirement was rejected as "toothless and malleable" because damages claims as large as $4,000 were considered sufficiently small for the California rule to apply. *Id.* And in *CompuCredit*, the Supreme Court observed that the federal Credit Repair Organization Act's guarantee of a "right to sue" left the parties free to specify the forum for adjudication as long as "*the guarantee of the legal power to impose liability*—is preserved." *CompuCredit*, No. 10-948, slip op. at 7. The opinion in *Amex III* appears to extend a statutory "guarantee" of a private cause of action under federal law to now require a class action (not simply an individual lawsuit) whenever the costs of an individual suit or arbitration are high.

Given the unprecedented result in *Amex III*, that certiorari was already granted once in the case and that the Supreme Court seems particularly focused on arbitration as of late, review by the Supreme Court appears likely. One important question may be whether Justice Sonia Sotomayor, a member of the panel that heard and decided *Amex I* and a dissenter in *Concepcion*, would be recused from ruling on any decision by the Supreme Court. For example, Chief Justice Roberts recused himself from the Supreme Court's ruling in *Hamdan v. Rumsfeld*, 548 U.S. 557 (2006), where he had been a member of the D.C. Circuit panel whose decision was under review. Given the 5-4 decision in *Concepcion* and the strong dissent, the possible recusal of Justice Sotomayor could tip the balance toward reversal in the Supreme Court.

Putting aside possible Supreme Court review, *Amex III* raises a series of important questions, including the following:

- How to resolve the apparent split between the Second Circuit's approach and that of other courts, such as the Eleventh Circuit, which prior to *Concepcion* held that the availability of attorney's fees is crucial to the analysis of a class action waiver's enforceability. *Cf. Dale v. Comcast Corp.*, 498 F.3d 1216, 1222 (11th Cir. 2007) (finding waiver to be substantively unconscionable, in part, because class members "cannot recover attorneys' fees under the [Cable Communications Policy Act of 1984] for the specific violations alleged").

- What evidence concerning the availability of compensatory damages and fees will be necessary for a defendant to oppose successfully the contention that arbitrating a federal statutory claim is prohibitively expensive.

- Whether *Amex III*'s vindication of statutory rights analysis will bar arbitration of federal claims that may be less complex and expensive than antitrust claims. *See LaVoice v. UBS Fin. Servs., Inc.*, 2012 WL 124590 (S.D.N.Y. Jan. 13, 2012) (Fair Labor Standards Act claim subject to

arbitration where claim admittedly worth more than $127,000 and expert testimony may have been inadmissible).

- Whether arbitration is still precluded under the Second Circuit's theory if a plaintiff's federal claims are dismissed after the case proceeds on the merits and only state law claims remain in the case.

- Whether the use of a consumer-friendly arbitration provision, along the lines of the clause in *Concepcion*, overcomes the Second Circuit's concern with vindicating important federal statutory rights.

These and other important issues will need to be addressed in the weeks and months to come. In the meantime, parties seeking to enforce arbitration provisions should be especially mindful of the need to create a favorable record on the cost to the plaintiff of pursuing statutory claims.

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