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The practical impact of the U.S. Supreme Court's two recent opinions involving class actions and the Federal Arbitration Act is ''significant,'' attorneys John M. Landry and Anna S. McLean say in this BNA Insight. *Oxford Health Plans v. Sutter* and *American Express v. Italian Colors* both ''elevate freedom of contract over virtually all other competing norms and policy considerations,'' and make clear that an arbitration agreement's terms will prevail unless they manifestly, and prospectively, exculpate the defendant, the authors say.

The Contract Is King: The U.S. Supreme Court's Two Recent FAA Decisions

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The U.S. Supreme Court addressed contract terms bearing on the availability of class arbitration in two opinions this term. The first, *Oxford Health Plans LLC v. Sutter*,[1] confirms a district court's limited power under the Federal Arbitration Act (the ''FAA'')[2] to review an arbitrator's determination that contract language authorizes class arbitration where the parties agreed the arbitrator would decide that question.

The second, *American Express Co. v. Italian Colors Restaurant*,[3] requires district courts to enforce class arbitration waivers, even where the cost of individual arbitration is arguably prohibitive, and will likely result in non-enforcement of a federal statutory right.

The practical impact of the opinions is significant. Both elevate freedom of contract—reflected in the FAA's command to faithfully enforce arbitration agreements according to their terms—over virtually all other competing norms and policy considerations. The Supreme Court has made clear that an arbitration agreement's terms will prevail unless they manifestly, and prospectively, exculpate the defendant. Arguments about practical impediments to arbitration are not enough.

[1] No. 12-135, 2013 BL 151235 (U.S. June 10, 2013).
[2] 9 U.S.C. §§ 1-14.
[3] No. 12-133, 2013 BL 163177 (U.S. June 20, 2013).

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This development continues the course set by the Supreme Court's 2011 decision in *AT&T Mobility LLC v. Concepcion*,[4] in which the Court found that the FAA preempted a California rule invalidating most class arbitration waivers as unconscionable. The potential ramifications of *American Express* on continued efforts to challenge arbitration agreements under state law contract principles post-*Concepcion* are particularly significant.

Overview of the Federal Arbitration Act

Congress intended the FAA to overcome judicial hostility toward arbitration agreements. The FAA's primary substantive provision declares arbitration agreements to be ''valid, irrevocable, and enforceable.''[5] That provision's ''saving clause'' recognizes an exception where legal or equitable grounds exist to revoke ''any contract'' and one of those grounds applies to the arbitration agreement at issue.[6] Moreover, once an arbitrator renders an award, a federal district court can only vacate it in unusual circumstances. One such circumstance is when the arbitrator exceeds the power contractually afforded him.[7]

Oxford Health Plans LLC v. Sutter

In *Oxford Health,* plaintiff physician provided medical services to insureds of Oxford Health Plan (''Oxford'') under a contract barring ''civil actions concerning any dispute under the Agreement'' and requiring arbitration of ''all such disputes.'' Plaintiff nevertheless filed a federal class action against Oxford for allegedly failing to timely pay plaintiff and other physicians in its network. Oxford filed a motion to compel arbitration, which the court granted. A natural question then arose: Did the contract authorize class arbitration? Oxford and plaintiff agreed that the arbitrator should decide this question, and he did, ruling that the language authorized class arbitration because it sent to arbitration ''the same universal class of disputes'' that it barred as civil actions, including class actions. Oxford moved to vacate the arbitrator's decision on the ground that his conclusion lacked a sufficient contractual basis and, as a result, the arbitrator had exceeded his power. The district court denied the motion and the Third Circuit affirmed.

The Supreme Court also affirmed, with Justice Elena Kagan writing for the Court. Although Oxford argued that its generic, garden-variety arbitration agreement lacked terms sufficient to permit class procedures, the Court rejected the argument out of hand as one ''not properly addressed to a court.''[8] Although the Court had held in *Stolt-Nielsen S.A. v. AnimalsFeeds Int'l Corp.*[9] that class arbitration could not be imposed where the parties' contract was silent on the issue, it distinguished *Stolt-Nielsen* on the ground that the arbitrators there did not purport to construe the contract, but rather ordered class arbitration pursuant to their own view of sound public policy.[10]

In *Oxford Health,* by contrast, the parties had agreed to allow the arbitrator to construe the arbitration agreement and decide whether it authorized class procedures. So long as the arbitrator ''arguably construed'' the contract, ''even his grave error . . . is not enough'' to reverse the decision.[11] Simply put, ''[t]he arbitrator's construction holds, however good, bad, or ugly.''[12]

Oxford Health's Potential Impact

The direct impact of *Oxford Health* is likely limited. To the extent businesses do not already include in their arbitration agreements unambiguous language expressly waiving class arbitration, *Oxford Health* is a good reminder to do so. Also, Oxford's agreement to delegate to the arbitrator the authority to decide the class arbitration question accounted for the result. This will not likely be repeated by others. In addition, as the Court notes, the delegation was unnecessary, as the availability of class arbitration is a ''gateway'' question of arbitrability, and so presumptively within the province of a court, not an arbitrator, to decide.

The underlying premise of *Oxford Health* is more profound. It centers on the Court's recognition of freedom of contract as the principal animating force behind the FAA, and the key consideration when deciding class arbitration issues. As the Court explained in the first sentence of the opinion, ''[c]lass arbitration is a matter of consent.''[13] *Oxford Health* illustrates that the FAA not only tolerates harsh, even erroneous, arbitration results, it likewise allows such results with respect to arbitrability questions when they spring from contractual consent. As the Court stated, ''Oxford chose arbitration, and it must now live with that choice.''[14] This singular emphasis on freedom of contract in *Oxford Health* foreshadowed the Court's more far-reaching opinion 10 days later in *American Express*.

American Express Co. v. Italian Colors Restaurant

The agreements between American Express (''Amex'') and the merchants who accept its cards required the arbitration of all disputes with ''no right or authority for any Claim to be arbitrated on a class action basis.'' Plaintiffs, eight merchants, nevertheless filed a putative class action against Amex asserting federal antitrust claims, and Amex moved to compel individual arbitration of each merchant's claims. In opposing the motion, plaintiffs submitted an economist's declaration estimating the cost for the expert analysis needed to prove the antitrust claims as potentially exceeding $1 million, whereas the maximum individual recovery to each merchant plaintiff was only $38,549. The district court granted Amex's motion to compel. The Second Circuit considered the issue in several rulings and ultimately reversed, declaring the class arbitration waiver unenforceable due to ''prohibitive'' individual arbitration costs.

The Supreme Court granted certiorari to decide ''[w]hether the [FAA] permits courts to invalidate arbitration agreements that do not permit class arbitration of a federal-law claim.''[15] In a 5–3 decision—this time by Justice Antonin Scalia, author of *Concepcion*—the

[4] 131 S. Ct. 1740 (2011).
[5] 9 U.S.C. § 2.
[6] *Id.*
[7] *Id.* § 9(a)(4).
[8] *Oxford Health*, 2013 BL 151235, at *5.
[9] 559 U.S. 662, 684 (2010).
[10] *Oxford Health*, 2013 BL 151235, at *4-5.
[11] *Id.* at *5.
[12] *Id.* at *6.
[13] *Id.* at *2.
[14] *Id.* at *6.
[15] *American Express*, 2013 BL 163177, at *3.

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Court preliminarily observed that, absent some ''contrary congressional command,'' the FAA's mandate to enforce agreed-upon arbitration terms applies to arbitrations concerning federal-law claims. It then found no such contrary command against class arbitration waivers emanating from either the federal antitrust statutes at issue (which pre-dated the class action device) or from Federal Rule of Civil Procedure 23.[16]

The Court then turned to the main issue, whether the lower court properly invalidated the class arbitration waiver on the ground that the high cost of individual arbitrations effectively precluded plaintiffs from pursuing their legal rights. In earlier cases, the Court had identified an implicit FAA exception that, in theory at least, might allow a court to invalidate an arbitration agreement if it would prevent the ''effective vindication'' of a federal statutory right. The *American Express* plaintiffs advanced this exception by arguing that individual arbitrations offered no economic incentive for them to pursue their antitrust claims. The Court acknowledged the existence of an effective-vindication exception, but limited it to arbitration terms that prospectively ''eliminate'' the right to pursue statutory remedies.[17]

The Court gave one example. The effective-vindication exception ''would certainly cover'' arbitration provisions expressly *forbidding* the assertion of certain statutory rights.[18] It struggled to find another. It stated the exception ''would perhaps cover'' terms imposing arbitration filing fees high enough to, ex ante, make access to the arbitral forum impracticable.[19] But a class arbitration waiver, according to the Court, bears only on a plaintiff's financial incentive, ex post, to incur expert-related expenses in *proving* statutory claims. It does not eliminate prospectively the right to *pursue* such claims.[20] In the Court's view, individual suits—considered adequate to privately enforce antitrust rights before the 1938 adoption of Rule 23—did not suddenly become ineffective upon the Rule's adoption. [21]

But the Court did not stop there. It asserted that examining the expense of proving claims would impose a ''superstructure'' of inquiries on top of any motion to compel arbitration. These inquiries would require the district court to ''determine (and the parties litigate) the legal requirements for success on the merits claim-by-claim and theory-by-theory, the evidence necessary to meet those requirements, the cost of developing that evidence, and the damages that would be recovered in the event of success.''[22]

The Court rejected such a ''superstructure'' as antithetical to the FAA and private efforts to agree on terms that secure speedy, efficient resolution of disputes. And, as it had previously done in *Concepcion*, the Court rejected the notion that the FAA bows to any countervailing interest in ensuring the prosecution of low-value claims.[23] Significantly, the Court in *American Express* did not reference the presence of any terms in the contract that favored the merchants or encouraged their prosecution of low-value claims, as it had with respect to the arbitration clause at issue in *Concepcion*.

American Express's Potential Impact

American Express raises two key questions. The first is whether the effective-vindication exception has any remaining vitality. The second is whether *American Express* will derail continued efforts to challenge arbitration clauses post-*Concepcion* under state law contract rules such as unconscionability.

Effective-Vindication Exception No Longer a Realistic Challenge to Arbitration Clause

From *American Express*'s majority opinion, we know that a class arbitration waiver, standing alone, lies outside the effective-vindication exception. The dissent accuses the majority of taking an artificially restrictive view of the arbitration terms at issue. According to the dissent, several terms in Amex's contract (including the class arbitration waiver), taken together, foreclosed merchants from pooling resources and expanding the scope of the arbitration sufficiently to justify the cost and effort of pursuing antitrust claims.

Specifically, the contract disallowed joinder or consolidation of claims or parties, and its confidentiality provision purportedly foreclosed the use of a common expert report. It also did not shift any costs to Amex even if a plaintiff prevailed. ''In short, the agreement as applied in this case cuts off not just class arbitration, but any avenue for sharing, shifting, or shrinking costs.''[24]

The majority defended its class waiver-only inquiry as required by the scope of the Second Circuit's decision. A possible issue, then, is whether a broader effective-vindication challenge is still possible after *American Express*.

It does not appear to be. Of significance to the majority is the ''superstructure'' required to assess the presence of prohibitive costs resulting from agreed-upon arbitration terms. That ''superstructure'' includes an assessment of the evidence required to prove a claim, and the cost of developing that proof. The majority opinion specifically condemns such unwieldy hurdles to arbitration as inconsistent with the FAA, and intolerable. The complexity of the analysis that would be required to assess the effect of multiple arbitration terms—as opposed to the single class action waiver term at issue in *American Express*—on the ability of parties to pursue claims would only require an even greater ''superstructure.''

Indeed, due to the Court's emphasis on streamlined procedures, there appears to be little room left to mount an effective-vindication challenge to any arbitration terms other than those that are manifestly exculpatory ex ante. Any question about the degree to which a term actually eliminates a right would need to be resolved in favor of arbitration if that determination would require a ''superstructure.'' As the Court noted, plainly exculpatory terms are those that foreclose the right to bring a federal claim *at all,* and possibly terms imposing up-front prohibitive hurdles to commencing arbitration.[25]

[16] *Id.* at *3-4.
[17] *Id.* at *4.
[18] *Id.* at *4-5.
[19] *Id.* at *5.
[20] *Id.*
[21] *Id.*
[22] *Id.* at *6.
[23] *Id.* at *5-6.
[24] *Id.* at*10 (Kagan, J., *dissenting*).
[25] *Id.* at *5.

Nothing else apparently falls within the effective-vindication exception.

State Contract Rules Used to Challenge Arbitration Clauses Are Also Impacted

Two years ago, the Supreme Court, in *Concepcion*, ruled that the FAA preempted a California rule that nearly always treated class action waivers in consumer contracts as unconscionable. *Concepcion* found the ''*Discover Bank*'' rule, while an application of state unconscionability law, and thus arguably within the FAA's saving clause, effectively required cumbersome class procedures in arbitration—procedures inconsistent with ''the fundamental attributes of arbitration'' and the FAA—and was therefore preempted.[26] *Concepcion* warned that states cannot require procedures inconsistent with the FAA, even if they are desirable for reasons unrelated to the FAA, such as enabling consumers to prosecute small-dollar claims ''that might otherwise slip through the legal system.''[27]

Notwithstanding the Supreme Court's directive, in response, some state courts sought to distinguish *Concepcion* based on the consumer-friendly terms (i.e., terms that assist or encourage the prosecution and resolution of claims) contained in AT&T's service contract.[28]

These terms included easy online initiation of arbitration proceedings, AT&T's bearing responsibility for all arbitration costs, arbitration in the customer's county, and AT&T's payment of a $7,500 minimum recovery and twice the customer's attorneys' fees in the event the customer obtained an award greater than AT&T's last written settlement offer. Many consumer product and service providers revised their arbitration provisions to include elements of AT&T's consumer-friendly clause to benefit from any safe harbor that might exist as a result of *Concepcion*.[29]

American Express, however, strongly suggests that the presence of such consumer-friendly terms is not essential to invoking FAA preemption. In rejecting the need to ensure a practical means of resolving the merchants' low-value claims, the Court notably did not look to any counter-balancing terms. In a closing footnote, it also clarified ''what [*Concepcion*] established—that the FAA's command to enforce arbitration agreements trumps any interest in ensuring the prosecution of low value claims.''[30]

The Court went even further, insisting ''the FAA *does . . . favor the absence of litigation* when that is the consequence of a class action waiver, since its 'principal purpose' is the enforcement of arbitration agreements according to their terms.''[31]

This last statement is significant to FAA preemption and ongoing efforts to invalidate arbitration agreements on state law substantive unconscionability grounds.[32] By identifying the ''absence of litigation'' as an affirmative FAA goal (when arbitration terms so require), *American Express* characterizes the FAA in a manner that may broadly restrict the application of unconscionability rules to arbitration agreements, where such rules merely reflect preferences for litigation over non-litigation.

Unconscionability rules that do not address defects in the making of the arbitration agreement, but only challenge the agreement's supposed lack of mutuality or one-sidedness, arguably do just that. In other words, they merely advance the state's policy preference for litigation as a means of resolving disputes and so conflict with the FAA, and must yield.

State courts that have attempted to cabin *Concepcion* by limiting its application to just the enforceability of class waiver terms, or just ''categorical'' rules against arbitration, or just pro-consumer arbitration clauses, will need to consider *American Express*'s restatement of ''what that case established.''

On the question of procedural unconscionability, as the Supreme Court noted in *Concepcion*, the lack of negotiations in consumer contracting is a reality of modern retail transactions. In practice, the analysis of procedural unconscionability factors in challenges to arbitration clauses often involves precisely the sort of legal ''superstructure'' that prevents arbitration clauses from fulfilling their intended purpose: speedy, cost-effective resolution of claims.

Discovery into the contracting process, competing declarations, stays, appeals, and remands are commonplace. At a minimum, *American Express* suggests courts should reject efforts to challenge arbitration clauses on procedural unconscionability grounds that require the presentation of extensive evidence. After *American Express*, how courts will further contain the ''superstructure'' that has developed around the enforcement of arbitration clauses remains to be seen.

Conclusion

American Express and *Oxford Health* elevate the FAA's freedom of contract goal over other state or federal public policy norms, save policies against manifest, prospective exculpatory clauses.

Barring such a clause, to the extent enforcement of an arbitration agreement results in no litigation, that result is fully consistent with the FAA's paramount purpose to enforce arbitration clauses according to their terms.

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[26] *Concepcion*, 131 S. Ct. at 1748, 1750.

[27] *Id.* at 1753.

[28] *See*, *e.g.*, *Brewer v. Missouri Title Loans*, 364 S.W.3d 486, 493-95 (Mo. 2012).

[29] *See* Myriam Gilles, *Killing Them With Kindness: Examining ''Consumer Friendly'' Arbitration Clauses After AT&T Mobility v. Concepcion*, 88 Notre Dame L. Rev. 825, 851-53 (2012).

[30] *American Express*, 2013 BL 163177, at *6 n.5.

[31] *Id.* (emphasis added).

[32] *See, e.g., Sanchez v. Valencia Holding Co. LLC*, 201 Cal. App. 4th 74, 88 (Cal. Ct. App. 2011), *petition for review granted*, 272 P.3d 976 (Cal. 2012) (stating that *Concepcion* ''does not preclude the application of the unconscionability doctrine to determine whether an arbitration provision is unenforceable'').

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