RECENT SECOND CIRCUIT DECISION CALLS INTO QUESTION THE ENFORCEABILITY OF CLASS-ACTION WAIVER CLAUSES

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To Our Clients and Friends:

The U.S. Court of Appeals for the Second Circuit recently issued an opinion in *In re: American Express Merchants' Litigation*, — F.3d —, 2011 WL 781698 (2nd Cir. Mar 08, 2011) (NO. 06-1871-CV), affirming its prior decision invalidating a class-action waiver in an arbitration agreement on the grounds that, in light of the expected recovery, the cost of bringing a claim alleging antitrust violations made it economically infeasible for a plaintiff to proceed as an individual. The Supreme Court had vacated and remanded the court's prior decision for reconsideration in light of its decision in *Stolt-Nielsen S.A. v. AnimalFeeds Int'l Corp.*, 130 S.Ct. 1758 (2010), which held that parties cannot be compelled to submit their dispute to class arbitration absent a contractual basis for concluding the parties agreed to do so. Unless the Supreme Court hears a second challenge to the court's ruling, which is a distinct possibility, the enforceability of class-action waivers in the Second Circuit will remain an unsettled area of law.

American Express involves an action, currently pending in the Southern District of New York, filed on behalf of merchants who accept the American Express card. The plaintiffs allege that by requiring merchants to accept all cards issued by American Express, the card issuer imposed an illegal "tying arrangement" in violation of Section 1 of the Sherman Act. Each plaintiff in the putative class had entered into a contract with American Express that contained an arbitration clause allowing either party to elect to arbitrate any claim arising from or relating to the agreement, including antitrust claims. The arbitration clause further prohibited parties from participating in a class action pertaining to any claims subject to arbitration and prohibited arbitrations brought on a class-wide basis.

In 2006, the District Court granted the *American Express* defendants' motion to compel arbitration. On appeal, the Second Circuit reversed, and has now twice ruled that the agreement's prohibition on class and representative claims is unenforceable under Section 2 of the Federal Arbitration Act. Relying heavily on expert testimony submitted by plaintiffs that the cost of conducting an antitrust study for the case would be at least several hundred thousand dollars, whereas the most any of the named plaintiffs would be likely to recover was less than $40,000, the court concluded that "the only economically feasible means for enforcing [the plaintiffs'] statutory rights is via a class action." *American Express*, 2011 WL 781698, at *11. Based on that finding, the court held that the class-action waiver provision in the arbitration agreement "precludes plaintiffs from enforcing their statutory rights" and

is therefore unenforceable. *Id.* at *12. The court specifically stated that the plaintiffs' status as "small" merchants was immaterial to its decision – suggesting that the parties' relative bargaining power and sophistication were not considered as part of the analysis. The court also stated that it was not announcing a per se rule with respect to class-action waivers in arbitration agreements generally, or even in the context of antitrust actions; future challenges to class-action waivers will be decided on their particular facts, with the burden of proof placed on the party challenging the enforceability of the waiver.

The Second Circuit acknowledged that, under the Supreme Court's recent decision in *Stolt-Nielsen*, it could not require American Express to defend a class arbitration. Because its decision had not imposed class arbitration, but merely invalidated a class-action waiver, the court ruled that *Stolt-Nielsen* did not require a different analysis or result. Although this approach accommodates the direct holding of *Stolt-Nielsen*, another reading of the Supreme Court's decision would dictate that when a sophisticated party agrees to an arbitration agreement it is bound by its terms with respect to the availability, or unavailability, of class arbitration.

The result in *American Express* leaves defendants whose contracts contain arbitration clauses with class-action waivers in a potentially difficult position. A judge faced with the same facts sitting in the Second Circuit, which includes federal district courts in New York, Connecticut and Vermont, would likely refuse to compel individual arbitration, if the judge found that doing so would effectively deny plaintiffs the ability to enforce their statutory rights; at the same time, however, the judge could not compel class arbitration consistent with the Supreme Court's decision in *Stolt-Nielsen*. In such a case, the defendant's only remaining option would be to defend a class action in court.

In light of the risk that an invalidated class-action waiver could force a defendant into an undesirable forum, when drafting arbitration clauses, parties should carefully consider what their preferred forum and mode of dispute resolution would be in the event their agreement's class-action waiver were to be deemed unenforceable. If the preference is to avoid litigation, parties might consider adding a provision explicitly stating that the class-action waiver is severable from the rest of the arbitration clause and providing, in the event the class-action waiver is deemed unenforceable, that the parties agree to class arbitration.

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