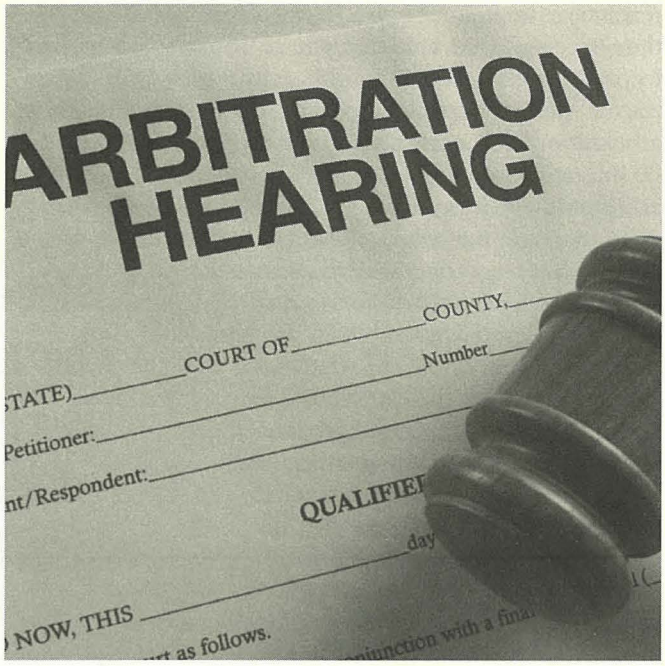
Closing the Circle: *American Express Company* Hits Class Arbitration

By John Jay Range

The Supreme Court's recent 5–3 decision in *American Express Co. v. Italian Colors Restaurant*[1] held that a contractual waiver of class action arbitration is enforceable under the Federal Arbitration Act (FAA),[2] even if the claimant's cost of arbitrating a federal statutory claim on an individual basis significantly exceeds the maximum possible recovery. *American Express* is the latest in a series of Supreme Court decisions that have voiced a growing disfavor for the class action mechanism, and have utilized the FAA to restrict access to class arbitration.[3] *American Express* is an important case that has significant implications for parties drafting arbitration clauses where a dispute involving multiple claimants could arise.



The Development of Class Arbitration

Interest in class arbitration has increased as more companies are utilizing arbitration clauses in their contracts to avoid exposure to class action litigation. Arbitral institutions, such as the American Arbitration Association (AAA), have adopted rules to allow arbitrators to administer arbitrations on a class basis. [4] The AAA Supplementary Rules for Class Arbitrations (AAA Supplementary Rules) provide that the arbitrator must decide, after a request for arbitration is submitted, whether it is appropriate for an arbitration to proceed on an individual or class basis.[5] The AAA Supplementary Rules apply to any dispute arising out of an agreement that provides for AAA arbitration where one party requests class arbitration.[6] As a consequence, a company that adopts a standard form AAA arbitration provision, which makes no reference to class arbitration, may discover after an arbitration is commenced that it must defend not just against the individual claimant, but also against a class of claimants.

John Jay Range

To avoid this risk, companies have increasingly utilized express waivers of class arbitration in their contractual dispute resolution provisions. However, some states, either through legislation or judicial decisions, have specifically sought to invalidate waivers of class arbitration, primarily in the context of consumer transactions involving adhesion contracts. Similarly, the federal common law was also thought to impose limits on class arbitration waivers involving federal statutory claims under what is known as the "effective vindication" doctrine. This doctrine limited, on public policy grounds, utilization of contractual provisions (i.e., arbitration) to prohibit or significantly burden a party's right to enforce a federal statutory right.

Recent Supreme Court decisions have relied on an expansive reading of the FAA to invalidate state laws that either require class arbitration or specifically seek to bar or limit the use of class arbitration waivers. The *American Express* decision continues this trend by limiting the authority of federal courts to invoke the "effective vindication" doctrine to invalidate class

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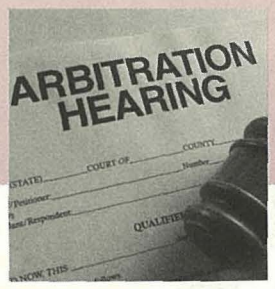
arbitration waivers in disputes involving federal statutory rights. The result is that class arbitration waivers will be upheld except in a limited number of circumstances.

The Supreme Court's Rulings Relating to Class Arbitration

The *Stolt-Nielsen* decision. The Supreme Court stepped into the fray over class arbitration by broadly construing the FAA to protect what the Court characterized as the consensual nature of alternative dispute resolution. In *Stolt-Nielsen S.A. v. AnimalFeeds Int'l Corp.*,[7] the Supreme Court held that parties could be compelled to participate in class arbitration only if there was a contractual basis for concluding they had consented to class arbitration. The Court further held that consent could not be inferred simply from the fact that parties agreed to arbitrate their disputes.[8]

In reaching this result, the Supreme Court expressed concern about the ways in which class arbitration procedures differed fundamentally from bilateral arbitration. Class arbitration would likely alter the duration, cost, and informality of bilateral arbitration. It would simultaneously increase risks due to potentially greater financial exposure without the same degree of procedural safeguards found in class action litigation, including a right of appeal, save for the limited grounds set out in the FAA for annulling awards. Accordingly, the Court held: "We think that the differences between bilateral and class-action arbitration are too great for arbitrators to presume, consistent with their limited powers under the FAA, that the parties' mere silence on the issue of class-action arbitration constitutes consent to resolve their disputes in class proceedings."[9]

Justice Kagan: The majority is ready to dismantel everything that "looks like class action."



Although the Supreme Court's decision in *Stolt-Nielsen* appeared to create a broad rule of decision, lower courts have grappled with the proper application of the case. Importantly, the case did not resolve whether parties that adopt broad form arbitration clauses, such as the standard form AAA arbitration clause, can be compelled to participate in class arbitration.

The *AT&T Mobility* decision. In *AT&T Mobility v. Concepcion*,[10] the Supreme Court held that the FAA preempted California's judicial rule (known as the *Discover Bank*[11] rule) governing unconscionability of class arbitration waivers in consumer contracts. Under the *Discover Bank* rule, class waivers in consumer arbitration agreements were deemed unconscionable in adhesion contracts involving small amounts of damages where the party with inferior bargaining power alleged a deliberate scheme to defraud.[12] The Supreme Court held that the FAA preempted the *Discover Bank* rule because that rule placed an impermissible burden on arbitration. As in *Stolt-Nielsen*, the Supreme Court was concerned about the differences between individual and class arbitration, and that companies that might otherwise be inclined to utilize arbitration for dispute resolution would be concerned about the lack of procedural and substantive protections available to defendants in class arbitration. Based on these considerations, the Supreme Court concluded California's *Discover Bank* rule voiding waivers of class arbitration was inconsistent with the FAA's policy of encouraging arbitration, and was therefore preempted by the federal law. *AT&T Mobility* has broad application, preempting state laws or judicial decisions that specifically seek to restrict waivers of class arbitration.

The *American Express* decision. In *American Express*, the Supreme Court extended *AT&T Mobility*'s protection for waivers of class arbitration by precluding federal courts from utilizing the FAA to invalidate class waivers based on the public policy grounds embodied in the "effective vindication" doctrine. *American Express* was initially filed by a number of merchants as a class action antitrust suit. The merchants claimed American Express used its monopoly power to create a tying arrangement in violation of § 1 of the Sherman Act.[13] Merchants who accepted American Express charge cards were also forced to accept American Express credit and debit cards at rates approximately 30 percent higher than the fees charged for competing credit cards.[14] American Express moved to dismiss the suit and compel individual arbitration against each merchant under the FAA, arguing each of the merchants had entered into a card acceptance agreement requiring disputes to be resolved through arbitration where "[t]here shall be no right or authority for any Claims to be arbitrated on a class action basis. . . ."[15]

The district court granted the motion to compel arbitration. On appeal, the Second Circuit reversed, holding that the class action waiver was unenforceable, "because enforcement of the clause would effectively preclude any action seeking to vindicate the statutory rights asserted by the plaintiffs."[16] In arguing that individual arbitration would be too expensive to vindicate its antitrust claim, plaintiffs relied on the testimony of

an economist who opined that the cost of providing required economic evidence would be in the range of several hundred thousand to as much as one million dollars, whereas the plaintiff *Italian Colors*' maximum recovery, after trebling damages, would be only $38,549.[17] The cost of the economic testimony necessary to prove the case, therefore, was so great that the plaintiff would have no reasonable path in an individual arbitration to vindicate its statutory antitrust rights.

Reversing the Second Circuit's judgment, the Supreme Court left in place the requirement that the antitrust dispute be arbitrated, rather than litigated in court, but rejected the conclusion that the FAA permits courts to invalidate a contractual waiver of class arbitration on the grounds that the cost of arbitrating an antitrust claim in an individual arbitration, as opposed to a class arbitration, exceeds the potential recovery. The Supreme Court started its analysis by stating that "Congress enacted the FAA in response to widespread judicial hostility to arbitration."[18] The Court held that, consistent with the text of the FAA, "courts must 'rigorously enforce' arbitration agreements according to their terms."[19] The FAA's mandate in favor of arbitration "holds true for claims that allege a violation of a federal statute" unless "'overridden by a contrary congressional command.'"[20] The Court found that no such contrary congressional command required rejection of the waiver of class arbitration in the card acceptance agreement.

Responding to the Second Circuit's concern that the cost of providing the required economic testimony rendered individual arbitration cost-prohibitive, the Supreme Court stated: "the antitrust laws do not guarantee an affordable procedural path to the vindication of every claim,"[21] and further "do not 'evinc[e] an intention to preclude a waiver' of class-action procedure."[22] In fact, the Court noted that neither the Sherman nor Clayton Acts make any reference to class actions, and it was decades after these statutes were enacted that Federal Rule of Civil Procedure 23 was adopted to allow claims to be prosecuted in a fashion other than '"on behalf of the individual named parties only.'"[23] The Court held that "congressional approval of Rule 23" does not "establish an entitlement to class proceedings for the vindication of statutory rights."[24] Further, the Supreme Court noted *AT&T Mobility* had rejected the proposition that "federal law secures a nonwaivable *opportunity* to vindicate federal policies by satisfying the procedural strictures of Rule 23 or invoking some other informal class mechanism in arbitration."[25] Because the "effective vindication" doctrine had its origin in the *right to pursue* statutory remedies, the doctrine was applicable to (i) "a provision in an arbitration agreement forbidding the assertion of certain statutory rights," or "perhaps" (ii) "filing and administrative fees attached to arbitration that are so high as to make access to the forum impracticable."[26] The Court concluded, however, that "the fact that it is not worth the expense involved in *providing* a statutory remedy does not constitute the elimination of the *right to pursue* that remedy."[27]

The dissenting opinion by Justice Kagan sharply criticizes the majority's reasoning, arguing that the majority is so "bent on diminishing the usefulness of Rule 23," that it is ready to dismantle everything that "looks like a class action."[28] Justice Kagan asserted that the outcome of the case "is a betrayal of our precedents, and of federal statutes like the antitrust laws,"[29] insisting that "the FAA was never meant to produce this outcome."[30] The dissent concludes:

> The FAA conceived of arbitration as a "method of *resolving* disputes"—a way of using tailored and streamlined procedures to facilitate redress of injuries. In the hands of today's majority, arbitration threatens to become more nearly the opposite—a mechanism easily made to block the vindication of meritorious federal claims and insulate wrongdoers from liability.[31]

The majority and dissenting opinions in *American Express* demonstrate the extent to which the issue of class arbitration has transformed the Supreme Court's jurisprudence on alternative dispute resolution—once the sleepy backwater of the Court's docket—into a political battleground.[32] The Court's business-friendly, anti-class action rulings have raised voices in Congress arguing that the FAA should be amended to protect the rights of consumers and employees. It is doubtful, however, that any common ground can be found for amending the FAA in the current left versus right, liberal versus conservative, red State versus blue State environment in Washington.

The Practical Impact of the Supreme Court's Decisions on Commercial Arbitration

When *American Express* is read in conjunction with *AT&T Mobility*, waivers of class arbitration can only be invalidated in three narrow circumstances. First, where the FAA is "overridden by a contrary congressional command" that allows or requires access to class dispute resolution. Second, under the now-limited "effective vindication" doctrine, which after *American Express* likely only applies in circumstances where the contract more or less directly precludes prosecution of a federal statutory claim. Third, under the FAA's savings clause,[33] which allows a state law of general applicability to void an arbitration clause based on "grounds as exist at law or in equity for the revocation of any contract."

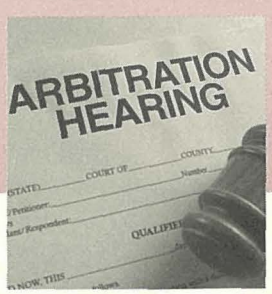
What this means as a practical matter is that if a company includes an express waiver of class arbitration in its dispute resolution agreement, that clause is likely be enforced.[34] A waiver will preclude an arbitrator or a court from compelling class arbitration, even if the result

is that the claimant has no commercially viable means of obtaining an adequate remedy if he or she prevails. As Justice Kagan noted in her dissent, the Supreme Court's construction of the FAA allows sophisticated parties to draft dispute resolution provisions that inhibit small claims, as there is no economic incentive to vindicate such claims in the absence of class procedures, particularly if the underlying contract does not provide for recovery of attorneys' fees by a prevailing party.

From a strictly commercial point of view, the tension between the majority's emphasis on enforcing arbitration clauses as drafted, and the dissent's objection that a party with superior economic power can craft a contract that indirectly insulates itself from liability, is a tension that is inherent in private dispute resolution. The Supreme Court's recent decisions have expanded and protected party autonomy in fashioning arbitration terms, in part by use of the FAA to restrict the authority of courts and legislatures to impose limits on privately agreed arbitration provisions. Parties can now contract to arbitrate a broader range of disputes than ever before, utilizing procedures that are highly customized to their commercial requirements.

When a sophisticated company prepares a customized procedure to address dispute resolution more efficiently and effectively, that procedure, *by design*, may indirectly limit the number of disputes filed against the company. This might be accomplished, for example, by greater reliance on mediation. But it might also be achieved through a variety of provisions that together make it more difficult or less financially attractive to file and prosecute a claim, including by restrictions intended to limit the aggregation of claims by multiple claimants. From the company's point of view, a well-drafted dispute resolution provision will not only more efficiently and economically resolve disputes that are filed, the process itself will reduce the total number of claims (or at least the aggregate value of the claims) that are filed. Fewer and/or lower value claims means less is spent to satisfy damage claims and defense costs are reduced.

Companies can insulate themselves from class action suits by adding arbitration clauses.



In short, companies can to a significant extent insulate themselves from class action litigation by including arbitration clauses in their contracts. Further, the combined effect of the *AT&T Mobility* and *American Express* cases is that companies can also insulate themselves from class arbitration *by including waivers of such arbitration in their contracts*. These waivers cannot in most instances be directly prohibited or restricted by state legislatures (as a result of FAA preemption of state law under *AT&T Mobility*). In addition, (as a result of *American Express*) the authority of the federal courts to invalidate the clauses under the FAA (through judicially created rules such as the "effective vindication" doctrine) has been curtailed.

The Circle Has not Fully Closed on Class Arbitration

Despite the trilogy of Supreme Court decisions discussed above, there is still one significant gap in the Court's case law that permits arbitrators to order class arbitration. In many if not most instances, arbitration provisions make no express reference to class arbitration. Further, there is often no extrinsic evidence from contract negotiations as to the parties' intent respecting class arbitration. Thus, lower courts have held that contractual intent may be *inferred* from the terms of the parties' dispute resolution provision.[35] The developing case law demonstrates, however, that when arbitrators are free to infer the parties' intent by construing the terms of their arbitration provision, the results are sometimes surprising and inconsistent.

By design, standard form arbitration clauses, such as the one recommended by the AAA, are "broad form" agreements intended to capture "all disputes" arising from the parties' contractual relationship. Further, most standard form arbitration clauses are broad enough to capture disputes involving not only the direct parties to the contract, but disputes one of the contracting parties has with other similarly situated persons. As such, the possibility of class arbitration might objectively be said to be foreseeable to both parties to a bilateral contract even if they have neither discussed nor reached an agreement concerning class arbitration.

Some arbitrators have relied solely or primarily on the breadth of the arbitration clause to infer that the parties intended to consent to class arbitration. The decisions authorizing class arbitration have in some instances been criticized as contravening the holding in *Stolt-Nielsen* that the mere *agreement* to arbitrate is not sufficient to conclude that parties intended to consent to class as opposed to bilateral arbitration.[36]

The circuit courts of appeal split, however, regarding whether the arbitrator's construction of the arbitration agreement could be scrutinized for compliance with *Stolt-Nielsen* given the deferential standard of review required by section 10(b)(4) of the FAA. The Second Circuit held that if the dispute resolution provision

authorized the arbitrator to decide the issue of class arbitration, then "[u]nder our precedent it is not for the district court to decide whether the arbitrator 'got it right' when the question has been properly submitted to the arbitrator and neither the law nor the agreement categorically bar her from deciding that issue."[37] In short, the Second Circuit, later joined by the First and Third Circuits, held that the district court could not substitute its judgment for the arbitrator's judgment respecting whether the arbitration agreement authorized class arbitration. The Fifth Circuit expressly parted way with the Second Circuit's conclusion that the FAA barred the court from examining the arbitrator's underlying reasoning to determine whether the arbitration clause authorized class arbitration.[38]

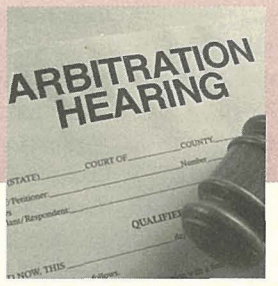
Oxford Heath Requires Deferential Review of Arbitral Decisions

The Supreme Court, in *Oxford Health Plans LLC v. Sutter*,[39] addressed the circuit split concerning the judicial deference to arbitral awards required by § 10(a)(4) of the FAA. The Court unanimously affirmed the Third Circuit in a decision that closely follows existing precedent and breaks little, if any, new ground.

The Supreme Court began its analysis by noting that the arbitrator in *Oxford Health Plans* had approved class arbitration before the decision in *Stolt-Nielsen*, and had revisited his decision in light of the Court's decision and concluded the contract nonetheless authorized class arbitration. Citing long-standing precedent, the Court held that "an arbitral decision 'even arguably construing or applying the contract' must stand, regardless of a court's view of its (de)merits."[40] The Court concluded that "the sole question for us is whether the arbitrator (even arguably) interpreted the parties' contract, not whether he got its meaning right or wrong."[41] Since the arbitrator had conducted two textual analyses of the arbitration agreement, each time concluding that the "text of the clause itself authorizes" class arbitration, the arbitrator's decision had to be confirmed. The Court was clear that "[n]othing we say in this opinion should be taken to reflect any agreement with the arbitrator's contract interpretation, or any quarrel with Oxford's contrary reading."[42] An "arbitrator's error—even his grave error—is not enough" to overturn his award under the deferential standard of review required by § 10(a)(4).[43]

Oxford Health Plans demonstrates that to the extent arbitrators, as opposed to courts, continue to make the determination whether an arbitration clause authorizes class arbitration, similar contract language may not necessarily be construed consistently. Each arbitrator or tribunal will have the responsibility to independently interpret the contract to determine the intent of the parties. To the extent that similar facts and contractual provisions result in conflicting results, the courts will have limited ability to address these inconsistencies under the FAA's deferential standard of review. As matters presently stand, the application of *Stolt-Nielsen* cannot be closely scrutinized by the federal courts because in most instances arbitrators are making the determinations and the courts must give wide deference to those determinations. Rarely will the arbitrator's determination be subject to annulment under § 10(a)(4) as applied in *Oxford Health Plans*.

Courts will be limited in addressing inconsistencies under the FAA's standard of review.



The Supreme Court could close this avenue to class arbitration if it revisits the plurality decision in *Green Tree Financial Corp. v. Bazzle*,[44] allowing the determination of consent to class arbitration to be made by the arbitrator. The decision in *Stolt-Nielsen* makes clear that the Supreme Court has not yet decided whether the availability of class arbitration is a "gateway" question for the courts (as opposed to arbitrators) to decide *de novo* under the FAA.[45] The concurring opinion in *Oxford Health Plans* by Justices Alito and Thomas suggests that at least two members of the Court may be interested in revisiting *Green Tree*.

If the Supreme Court decides in a future case that courts must decide *de novo* under the FAA whether a dispute resolution provision permits class arbitration, then the federal courts will have the ability to more closely police compliance with the holding in *Stolt-Nielsen*. In that event, the Supreme Court will have closed the circle on class arbitration, prohibiting it save for clear contractual evidence that the parties intended to consent to that arbitral procedure. Until then, a party desiring to avoid class arbitration would be well-advised to include an express waiver of such arbitration in its dispute resolution provisions.

Endnotes

1. 133 S. Ct. 2304 (2013).
2. 9 U.S.C. §§ 1–307.
3. *See, e.g.*, Stolt-Nielsen S.A. v. AnimalFeeds Int'l Corp. 559 U.S. 662 (2010) (in the absence of contractual evidence of consent, parties may not be compelled to participate in class arbitration); AT&T Mobility LLC v. Concepcion, 131 S. Ct. 1740 (2011) (holding that a

state law invalidating class action waivers in consumer arbitration agreements was preempted by the FAA).

4. *See* American Arbitration Association, Supplementary Rules for Class Arbitrations (2003), *available at* http://www.adr.org.

5. *Id.* at R. 3–4.

6. *Id.* at R. 1(a).

7. 559 U.S. 662 (2010).

8. *Id.* at 687.

9. *Id.*

10. 131 S. Ct. 1740 (2011).

11. Discover Bank v. Superior Court, 113 P.3d 1100 (Cal. 2005).

12. *Id.* at 1110.

13. 15 U.S.C. § 1.

14. A charge card requires its holders to pay the full outstanding balance at the end of a billing cycle, whereas a credit card can be used to finance a purchase. American Express focused its business on charge cards issued to businesses and wealthy individuals, claiming its charge card holders were more affluent than credit cardholders and thus were "a higher class of customer" justifying higher "merchant discount fees" than mass-market credit cards such as Visa, MasterCard, and Discover. *See In re* Am. Express Merchants' Litig., 667 F.3d 204, 207 (2d Cir. 2012) ("Amex III").

15. *Id.* at 209.

16. *In re* Am. Express Merchants' Litig., 554 F.3d 300, 304 (2d Cir. 2009) ("Amex I").

17. Am. Express Co. v. Italian Colors Restaurant, 133 S. Ct. 2304–08 (2013).

18. *Id.* at 2308–09.

19. *Id.* at 2309 (quoting Dean Witter Reynolds Inc. v. Byrd, 470 U.S. 213, 221 (1985)).

20. *Id.* (quoting Shearson/Am. Express Inc. v. McMahon, 482 U.S. 220, 226 (1987)).

21. *Id.*

22. *Id.* (quoting Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc., 473 U.S. 614, 628 (1985) (alteration in original).

23. *Id.* (quoting Califano v. Yamasaki, 442 U.S. 682, 700-01 (1979)).

24. *Id.*

25. *Id.* at 2310.

26. *Id.* at 2310–11.

27. *Id.* at 2311.

28. *Id.* at 2320 (Kagan, J., dissenting).

29. *Id.* at 2313.

30. *Id.* at 2320.

31. *Id.* (citations omitted).

32. The American Civil Liberties Union included the Supreme Court's *American Express* and *Oxford Health Plans* arbitration decisions in its summary of "Major Civil Liberties Decisions" for the 2012 Supreme Court Term. *See* Steven R. Shapiro, ACLU Summary of the 2012 Supreme Court Term: Major Civil Liberties Decisions, (2013), http://aclu.org/files/assets/summ-12-mem.pdf.

33. 9 U.S.C. § 2.

34. After the *American Express* decision, the Massachusetts Supreme Judicial Court reversed its rulings in a consumer class action case brought against Dell where Dell's dispute resolution clause with the lead plaintiff required individual arbitration. While vigorously disagreeing with the majority's analysis, the Massachusetts court concluded *American Express* preempted its ruling permitting class arbitration on what amounted to an "effective vindication" theory. *See* Feeney v. Dell Inc., 466 Mass. 1001 (2013).

35. *See, e.g.*, Jock v. Sterling Jewelers Inc., 646 F.3d 113, 118 (2d Cir. 2011), *cert. denied*, 132 S. Ct. 1742 (2012).

36. In his concurring opinion in Oxford Health Plans LLC v. Sutter, 133 S. Ct. 2064 (2013), Justice Alito wrote: "If we were reviewing the arbitrator's interpretation of the contract *de novo*, we would have little trouble concluding he improperly inferred '[a]n implicit agreement to authorize class arbitration . . . from the fact of the parties' agreement to arbitrate.'" *Id.* at 2071 (Alito, J., concurring) (quoting Stolt-Nielsen S.A. v. AnimalFeeds Int'l Corp., 559 U.S. 662 (2010)).

37. *Jock*, 646 F.3d at 124 (citing ReliaStar Life Ins. Co. of New York v. EMC Nat'l Life Co., 564 F.3d 81, 85–86 (2d Cir. 2009)).

38. The Second Circuit's analysis in *Jock* was later adopted by the First Circuit in Fantastic Sams Franchise Corporation v. FSRO Ass'n Ltd., 683 F.3d 18 (1st Cir. 2012) and the Third Circuit in Sutter v. Oxford Health Plans LLC, 675 F.3d 215 (3d Cir. 2012), such that there was a split between the First, Second, and Third Circuits, and the Fifth Circuit's decision in Reed v. Florida Metro. Univ., Inc., 681 F.3d 630, 644-45 (5th Cir. 2012), *reh'g en banc denied* (2012).

39. 133 S. Ct. 2064 (2013).

40. *Id.* at 2068 (quoting Steelworkers v. Enter. Wheel & Car Corp., 363 U.S. 593, 599 (1960)).

41. *Id.*

42. *Id.* at 2070.

43. *Id.*

44. 539 U.S. 444 (2003).

45. *Stolt-Nielsen*, 559 U.S. at 679.