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Second Circuit Strikes Down Class Arbitration Prohibitions in *In re American Express Merchants Litigation*

On January 30, 2009, the Second Circuit Court of Appeals issued a decision holding that class action waiver provisions in American Express's arbitration agreements with its merchants, which permitted the parties to pursue only individual claims, were unenforceable because they would effectively preclude the merchants from pursuing the only feasible means of recovery for alleged antitrust violations against American Express (AmEx). The decision calls into question many class arbitration waivers in a Circuit that covers the commercial center of New York and that is considered highly influential on commercial law issues. In light of the Second Circuit's decision, companies that employ arbitration agreements prohibiting class arbitration should reevaluate the effectiveness of the prohibitions and assess whether they would be more advantaged by allowing class claims to remain in court rather than in arbitrations that lack certain procedural safeguards (such as meaningful appellate review).

The Second Circuit's Decision

The plaintiff-merchants asserted that AmEx had illegally tied its charge and credit/debit cards, requiring the merchants to honor AmEx's credit/debit cards on the same terms as AmEx's charge cards. The merchants claimed they were harmed by the tying because AmEx credit/debit card users typically made smaller average purchases than AmEx charge card users, yet the merchants had to pay the same AmEx discount rates for all of its cards.

The same merchant agreements that contained the alleged tying provision also contained provisions requiring mandatory arbitration of disputes and prohibiting class arbitrations. AmEx accordingly moved to compel arbitration of the plaintiff-merchants' antitrust claims. The district court granted the motion, concluding that the plaintiffs' substantive claims were arbitrable and that arbitrators should decide the enforceability of the class action waiver provisions. On appeal, the Second Circuit reversed.

First, the Court held that, while arbitrators may rule on the enforceability of an entire contract, the enforceability of a class action waiver provision in an arbitration clause is a matter for courts to decide.

Second, the Court concluded that "enforcement of the class action waiver in the Card Acceptance Agreement to cover [the merchants'] claims against Amex under federal antitrust statutes would be incompatible with the federal substantive law of arbitration."[1] The most significant factor in the Court's analysis was its view that the expert fees and expenses a single merchant would have to bear to bring an individual antitrust claim against AmEx would far exceed the value of the merchant's claim, thereby making it highly unlikely that any such individual claims would be pursued. The Court recognized that the antitrust laws permit a plaintiff to recover *attorneys' fees* from a defendant if the plaintiff wins, but the Court determined that a successful antitrust plaintiff could not also recover its *expert fees and expenses* from a defendant. Because expert costs are so

substantial in antitrust cases, the Court held, the merchants' "antitrust claims against Amex can, for all intents and purposes, only be pursued through the aggregation of individual claims, either in class action litigation or in class arbitration."[2] Accordingly, the Court struck down AmEx's class arbitration waiver because, to do otherwise, "would grant Amex *de facto* immunity from antitrust liability."[3]

In finding AmEx's class action waiver clauses unenforceable, the Court reiterated, at several points in the opinion, that it was not creating a *per se* rule of unenforceability for class arbitration waiver provisions and that, instead, enforceability must be resolved on a case-by-case basis: "The enforceability of a particular class action waiver in an arbitration agreement must be determined on a case-by-case basis, considering the totality of the facts and circumstances. Relevant circumstances may include, but are not limited to, the fairness of the provisions, the cost to an individual plaintiff of vindicating the claim when compared to the plaintiff's potential recovery, the ability to recover attorneys' fees and other costs and thus obtain legal representation to prosecute the underlying claim, the practical affect the waiver will have on a company's ability to engage in unchecked market behavior, and related public policy concerns."[4] The Court also emphasized that it was relying on the fairly extensive record created by the merchants in the district court concerning what their expert costs would be, and that a court should not strike a class arbitration waiver without sound evidence in the record of such high costs.

While there is certainly no unanimity among the decisions within the Second Circuit[5] or among the various Circuit Courts of Appeals regarding the enforceability of class arbitration waiver provisions,[6] the decision serves to deepen the more recent trend of not enforcing such provisions on similar grounds. Further, the context of the case as a business-to-business dispute, as opposed to the prototypical consumer-based class action where challenges to the enforceability of such provisions has been met with frequent success, also reveals a willingness to strike down such provisions outside of the consumer context.

Reevaluating Class Arbitration

Given that a class certification motion is a watershed event in many litigations and that the standards applied for resolution of the class certification issue can often be outcome determinative, businesses with class action waiver provisions in their arbitration agreements should be mindful of the possible consequences of having these provisions in their contracts with customers or other businesses. Should the enforceability of such provisions be successfully challenged, a business could find itself in class arbitration, without the ability to seek meaningful review of any resulting awards in arbitration.

Following the *Hall Street* decision last year, where the United States Supreme Court held that parties could not contractually expand the standard of review prescribed by the Federal Arbitration Act to arbitral awards,[7] the Second Circuit just a few months ago concluded that the highly deferential "manifest disregard of the law" standard continues to apply to judicial review of arbitral awards in the Circuit.[8] Under the "manifest disregard" standard, vacatur of an arbitral award, including an award certifying a class, is appropriate only where "the arbitrator knew of the relevant legal principle, appreciated that this principle controlled the outcome of the disputed issue, and nonetheless willfully flouted the governing law by refusing to apply it."[9] The Second

Circuit's earlier *In re IPO* ruling, in contrast, *increased* the level of rigor required for district court class certification decisions by requiring, among other things, that courts engage in a searching review of the evidence, even resolving factual disputes related to the underlying merits of the claims.[10] Thus, while courts in the Second Circuit must engage in the rigorous analysis of the evidence prescribed by *In re IPO* before certifying a class, arbitrators may not, and any class certification decisions by arbitrators will be subject to review that is said to be "among the narrowest known to the law."[11]

Accordingly, businesses should give serious consideration to what forum they would prefer to be in for class proceedings and how they should address this issue in their arbitration agreements without sacrificing efficacy. For example, businesses may choose to expressly exclude class proceedings from their arbitration clauses, so that to the extent class actions are to be had, they will proceed in court.[12] Such a provision would enable the parties to retain numerous benefits not available in class arbitration, including meaningful review of any adverse class-related decisions, the ability to raise preliminary and potentially dispositive issues at the outset of the case (which may avoid prolonged proceedings that could be motivated, at least in part, by monetary incentives), and the preservation of due process and other procedural guarantees and protections. Another option for businesses to consider, to the extent they wish to increase the possibility that their class arbitration waiver provisions will be enforceable under *In re American Express*, is the inclusion of a fee-shifting provision for attorneys' fees and expert costs.

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[1] *In re Am. Express Merchants Litig.*, --- F.3d ---, Case No. 06-1871-cv, 2009 WL 214525, *9 (2d Cir. Jan. 30, 2009).

[2] *Id.* at *14.

[3] *Id.* at *17.

[4] *Id.* at *18.

[5] *See id.* at *1, n.1.

[6] *See, e.g., Lowden v. T-Mobile USA, Inc.*, 512 F.3d 1213 (9th Cir. 2008) (finding FAA did not preempt district court ruling that class action waiver provision in an arbitration agreement was both procedurally and substantively unconscionable under Washington law); *Skirchak v. Dynamics Research Corp.*, 508 F.3d 49 (1st Cir. 2007) (finding class action waiver in an arbitration agreement unenforceable under Massachusetts law); *Dale v. Comcast Corp.*, 498 F.3d 1216 (11th Cir. 2007) (finding class action waiver provision in arbitration agreement unenforceable); *Kristian v. Comcast Corp.*, 446 F.3d 25 (1st Cir. 2006) (finding class action waiver provision in an arbitration agreement unenforceable); *but see In re Detwiler*, slip op., 2008 WL 5213704 (9th Cir. Dec. 12, 2008) (rejecting plaintiff's argument that a choice of law provision in an arbitration agreement was substantively unconscionable because it would lead to enforcement of arbitration and class action waiver provisions under Florida law); *Pleasants v. Am. Express Co.*, 541 F.3d 853 (8th Cir. 2008) (affirming district court's grant of a motion to compel arbitration of plaintiff's claims on an individual basis, since class action waiver was enforceable); *Gay v. CreditInform*, 511 F.3d 369 (3d Cir. 2007) (affirming district court's grant of a motion to compel arbitration of plaintiff's claims on an individual basis, since provision prescribing only individual arbitration was enforceable).

[7] *See Hall Street Assocs., L.L.C. v. Mattel*, 128 S.Ct. 1396 (2008).

[8] *See Stolt-Nielsen SA v. Animalfeeds Int'l Corp.*, 548 F.3d 85 (2d Cir. 2008).

[9] *Id.* at 95 (quotations omitted).

[10] *In re Initial Pub. Offerings Secs. Litig.*, 471 F.3d 24 (2d Cir. 2006).

[11] *ARW Exploration Corp. v. Aguirre*, 45 F.3d 1455, 1462 (10th Cir. 1995).

[12] Recent decisions from other jurisdictions have underscored the need for such provisions to be carefully crafted to increase the likelihood that they will achieve their intended goal. *See, e.g., Kinkel v. Cingular Wireless LLC*, 857 N.E.2d 250, 277-78 (Ill. 2006); *Muhammad v. County Bank of Rehoboth Beach, Delaware*, 912 A.2d 88, 103 (N.J. 2006); *Kristian*, 446 F.3d at 38.