Client Alert

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Supreme Court Upholds Contractual Provision Waiving Class Arbitration in *American Express Co. v. Italian Colors Restaurant*, Case No. 12-133 (June 20, 2013)

In the critical final weeks of its 2012-2013 term, the Supreme Court confirmed that an express class waiver in an arbitration agreement is enforceable under the Federal Arbitration Act, even when federal statutory claims are at issue and when the cost of arbitrating the claims on an individual basis would significantly exceed the potential recovery. Like the Court's recent decision upholding an arbitrator's broad discretion in interpreting an arbitration provision,[1] *American Express Co. v. Italian Colors Restaurant* has wide-ranging implications for companies that use arbitration provisions and for class action and Federal Arbitration Act jurisprudence.

Background of the Case

In *American Express Co. v. Italian Colors Restaurant*, Italian Colors brought antitrust claims against American Express on behalf of itself and a putative class of all merchants that contracted with American Express to accept its credit cards. The plaintiffs alleged that American Express violated federal antitrust laws by using its monopoly power in the charge card market to force merchants into an illegal tying arrangement under which their fees for accepting American Express credit cards were significantly higher than the fees for competing credit cards.

The Card Acceptance Agreement at issue between American Express and its merchants required all disputes arising thereunder to be resolved by arbitration, and provided that there "shall be no right or authority for any Claims to be arbitrated on a class action basis." American Express moved pursuant to this provision and the Federal Arbitration Act ("FAA") to compel individual arbitration of the plaintiffs' claims. The plaintiffs countered that because the cost of adjudicating the claims on an individual basis so significantly exceeded the maximum recovery available to any individual plaintiff, enforcement of the class arbitration waiver provision would preclude the plaintiffs from effectively vindicating their federal statutory rights.

Holding that the class arbitration waiver was enforceable and could not be invalidated by the high cost of individual adjudication, the district court granted American Express' motion to compel arbitration and dismissed the lawsuit. The Court of Appeals for the Second Circuit reversed, holding that the plaintiffs "would incur prohibitive costs if compelled to arbitrate under the class action waiver" and that the class mechanism was therefore the only economically feasible way for the plaintiffs to proceed. The Second Circuit reaffirmed its decision when the Supreme Court remanded the case for further consideration in light of its ruling in *Stolt-Nielsen S.A. v. AnimalFeeds Int'l Corp.*, 599 U.S. 662 (2010), and again when it *sua sponte* reconsidered its decision in light of the Supreme Court's ruling in *AT&T Mobility LLC v. Concepcion*, 563 U.S. __, 131 S. Ct. 1740 (2011) (holding that a state law that invalidated class action waivers in consumer arbitration agreements was preempted by the FAA and unenforceable).

[1] For an analysis of this decision, please see our June 14, 2013 alert, "Supreme Court Upholds Arbitrator's Ruling Authorizing Class-Wide Arbitration in *Oxford Health Plans LLC v. Sutter*, Case No. 12-135 (June 10, 2013)."

The Supreme Court's Decision

On June 20, 2013, in a 5-3 decision authored by Justice Antonin Scalia (with Justice Sonia Sotomayor recused), the Supreme Court upheld the validity of American Express' arbitration and class waiver provisions, and held that a court cannot invalidate a contractual waiver of class arbitration because the cost of individual arbitration allegedly exceeds the potential recovery.

Three principles inform the majority's holding. First, the Court reaffirmed that absent an express congressional command to the contrary, the maxims espoused in *CompuCredit Corp. v. Greenwood*, 565 U.S. __, 132 S. Ct. 665 (2012), namely "that arbitration is a matter of contract" and that courts should strictly enforce the terms of arbitration agreements, also apply to claims that allege violations of federal statutes. The Court concluded that the federal antitrust laws at issue and Rule 23 of the Federal Rules of Civil Procedure do not "guarantee an affordable procedural path to the vindication of every claim," "'evince an intent to preclude a waiver' of class-action procedure," or override the FAA's mandate that courts "rigorously enforce arbitration agreements according to their terms."

Second, the Court held that the judge-made "effective vindication" exception to the FAA, which bars provisions that "forbid[] the assertion of certain statutory rights" and is based on dictum from *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*, 473 U.S. 614 (1985), does not apply to class action waivers or other provisions that merely increase the costs of proving a claim. In fact, the Court identified only one type of provision clearly barred by the exception: "an express prohibition on the assertion of certain statutory rights." It drew a critical distinction between such prohibitions and a provision that leads only to increased costs: "the fact that it is not worth the expense involved in *proving* a statutory remedy does not constitute the elimination of the *right to pursue* that remedy." The Court stressed that "the FAA's command to enforce arbitration agreements trumps any interest in ensuring the prosecution of low-value claims," even where the "absence of litigation . . . is the consequence of a class-action waiver."

Third, the Court reasoned that invalidating a class waiver due to the cost of individual arbitration would impose upon parties and courts at the outset of each case the "unwieldy" task of determining whether a bilateral arbitration agreement should be enforced based on an inquiry into "the legal requirements for success on the merits . . . , the evidence necessary to meet those requirements, the cost of developing that evidence, and the damages that would be recovered in the event of success." Such a "preliminary litigating hurdle," the Court said, would "destroy the prospect of speedy resolution that arbitration . . . was meant to secure."

Justice Kagan, who authored the Court's unanimous decision in *Oxford Health*, 133 S. Ct. 2064 (June 10, 2013), wrote a lengthy dissent in which she argued that an arbitration agreement is unenforceable under the "effective vindication" doctrine where it "forecloses (not diminishes) a plaintiff's opportunity to gain relief" and thus "confer[s] immunity from potentially meritorious federal claims." Justice Kagan stated that, under this standard, high arbitration fees can serve as the basis for unenforceability where they are "'prohibitive' (not high, excessive, or extravagant)." Turning to the facts at issue, she opined that the difference between the plaintiffs' maximum potential recovery ($38,549 after trebling) and the cost of obtaining an expert report (between several hundred thousand and one million dollars) amounted to a "prohibitive" cost that effectively precluded individual arbitration and thus prevented Italian Colors from vindicating its rights under the federal antitrust laws. Justice Kagan also expressed concern that the majority's opinion invited companies to include in their arbitration agreements other *de facto* prohibitions—such as expensive filing fees or short statutes of limitations—that would be "less direct than an exculpatory clause, but no less fatal." She said that the dangers of arbitration-provision abuse are especially palpable in the antitrust context, where "[t]he monopolist gets to use its monopoly power to insist on a contract effectively depriving its victims of all legal recourse."

Implications for Arbitration Clauses and Litigation Strategy

Several important lessons can be gleaned from the Court's decision in *Italian Colors*:

A. The decision accords with two emerging trends in the Supreme Court: (1) a heightened deference to arbitration agreements and insistence that courts "rigorously enforce" their terms and stipulations as to their meaning, *see Stolt-Nielsen*, *Concepcion*, *CompuCredit*, and *Oxford Health*; and (2) a growing disfavor for the class action mechanism, *see Comcast Corp. v. Behrend*, 133 S. Ct. 1426 (2013); *Wal-Mart Stores, Inc. v. Dukes*, 131 S. Ct. 2541 (2011). The Court's rulings in *Oxford Health* and *Italian Colors* make clear that, if a company seeks to avoid class action litigation, it need only include in its contracts an arbitration agreement that contains an express class waiver. Subject to limited exceptions, such provisions generally will be upheld under the FAA.

B. The ruling appears to leave open only three routes by which plaintiffs can seek to invalidate class action waivers. The first is the FAA savings clause, 9 U.S.C. § 2, which provides that arbitration provisions are unenforceable where there exist "grounds at law or in equity for the revocation of any contract." Companies using arbitration agreements are well advised to review their contract-formation procedures and evaluate their contracts' susceptibility to defenses such as fraud, unconscionability, and duress. The second is the now-limited "effective vindication" exception set forth in *Mitsubishi Motors*, which until *Italian Colors* many believed to be the largest hurdle to the enforcement of class action waivers. Third, the FAA's mandate that the terms of arbitration agreements be "rigorously enforce[d]" still can be "overridden by a contrary congressional command," such as a law limiting the scope of the FAA or an express determination by the legislature that class actions are necessary to the enforcement of a particular statutory right and therefore cannot be waived.

C. The holdings in *Italian Colors* are broadly worded and not limited to antitrust litigation. As such, the case likely will affect other subject areas, particularly in the labor and employment context where class and collective actions are commonplace. Currently pending before the Fifth Circuit is a case in which the National Labor Relations Board ("NLRB") held that employee class arbitration waivers violate Section 7 of the National Labor Relations Act ("NLRA"). *See D.R. Horton, Inc. v. N.L.R.B.*, No. 12-60031 (challenging *In re D.R. Horton, Inc.*, 357 N.L.R.B. No. 184 (2012)). In *Italian Colors*, the Supreme Court reasoned that federal antitrust laws and civil procedure rules do not authorize class arbitrations in part because (1) the substantive laws existed long before Rule 23 was adopted; (2) Rule 23 does not create a nonwaivable right to petition for class certification; and (3) the Court's reasoning in *Gilmer v. Interstate/Johnson Lane Corp.*, 500 U.S. 20 (1991) (Age Discrimination in Employment Act case) is instructive in class waiver cases. These rationales are equally applicable to the NLRA and the Fair Labor Standards Act. Though several courts already have rejected the NLRB's position in *In re D.R. Horton*, *Italian Colors* further weakens the vitality of the NLRB's broad reading of Section 7 as a barrier to class waiver provisions.

   Another area in which *Italian Colors* could have important implications is in the new Consumer Financial Protection Bureau's ("CFPB") rulemaking on mandatory arbitration and federal claim waivers in consumer contexts. Section 1028 of the Dodd-Frank Act authorizes the CFPB to restrict or prohibit pre-dispute arbitration agreements between financial service providers and consumers if it finds that doing so "is in the public interest and for the protection of consumers." On June 1, 2013, the CFPB issued final rules barring pre-dispute arbitration clauses, and pre-dispute waivers of federal law claims, in mortgage and home equity loan contracts. On June 7, 2013, the CFPB announced that it was expanding its study of pre-dispute agreements to include a telephone survey about dispute resolution provisions in credit card agreements, which may signal the CFPB's plans to expand its existing regulations to other areas of consumer finance, such as credit cards, automobile loans, and student loans. For plaintiffs, their lawyers, and consumer interest groups, the broad authority vested in the CFPB provides a glimmer of hope, after many unfavorable court decisions, that pre-dispute arbitration clauses may be limited. It is unclear whether the *Italian Colors* decision will encourage legal challenges to the CFPB's new or future pre-dispute arbitration clause rules, and if so, whether the reasoning in *Italian Colors* will be relevant in this context.

The coming year promises additional legal developments in the areas of class arbitration and class action waivers, as the comment period for the CFPB's survey of credit card consumers ends on August 6, 2013, and next term the Supreme Court will hear *BG Group PLC v. Argentina*, Case No. 12-138, which concerns whether arbitrators or courts have the authority to determine whether prerequisites to arbitration have been satisfied.

Hunton & Williams' litigation team will stay apprised of all such developments, and has extensive experience advising clients on drafting arbitration clauses, litigating and arbitrating disputes that arise, and enforcing arbitral awards. If you need legal assistance in these areas, please contact us.

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