MORRISON | FOERSTER

Legal Updates & News

Legal Updates

The Second Circuit Refuses to Enforce a Class Action Waiver Under the FAA

February 2009
by Rebekah Kaufman, William L. Stern

Related Practices:

- Antitrust & Competition Law
- Consumer Litigation & Class Action
- Financial Services Law
- Financial Services Litigation
- Litigation

In the wake of an increasing refusal by courts to enforce class action waivers under state unconscionability law, the Second Circuit has called into question the continued viability of such waivers under the Federal Arbitration Act ("FAA").

On January 30, 2009, the Second Circuit refused to enforce a class action waiver contained in American Express Company's merchant agreement. *In re American Express Merchants' Litigation*, No. 06-871 (2d Cir. 2009). Filed on behalf of merchants who accept American Express cards, the suit alleges that American Express has engaged in an illegal "tying arrangement" in violation of the Sherman Act by conditioning acceptance of its charge cards on acceptance of its Card Acceptance Agreement, which contains an "Honor All Cards" provision.

Courts, Not Arbitrators, Must Decide Whether Class Action Waiver Is Enforceable. The Second Circuit first held that the determination of whether a class action waiver is enforceable is an issue to be decided by the court. In particular, the Second Circuit held that the enforceability of a class action waiver in an arbitration clause goes to the "making of the agreement to arbitrate" and, so, under the Supreme Court's *Prima Paint* decision, is an issue for the court, not the arbitrator, to decide. *Prima Paint Corp. v. Flood & Conklin Mfg. Co.*, 388 U.S. 395 (1967).

Class Action Waiver Is Unenforceable Under the FAA. Relying on Section 2 of the FAA, which allows for the enforcement of arbitration clauses "save upon such grounds as exist in law or equity for the revocation of any contract," the Second Circuit analyzed the enforceability of the class action waiver under the FAA and federal cases interpreting the Act. In the face of evidence showing that the likely costs of an expert study necessary to prove the antitrust claim might exceed $1 million, while the potential recovery for an individual merchant would be only approximately $5,000 after trebling, the Second Circuit determined that "enforcement of the [class action waiver] would effectively preclude any action seeking to vindicate the statutory rights asserted by the Plaintiffs," in violation of federal arbitrability law. On that basis, the Second Circuit held that the class action waiver was unenforceable.

Effect on Enforceability of Class Action Waivers Generally. The court was careful to stress that it was not holding class action waivers unenforceable *per se*, and that the enforceability of class action waivers must be analyzed on a case-by-case basis. The likely effect of the decision will be, however, that class action waivers will be struck down in most antitrust cases due to the large costs typically associated with litigating such actions.

The decision may also impact the viability of choice-of-law provisions that would have mandated application of the laws of a state that has been more favorable to class action waivers.[1] Courts could ignore such a choice-of-law provision altogether and instead analyze enforceability under the FAA (at least in those arbitration agreements to which the FAA would apply).

Finally, the decision suggests an unpredictable landscape in which the enforceability of a class action waiver, whether brought under the FAA or under state unconscionability law, will largely

depend upon (i) the law of the applicable court and (ii) the types of claims brought by the putative class.

Footnotes

[1]Some courts have already refused to enforce choice-of-law provisions where application of the chosen law would violate the public policy of the forum state where the chosen law would render the waiver enforceable, but the laws of the forum state would not. Those courts have instead applied the law of the forum state. *See, e.g., Fisher v. Dell Computer Corp.*, 2008 N.M. LEXIS 419 (N.M. June 27, 2008); *Klussman v. Cross Country Bank*, 134 Cal. App. 4th 1283 (2005).