Second Circuit Invalidates Class Action Waiver Provision (Again) on Public Policy Grounds Under the Antitrust Laws

Stephen G. Harvey | harveys@pepperlaw.com
James H.S. Levine | levinejh@pepperlaw.com

In an important case about arbitration and class action waivers, the Second Circuit recently affirmed its 2009 decision that class action waiver provisions contained in American Express’s merchant arbitration agreements, which permitted merchants to pursue only individual claims, not class action claims, are unenforceable because “the cost of plaintiffs’ individually arbitrating their dispute[s] with Amex would be prohibitive, effectively depriving plaintiffs of the statutory protections of the antitrust laws.” In Re: American Express Merchants’ Litigation, No. 06-cv-1871, 2011 U.S. App. LEXIS 4507 (2d Cir. March 8, 2011). The case came to the Second Circuit on remand from the United States Supreme Court for reconsideration in light of the April 2010 decision in Stolt-Nielsen S.A. v. AnimalFeeds Int’l Corp., 130 S. Ct. 1758 (2010).1 In Stolt-Nielsen, the Court held that “a party may not be compelled under the FAA [Federal Arbitration Act] to submit to class arbitration unless there is a contractual basis for concluding that the party agreed to do so.” The Second Circuit concluded that Stolt-Nielsen did not impact its prior analysis and so reaffirmed.

In Re: American Express Merchants’ Litigation is a consolidated class action filed by merchants who contracted to accept American Express cards, alleging antitrust violations over being forced to accept American Express credit and debit cards in violation of the Sherman Act. The merchant contracts contained arbitration provisions requiring all claims “arising from or relating to [the] Agreement” to be resolved by arbitration. The contracts also contained class action waiver restrictions that precluded merchants from bringing or participating in a class action related to issues subject to the contract’s arbitration requirement. In 2006, the United States District Court for the Southern District of New York granted American Express’s motion to compel arbitration pursuant to the contract’s arbitration clause and class action waiver. The District Court also determined that the enforceability of the class action waiver was an issue for an arbitrator, rather than the court, to decide. The merchants appealed and in 2009 the Second Circuit reversed the District Court, ruling that (1) the class action waiver’s enforceability was a matter properly decided by the court, rather than an arbitrator, and (2) that the class action waiver in question “cannot be enforced ... because to do so would grant Amex de facto immunity from antitrust liability by removing the plaintiffs’ only reasonably feasible means of recovery.”

American Express subsequently appealed to the United States Supreme Court. In May 2010, the Supreme Court vacated the Second Circuit’s ruling, remanding the case with instructions to re-evaluate its decision in light of Stolt-Nielsen.

On remand, American Express argued that Stolt-Nielsen required the Second Circuit to reverse its earlier decision and uphold the class action waiver as enforceable. The Second Circuit rejected this argument, reasoning that although Stolt-Nielsen prohibits requiring parties to engage in class action arbitration absent a contractual agreement to do so, this prohibition does not lead to the conclusion that a contractual clause barring class action arbitration is per se enforceable.

Rather, the Second Circuit affirmed its earlier judgment in favor of plaintiffs, holding that the class action waiver within the merchant agreements was unenforceable on public policy grounds. The court of appeals based this conclusion on earlier Supreme Court decisions in Green Tree Financial Corp. v. Randolph, 531 U.S. 79 (2000), and Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc., 473 U.S. 614 (1985). The court found “Randolph controlling here to the extent that it holds that when a party seeks to invalidate an arbitration agreement on the ground that arbitration would be prohibitively expensive, that party bears the burden of showing the likelihood of incurring such costs,” and
recognized Mitsubishi in support of “a firm principle of antitrust law that an agreement which in practice acts as a waiver of future liability under the federal antitrust statutes is void as a matter of public policy.”

Against this backdrop, the Second Circuit concluded that “the cost of plaintiffs’ individually arbitrating their dispute with Amex would be prohibitive, effectively depriving plaintiffs of the statutory protections of the antitrust laws.” It reiterated that, as articulated in Randolph, plaintiffs, as the party seeking to invalidate the merchant agreement’s arbitration clause, bore the burden of demonstrating that the costs of individually arbitrating such claims would be prohibitively expensive. The court found that plaintiffs had met this burden, relying on an expert affidavit that the costs of individual enforcement paled in comparison to the amount of any possible recovery, and that “the only economically feasible means for enforcing [plaintiffs’] statutory rights is via a class action.” The court determined that “the size of any potential recovery by an individual plaintiff will be too small to justify the expense of bringing an individual action,” and that “the class action waiver in this case precludes plaintiffs from enforcing their statutory rights.” Consequently, the court held that the class action waiver provision was unenforceable, confirming its earlier conclusion that “enforcement of the class action waiver in the Card Acceptance Agreement flatly ensures that no small merchant may challenge American Express’s tying arrangements under the federal antitrust laws.”

The court of appeals dismissed American Express’s argument that Stolt-Nielsen rejected public policy as a basis for invalidating contractual language: “While 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.” Instead, the court embraced plaintiffs’ argument that “[t]o infer from Stolt-Nielsen’s narrow ruling on contractual construction that the Supreme Court meant to imply that an arbitration is valid and enforceable where, as a demonstrated factual matter, it prevents the effective vindication of federal rights would be to presume that the Stolt-Nielsen court meant to overrule or drastically limit its prior precedent.”

The Second Circuit qualified its holding in two important ways. First, the court explicitly stated that “we do not conclude here that class action waivers in arbitration agreements are per se unenforceable ... or that they are per se unenforceable in the context of antitrust actions.” Second, the court clarified that its decision was not based on the plaintiffs’ status as “small” merchants, but rather that “each case which presents a question of the enforceability of a class action waiver in an arbitration agreement must be considered on its own merits,” and that it based its decision on “the need for plaintiffs to have the opportunity to vindicate their statutory rights.”

The Second Circuit’s decision in American Express comes just before what promises to be an extremely important development regarding class action waivers, specifically the Supreme Court’s much-anticipated decision in AT&T Mobility LLC v. Concepcion, which was argued on November 9, 2010. In Concepcion, the Supreme Court is asked to determine whether the FAA preempts challenges to class arbitration waivers as unconscionable under state law. We predict, based on the Court’s continuing respect for enforcing arbitration agreements as written, that the Court will at the very least limit the use of state law unconscionability doctrines as a grounds for invalidating class action waiver provisions.2 If so, then the grounds for invalidating class action waivers recognized by the Second Circuit in American Express would appear to be the best argument available for invalidating such waivers, other than generally applicable contract defenses, such as fraud or lack of consideration. And the question left to be decided in the future by the Supreme Court will be whether the Second Circuit’s reasoning in American Express is itself preempted by the FAA and its command that arbitration agreements be enforced as written.

ENDNOTES
