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Class and Derivative Actions Client Service Group

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Important Limits On Class Action Arbitration Waivers

Companies that face class action claims should take note of two recent federal court decisions that could make it harder to avoid class actions through the use of mandatory arbitration clauses in contracts with customers.

The decisions, one from a California district court and the other from a New York appellate court, emphasize the limits on waivers of class action arbitration, despite recent United States Supreme Court opinions that breathed new life into such waiver provisions. In the recent New York and California cases, courts invalidated arbitration provisions when they concluded that an individual plaintiff could not feasibly pursue arbitration.

Vindication of Federal Rights

In *AT&T Mobility LLC v. Concepcion*, 131 S. Ct. 1740 (2011), the Supreme Court held that the Federal Arbitration Act preempts *state* law that imposes particular restrictions on arbitration provisions, and held that a contract clause waiving class arbitration was enforceable. This followed the Court's earlier opinion holding that parties could not be forced to participate in class arbitrations if their arbitration agreement was silent on the topic, and thus only individual arbitration is allowed in such cases. *Stolt-Nielsen, S.A. v. AnimalFeeds Int'l Corp.*, 130 S. Ct. 1758 (2010).

The issue before the U.S. Court of Appeals for the Second Circuit in New York concerned how *Concepcion* applied to a class action waiver in the context of a federal law claim. *In re American Express Merchants' Litigation*, No. 06-1871-cv (2d Cir. Feb. 1, 2012).

Merchants in that case are pursuing Sherman Act antitrust claims against American Express, alleging that American Express improperly ties its non-premium credit cards to its premium charge card services. Charge cards require that the customer pay the entire balance each month; credit cards allow the customer to pay a portion of the balance but also charge interest on that balance. Charge card customers tend to be more affluent and make larger purchases. Because charge card customers are much more desirable from the merchants' perspective, American Express is able to charge higher processing fees for those transactions. These plaintiffs allege that American Express forces merchants

to also accept its credit cards and to pay higher processing fees for them even though the credit card customers tend to make smaller purchases.

In two earlier opinions, 554 F.3d 300 (2d Cir. 2009) and 634 F.3d 187 (2d Cir. 2011), the Second Circuit had held that the arbitration provision in the merchants' agreements (which does not permit class actions) with American Express was unenforceable, and that the plaintiffs could therefore bring class action litigation in federal court. Following the Supreme Court's opinion in *Concepcion*, the Second Circuit asked for supplemental briefing on the enforceability of the arbitration clause.

In its recent decision, the Second Circuit held for a third time that, notwithstanding *Concepcion*, American Express' arbitration clause is unenforceable because it prevents an aggrieved party from vindicating a *federal* statutory right; that is, a claim under the federal antitrust laws.

In this third opinion, the Second Circuit concluded that Supreme Court authority "leaves open the question presented on this appeal: whether a mandatory class action waiver clause is enforceable even if the plaintiffs are able to demonstrate that the practical effect of enforcement would be to preclude their ability to bring federal antitrust claims." [Slip Op. at 15]

These plaintiffs satisfied the Second Circuit that they would be precluded from doing so in individual arbitrations because individual damages (a mean of $5,300 and a maximum of $39,000) could not compare to the several hundred thousands of dollars needed for an expert economic analysis of liability and damages. [*Id*. at 22] Thus, "the only economically feasible means for plaintiffs enforcing their statutory rights is via a class action." [*Id*.] To the court, it is not enough to overcome the burden on plaintiffs that the Clayton Act, 15 U.S.C. § 15, allows for treble damages, attorneys' fees, and expenses, since a plaintiff must still advance the expert costs and then assume the risk of losing—a significant deterrent to pursuing civil antitrust claims in the court's mind. [*Id*. at 23]

The plaintiffs relied on an economist's declaration to establish the likely cost of the necessary analysis. The court concluded that American Express did not seriously challenge that evidence, which amounted to a concession that an individual plaintiff could not reasonably pursue the claims, whether in court or arbitration. [*Id*.] Just as notable, the court's "decision in no way relies upon the status of plaintiffs as 'small' merchants. We rely instead on the need for plaintiffs to have the opportunity to vindicate their statutory rights." [*Id*. at 24]

Other courts, particularly lower courts in the Second Circuit, have applied this vindication-of-federal-right approach to other statutory claims, such as Title VII employment discrimination suits. *E.g., Chen-Oster v. Goldman, Sachs & Co.*, 2011 WL 2671813 (S.D.N.Y. July 7, 2011). With the Second Circuit's most recent opinion, expect such attacks on arbitration provisions to increase. For defendant companies, it will become more important to challenge the validity of an expert's assertion as to the costs of proceeding with individual arbitration—perhaps to the point of seeking *Daubert* hearings challenging plaintiffs' experts as part of this process.

Traditional Unconscionability

On the other side of the country one day before the Second Circuit decided *American Express*, a judge in the Northern District of California relied on traditional unconscionability principles to invalidate an

arbitration provision *in Lau v. Mercedes-Benz USA, LLC*, No. CV 11-1940-MEJ (N.D. Cal. Jan. 31, 2012). *Lau* is not a putative class action, but that court voided a typical arbitration clause based on arguments that class plaintiffs are using more frequently.

The *Lau* plaintiff bought a luxury car that he alleged had numerous mechanical problems. The plaintiff sued in court, but Mercedes sought to compel arbitration. The court found the provision procedurally and substantively unconscionable, and declined to order arbitration.

The contract contained a paragraph in capital letters noting the plaintiff's ability to take the contract to review it and that it contained an arbitration provision on the back. The arbitration provision had a bold font heading and also was in capital letters. [Slip Op. at 2] The court still found that procedural unconscionability existed because the dealership presented the contract on a take-it-or-leave-it basis. It did not matter to the court that the plaintiff signed next to a paragraph mentioning the arbitration provision on the back of the contract. While the plaintiff negotiated the price (apparently exceeding $100,000), he "was never offered the opportunity to negotiate the inclusion or exclusion of specific pre-printed terms." [*Id*. at 12]

The court found substantive unconscionability because the plaintiff faced substantial expenses in arbitration that do not exist in litigation. Those expenses include the arbitrator's hourly fee and the administrative body's fees. [*Id*. at 13] The provision also was unbalanced because it allowed for a *de novo* appeal to a three-member panel only if the award was $0 or in excess of $100,000. The practical effect was to deny plaintiff an appeal right if he recovered less than his full reimbursement right of more than $100,000 but allowed Mercedes to appeal if plaintiff received that full recovery. Of course, plaintiff also faced advancing more costs if he appealed any award. [*Id*. at 14]

Courts frequently undertake this traditional unconscionability analysis to invalidate arbitration provisions. Plaintiffs' counsel are being more aggressive in attacking provisions on those grounds, including seeking discovery about a corporation's experience in arbitration in hopes of showing that the deck is stacked against the consumer. Thus, for businesses, it is crucial to take care in drafting an arbitration provision, presenting it to the consumer/employee, and documenting those efforts well before the threat of suit arises.

For further questions, please speak to your Bryan Cave contact or any member of the Class and Derivative Actions Client Service Group.