Legal Backgrounder

Washington Legal Foundation
Advocate for freedom and justice®
2009 Massachusetts Avenue, NW
Washington, DC 20036
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Vol. 28 No. 13 September 13, 2013

PARTY AUTONOMY REIGNS SUPREME:
ARBITRATION AND CLASS ACTIONS
IN THE HIGH COURT'S OCTOBER 2012 TERM

by
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In *American Express Co. v. Italian Colors Restaurant*, 570 U.S. __ (2013) and *Oxford Health Plans LLC v. Sutter*, 569 U.S.__ (2013) the U.S. Supreme Court in its October 2012 Term took deference to party autonomy in arbitration to new heights. With exceptions sharply narrowed, a party who negotiates an arbitration agreement which defines and limits the arbitral process now has every reason to expect its choices to be upheld. In unusually blunt language, the Court also has reminded lower courts that the arbitrator's contract construction almost always should hold, "however good, bad or ugly."

Building on these principles, *American Express* is an important pro-business landmark in a long-running battle over the validity of class action waivers in arbitration. Read together with *AT&T Mobility LLC v. Concepcion* 131 S. Ct. 1740 (2011) from the October 2011 Term, it clears the field for companies to enforce consumer and commercial agreements which foreclose class actions and other tactics to aggregate claims and proof.

Variations on a Familiar Theme. The Court has strongly favored arbitration for decades and in recent terms has rebuffed tactics to impose class arbitrations on unwilling parties.

In *Stolt-Nielsen S.A. v. AnimalFeeds Int'l Corp*, 130 S. Ct. 1758 (2010), the Court held that a party cannot be compelled to class arbitrate without an agreement to do so. The arbitrators had permitted a class arbitration to proceed where the agreement was silent on class treatment because they deemed it sound policy. The Court held that this violated the "foundational FAA [Federal Arbitration Act] principle that arbitration is a matter of consent." The Court observed that class arbitration is in many respects inherently inconsistent with the positive attributes of arbitration. It is likely not to be confidential since it requires notification to absent parties. It is less likely to be streamlined and defendants may be under unfair pressure to settle.

In the 2011 Term, the Court in *AT&T Mobility* invalidated a longstanding consumer initiative to void class action waivers in consumer "form" contracts as unconscionable. At least fourteen states had followed the California Supreme Court's 2005 decision in *Discover Bank v. Superior Court*, 113 P.3d 1100 (Cal. 2005) which voided a class action waiver on such grounds. AT&T, clearly playing the long game, carefully crafted a consumer arbitration agreement with a class waiver. The agreement also provided an obviously effective path to vindicate an individual claim. Among other things, AT&T would pay a minimum of $7500 and double attorneys' fees to any claimant who recovered more in arbitration than AT&T's last settlement offer.

The Court held the FAA preempts the *Discover Bank* line of cases because the contracts in those cases "interfere with" fundamental attributes of arbitration," including the public policy of "enforcing arbitration agreements according to their terms so as to facilitate streamlined proceedings." In the meantime,

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the *American Express* case, with a different theory of attack on class action waivers, was working its way up to the Court.

American Express Co. v. Italian Colors Restaurant. Like AT&T Mobility, American Express was playing the long game. It carefully crafted an agreement calculated both to keep merchant claims out of court and to curb the aggregation of relatively small merchant claims into a big headache. Its arbitration clause conferred "all disputes" to individual arbitration, with an express class action waiver. It also disallowed joinder of claims or parties and had a confidentiality clause that effectively precluded claimants from using a common expert.

Italian Colors Restaurant filed an antitrust class action in federal court asserting that American Express had used monopoly power to force merchants to accept credit cards at rates approximately 30% higher than competing cards. American Express moved promptly in court to dismiss the suit and compel individual arbitration. Asserting that the cost of an expert economist would far exceed the value of each individual plaintiff's case, the named plaintiff argued that a class action was required to effectively vindicate its claim.

The case spent three years in the Second Circuit. In 2009, the Circuit held the waiver unenforceable and refused to compel arbitration. The Supreme Court remanded for further consideration in light of *Stolt-Nielsen*. Given that the American Express agreement contained an express waiver of class claims, *Stolt-Nielsen* appeared highly relevant to say the least. But the Second Circuit stood its ground, issuing a second decision in 2011 finding *Stolt-Nielsen* inapplicable since its 2009 decision had declined to enforce the arbitration clause altogether and therefore had not compelled class arbitration. The Circuit also *sua sponte* reconsidered its decision in light of *AT&T Mobility* and issued a third opinion in 2012, finding that case inapplicable since it dealt with preemption. The Circuit held the arbitration clause unenforceable because the prohibitive cost of an individual case would "effectively preclude" the plaintiff from vindicating its antitrust claim.

The Supreme Court reversed, upholding the class waiver. Justice Scalia's majority decision reads similarly to the *Stolt-Nielsen* and *AT&T Mobility* opinions. Indeed, Justice Scalia wrote that the American Express case was "all but decided" by the Court's decision in *AT&T Mobility*: The FAA reflects a strong public policy to enforce arbitration agreements as a matter of contract. Courts are required to "vigorously enforce" such agreements according to their terms, including terms that specify with whom a party has agreed to arbitrate, i.e., individuals and not classes, and the rules under which the arbitration will be conducted.

The majority rejected the "effective vindication" argument. The doctrine arises from language in *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*, 473 U.S. 614 (1985), where the Court stated a federal statutory claim was arbitrable "so long as the prospective litigant may vindicate its statutory cause of action…." Subsequent cases appeared to recognize the existence of an "effective vindication" doctrine, but the Court never precisely defined its contours and never applied it to actually invalidate an arbitration clause. The high water mark was *Green Tree Fin Corp.-Alabama v. Randolph,* 531 U.S. 79 (2000), where the Court held an arbitration clause might be invalidated where high filing or processing fees made access to an arbitration forum to assert a federal statutory claim impracticable. But the *Randolph* Court held that the plaintiff had failed to present adequate proof of such a barrier and enforced the arbitration clause.

American Express did not repudiate the "effective vindication" doctrine, but sharply limited it essentially to guarantee access to *a* forum to assert a claim, without regard to the effectiveness of the forum: Thus, the doctrine would certainly cover a provision outright forbidding the assertion of any federal statutory rights. Beyond that, citing to *Randolph*, it "would perhaps" also cover administrative and arbitration filing fees so high as to make access to the forum "impracticable." But the majority declined to recognize any effective vindication right beyond access to a forum. That it is not worth the expense involved in securing a statutory remedy does not constitute elimination of the right to pursue a claim.

Justices Kagan, Breyer, and Ginsburg dissented in a strongly worded, acerbic opinion authored by Justice Kagan. They argued the effective vindication rule should not be read narrowly to apply only to

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agreements with express waivers of the right to assert a federal statutory claim or to fees that make access to an arbitral forum impracticable. Instead, a court should consider whether the agreement as a whole precludes a claimant from enforcing federal statutory rights. Since the American Express agreement also disallowed joinder or consolidation of parties or claims and precluded use of common experts, the claimant was deprived of any "effective opportunity" to challenge allegedly monopolistic conduct. In the dissent's view, this result undermines FAA policy by potentially turning arbitration into a "mechanism easily made to block the vindication of meritorious federal claims and insulate wrongdoers from liability."

Oxford Health Plans LLC v. Sutter. While bitterly divided on class action waivers, the Court was unanimous in validating the strong public policy supporting arbitration. In *Oxford Health Plans,* a unanimous Court admonished lower courts not to second-guess an arbitrator's contract interpretation, even where it is palpably incorrect.

Plaintiff, a pediatrician, filed a putative class action in state court alleging that Oxford failed to make full and prompt payments to its network doctors. The court granted Oxford's motion to compel individual arbitration based on a form arbitration clause which stated "all claims" were subject to arbitration. The parties agreed the arbitrator should decide whether the clause authorized class arbitration.

The arbitrator reasoned that by conferring "all claims" to arbitration, the parties intended anything that could be litigated in court to be heard in arbitration. Since class actions are heard in court, the arbitrator concluded the parties must have intended them to be included in their arbitration clause. This reasoning is, to say the least, dubious. Among other things, a class action is a procedural device, not a substantive claim, so it is difficult to see how a clause conferring all "claims" to arbitration addresses class actions at all.

Oxford asked the arbitrator to reconsider after the Court's *Stolt-Nielsen* decision.[1] This appeared to be a simple case under *Stolt-Nielsen*. Where the clause is silent on the availability of class arbitration, under *Stolt-Nielsen* there should be no class arbitration. But the arbitrator distinguished *Stolt-Nielsen*, reasoning that the parties in the case agreed that their contract did not provide for class arbitration and held that he had simply construed the arbitration clause "in the ordinary way" and it "unambiguously evinced an intention to allow class arbitration." The district court and the Third Circuit denied Oxford's motion to vacate the arbitrator's decision.

Justice Kagan's opinion for a unanimous Court affirming the Third Circuit is a virtual paean to arbitration. Hailing arbitration's "essential virtue of resolving business disputes right away," the opinion held that an arbitral decision "even arguably construing" the contract must be upheld "regardless of a court's view of its (de)merits." An arbitrator may be found to have exceeded his or her authority only where the award "simply reflects his own notions of economic justice rather than drawing its essence from the contract." The potential for mistakes is the price of reaping the benefits of arbitration. Having conferred the dispute to that process, the arbitrator's contract construction holds, "however good, bad or ugly." [2]

Looking Ahead. So where does all this leave us? From an arbitration process viewpoint, we have two important new cases reminding lower courts of the significant "overriding purpose" of arbitration in providing a streamlined and economic dispute resolution process. Party autonomy to devise the process is almost always to be respected and courts should not be in the business of second-guessing decisions of an arbitrator who even arguably is interpreting the contract. This is consistent with prior cases, but it is a resounding and current validation of the arbitration process.

American Express and *AT&T Mobility* together provide a clear path to effectively end the availability of class action arbitration in both consumer and business-to-business contracts. Moreover, although *American*

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[1] By twice submitting to the arbitrator the question whether the arbitration "but" clause covered a class claim, Oxford put itself at risk of an erroneous but unreviewable determination. As Justice Kagan noted, this threshold issue is presumptively for a *court* to decide.

[2] Justices Alito's and Thomas' concurring opinion highlighted another risk: although Oxford and the individual plaintiff agreed the arbitrator could decide the class issue, the absent class members had never agreed. Hence, the absent class members potentially could have benefited from a favorable result without having subjected themselves to the binding effect of an unfavorable one.

Express arose in the context of a federal statutory claim, by finding the class action waiver to be no more than an arbitration contract provision which courts must "vigorously enforce," the majority crafts a rule that will have much broader application. This undoubtedly will disappoint those who had viewed the case as a potential vehicle to broadly invalidate all manner of procedural waivers. The "effective vindication" doctrine, while not totally repudiated, has been reduced to a right to access *a* forum, without regard to whether prosecution of the claim is "practicable" there.

In an era of clogged dockets and drastically reduced court budgets, the reliable availability of a privately-ordered and efficient system to resolve disputes is no small benefit. As Justice Kagan wrote in *Oxford Health Plans*, that benefit inevitably comes with the trade-off of some other values. But cases litigated on an individual basis can set precedents, even in arbitration. Companies are likely to pay attention when arbitrators have found merit in a series of individually litigated claims. If diminished private enforcement leaves a significant gap, federal and state regulators and legislators can step in.

Looking forward, some cautionary notes are in order. First, curbing judicial class actions is undoubtedly of great benefit to business. But concerted effort by like-minded parties and inventive plaintiffs' counsel is not likely to disappear. Class actions long have been ruled out in mass tort cases for lack of commonality, but we still see mass-produced and processed litigation of similar claims and the use of common experts across many cases. American Express carefully crafted a clause that precluded its merchants not only from class arbitration, but also from other cost-sharing and proof-aggregating techniques. Given the Court's great respect for party autonomy, corporate counsel should be as attentive as American Express was to negotiating clauses that anticipate the potential workarounds, and they should review and update their clauses as events dictate.

Second, there is an element of "be careful what you wish for" in all this. Undoubtedly, as the Court recognized, arbitration has the potential to provide a speedy resolution of disputes while avoiding the painful and slow procedural morass that is largely unavoidable in the court system. But the opportunity to avoid pain is not the same as actually avoiding it and there are examples available of big complex arbitrations that look a lot like big complex *litigations*, complete with out of control e-discovery, motion practice, and protracted hearings.

The answer again lies in party autonomy. The opportunity to negotiate a process that will ensure the advantages and minimize the risks of an expensive out-of-control arbitration is best exercised at the transaction stage. Oxford Health Plans likely would have been home free if its agreement had included a class arbitration waiver. When a dispute arises, the parties' tactical interests will undoubtedly diverge. A well-crafted clause at the outset can go a long way towards preserving an efficient process (while ensuring that there is enough process fairly to adjudicate the matter) by dealing upfront with such subjects as claims to be arbitrated, parties to the arbitration, applicable law, choice of arbitral institution and rules, place of arbitration, scope of discovery, and arbitrator selection process. The courts are on strong notice not to second-guess these choices when the parties make them. Now it is up to the parties to exercise this power wisely.

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