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May 2011

Prior to the U.S. Supreme Court's recent decision in *AT&T Mobility L.L.C. v. Concepcion*, courts in the Second Circuit Court of Appeals had refused to enforce class action waivers in pre-dispute arbitration agreements even though the courts found that such waivers were not *per se* unenforceable.

Damming the Deluge of Employee Class Actions in the Second Circuit: Class Action Waivers in Employment Arbitration Agreements Following Supreme Court Decision

By Henry Lederman and Elias Kahn

Prior to the U.S. Supreme Court's recent decision in *AT&T Mobility L.L.C. v. Concepcion*,¹ courts in the Second Circuit Court of Appeals had refused to enforce pre-dispute arbitration agreements even though the courts found that such waivers were not *per se* unenforceable. This Insight proposes that the U.S. Supreme Court's decision in *Concepcion* implicitly overrules the cases within the Second Circuit, which refused to enforce explicit class action waivers, and addresses the practical effect of *Concepcion* on employers.

Employers sometimes request that employees sign mandatory pre-dispute arbitration agreements, which contain "class action waivers." The class action waiver forces the parties to resolve their disputes in arbitration and forbids them from pursuing anything other than individual legal claims.

In *Stolt-Nielsen S.A. v. AnimalFeeds Int'l Corp.*,² ("Stolt-Nielsen"), the U.S. Supreme Court held that when a mandatory arbitration clause is silent concerning classwide arbitration, a party cannot be forced to submit to classwide arbitration. Two recent decisions by the Second Circuit Court of Appeals have addressed *Stolt-Nielsen* and whether explicit class action waivers in arbitration agreements are enforceable.³ In addition, a March 2011 federal district court decision in the Southern District of New York addressed whether an explicit class action waiver in an employment agreement is enforceable in light of *Stolt-Nielsen*.⁴ In each of these decisions, despite holding that explicit class action waivers are not *per se* unenforceable, the courts refused to enforce a class action waiver.

On April 27, 2011, in *AT&T Mobility L.L.C. v. Concepcion*,⁵ ("Concepcion"), the U.S. Supreme Court held that an explicit class action waiver in a consumer arbitration agreement covered by the Federal Arbitration Act was enforceable and did not violate public policy. Specifically, the Court overruled *Discover Bank v. Superior Court*,⁶ a California Supreme Court decision finding that a class action waiver in a consumer arbitration agreement was unconscionable and thus unenforceable.

April 2010: U.S. Supreme Court's Decision In *Stolt-Nielson v. Animal Feeds Int'l Corp.* – The Court Refuses to Impose Classwide Arbitration Where the Arbitration Agreement Is Silent on Classwide Arbitration

In *Stolt-Nielson*, the customers' antitrust claims against Stolt-Nielson were subject to arbitration under a mandatory arbitration clause.⁷ However, the arbitration agreement did not state whether the customers could bring a classwide arbitration.⁸ The Supreme Court was asked to decide "whether imposing class arbitration on parties whose arbitration clauses are 'silent' on that issue is consistent with the Federal Arbitration Act (FAA), 9 U. S. C. § 1 *et seq.*"⁹ The Court held that Stolt-Nielson could not be forced to submit to classwide arbitration because there was no contractual basis to compel the company to do so.¹⁰

July 2010: Second Circuit's Decision in *Fensterstock v. Education Finance Partners* – The Court Refuses to Enforce an Explicit Class Action Waiver Based on *Discover Bank*

In *Fensterstock v. Education Finance Partners*, a borrower brought a class action against a loan servicer claiming fraud in connection with student loans.¹¹ The defendant argued that the plaintiff could not bring his claim as a class action because he had signed a class action waiver in an arbitration agreement with the defendant, which was governed by California law.¹² The Second Circuit applied *Discover Bank*, and found that the class action waiver plaintiff signed was unconscionable and therefore unenforceable.¹³

Fensterstock also addressed *Stolt-Nielson*. It explained that since the court excised the parties' class action waiver clause, the parties' agreement was now silent on the issue of class-based arbitration.¹⁴ Accordingly, pursuant to *Stolt-Nielson*, the court held that it had no authority to order defendant to submit to class-based arbitration because the "parties plainly did not agree that arbitration may be conducted on a classwide basis."¹⁵

March 2011: The Second Circuit Decision in *In re Am. Express Merchants' Litigation* – Court Holds that *Stolt-Nielson* Does Not Require Courts to Always Enforce Explicit Class Action Waivers in Arbitration Agreements

In *In re American Express Merchants' Litigation* ("Amex"), plaintiff merchants brought an antitrust class action against American Express.¹⁶ The parties had previously signed an agreement which provided that they could only individually arbitrate legal claims and could not bring classwide arbitration.¹⁷ The court found that this class action waiver was unenforceable because "the cost of plaintiffs' individually arbitrating their dispute . . . would be prohibitive, effectively depriving plaintiffs of the statutory protections of the antitrust laws."¹⁸

The *Amex* court based its ruling on the U.S. Supreme Court's decision in *Green Tree Financial Corp.-Alabama v. Randolph*.¹⁹ In *Green Tree*, the Court was asked to decide "whether an arbitration agreement that does not mention arbitration costs and fees is unenforceable because it fails to affirmatively protect a party from potentially steep arbitration costs."²⁰ The Court in *Green Tree* explained that it might not enforce an arbitration agreement that does not mention costs and fees if the existence of large arbitration costs would prevent a litigant from vindicating his statutory rights in arbitration and if the plaintiff could provide concrete evidence of such costs.²¹ *Green Tree*, however, did not address whether a court could invalidate class action waivers in arbitration agreements. Therefore, *Amex* created a judicial policy to bar enforcement of contractual class action waivers that was not directly supported by Supreme Court authority.

The *Amex* decision also addressed whether *Stolt-Nielson* mandated the enforcement of explicit class action waivers in arbitration agreements. The court in *Amex* explained that the Supreme Court's ruling in *Stolt-Nielson* did not mean that class action waivers in arbitration agreements are always enforceable: "*Stolt-Nielson* states that parties cannot be forced to engage in a class arbitration absent a contractual agreement to do so. It does not follow . . . that a contractual clause barring class arbitration is *per se* enforceable."²² The Second Circuit, however, also emphasized that class action waivers in arbitration agreements are not *per se* unenforceable.²³

The court explained that because the class action waiver was void and the arbitration agreement was therefore silent on classwide arbitration, American Express could not be forced to submit to classwide arbitration.²⁴ American Express had the choice to submit to classwide arbitration or a class action in court.

March 2011: *Sutherland v. Ernst & Young* – A District Court Decides Not to Enforce an Explicit Classwide Arbitration Waiver in an Employee's Lawsuit for Overtime Wages

The Second Circuit's decision in *Amex* came only days after a district court in the Southern District of New York refused to enforce a

class action waiver in an employment arbitration agreement. In *Sutherland v. Ernst & Young L.L.P.*, an accountant at Ernst & Young (“E&Y”) brought a class action in court claiming she was owed overtime wages under the Fair Labor Standards Act (FLSA).²⁵ She had signed an employment arbitration agreement containing a class action waiver which, if enforceable, would require her to individually arbitrate her legal claims.²⁶ The court used a three-part test to determine whether the class action waiver was enforceable: (1) cost to individual plaintiff versus potential recovery; (2) ability to obtain legal representation; and (3) the practical effect of waiver.²⁷ As in *Amex*, the court crafted this judicial policy based in part on the Supreme Court’s decision in *Green Tree*.²⁸ Based on this test, the court found the class action waiver at issue to be unenforceable mainly because the employee’s maximum recovery on her individual overtime claims in arbitration “would be too meager to justify the expenses required for the individual prosecution of her [FLSA overtime] claim.”²⁹

The court in *Sutherland* distinguished *Stolt-Nielson* by explaining that *Stolt-Nielson* involved a question of “contract construction – whether the FAA requires an employer to permit a claimant to represent a class where the arbitration agreement is silent on that issue” – whereas *Sutherland* involved a question of “contract enforceability” (i.e., whether a court must enforce an explicit class action waiver in an arbitration agreement).³⁰

The court explained that because it voided the class action waiver and the arbitration agreement was now “rendered silent as to whether class arbitration is permissible,” *Stolt-Nielson* dictated that E&Y could not be forced to submit to class arbitration.³¹ At this point, E&Y could choose between class arbitration or a class action in court.

April 2011: Supreme Court’s Decision in *AT&T Mobility v. Concepcion* – Court Strikes Down Rule Prohibiting Most Explicit Class Action Waivers in Consumer Agreements

In *Concepcion*, the question presented was whether Section 2 of the FAA³² preempts a California rule announced in *Discover Bank* holding that arbitral class action waivers in consumer contracts are unenforceable where: (1) the agreement is a contract of adhesion drafted by a party with superior bargaining power; (2) the consumer alleges a scheme to cheat consumers; and (3) the consumer’s individual damages are predictably small.³³

The Court in *Concepcion* held that Section 2 of the FAA preempts the *Discover Bank* rule because the purpose of the FAA “is to ensure the enforcement of arbitration agreements according to their terms so as to facilitate streamlined proceedings.”³⁴ The Court found that “[r]equiring the availability of classwide arbitration interferes with fundamental attributes of arbitration and thus creates a scheme inconsistent with the FAA.”³⁵ Importantly, the Court’s majority dismissed the dissent’s contention that “class proceedings are necessary to prosecute small-dollar claims that might otherwise slip through the system.”³⁶ Consistent with the Court’s main holding, the majority explained: “But States cannot require a procedure that is inconsistent with the FAA, even if it is desirable for unrelated reasons.”³⁷

The Second Circuit and SDNY District Court Decisions Are Incompatible with *Concepcion*

Pursuant to *Concepcion*, which explicitly overruled *Discover Bank*, there is little doubt that the Second Circuit’s decision in *Fensterstock*, which principally relied on *Discover Bank*, is no longer good law.

It is also likely that the Second Circuit’s decision in *Amex* was overruled by *Concepcion*. The primary basis for finding the class action waiver to be unenforceable in *Amex* was that the cost for a plaintiff merchant to bring its antitrust claim individually would be prohibitively expensive, especially in relation to the potential damages for each individual claim.³⁸ However, as explained above, *Concepcion* explicitly rejected this rationale for striking down class action waivers in consumer arbitration agreements. Accordingly, there is strong reason to believe that *Concepcion* has overruled *Amex*.

Finally, it is probable that *Concepcion* overruled *Sutherland* as well. While *Concepcion* specifically addressed a class action waiver in a consumer arbitration agreement rather than an employment arbitration agreement, it is likely that the reasoning in *Concepcion* will also apply to the enforceability of employment arbitration agreements. The Court in *Concepcion* stressed that the purpose of the FAA “is to ensure the enforcement of arbitration agreements according to their terms so as to facilitate streamlined proceedings.”³⁹ Pursuant to this rationale, it should not matter whether the arbitration agreement is a consumer or an employment contract because refusing to enforce explicit and agreed upon class action waivers would interfere with the purpose of the FAA regardless of the type of agreement at issue.

Furthermore, as explained above, *Concepcion* specifically rejected the reasoning relied upon by the *Sutherland* court in finding the class action waiver in the employment arbitration agreement to be unenforceable – that the potential recovery would be too small compared to the expense of bringing the litigation.

Implications and Recommendations for Employers

Given the U.S. Supreme Court's preference for enforcing the specific terms of arbitration agreements under the FAA, it is unlikely that the Court will permit states or courts to strike down explicit class action waivers in employment arbitration agreements. Accordingly, it is suggested that employers consider implementing arbitration agreements containing explicit class and collective action waivers. The waivers would, if enforceable under *Concepcion*, preclude an individual from participating in or leading a class or collective arbitration action but would permit that individual to fully recover damages and other relief to which he or she is entitled.

While it appears that the Second Circuit's recent opinions will be found to have been implicitly overruled by *Concepcion*, until there is express recognition of that consequence by courts within the Second Circuit, employers still should argue in the alternative, in an appropriate case, that a class waiver nevertheless should be enforced because the potential recovery is large enough to justify individual arbitration of the claim.

As stated in *Fensterstock*, *Jock*, *Amex* and *Sutherland*, even if (and despite *Concepcion*) a court voids a class action waiver, the employer cannot be forced to submit to class arbitration. Once the class action waiver is voided, the employer has a choice between classwide arbitration or a class action in court.

In every case, employers should consult experienced labor and employment counsel regarding class action waivers in their arbitration agreements.

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¹ 179 L. Ed. 2d 742 (2011).

² 130 S. Ct. 1758 (2010).

³ *Fensterstock v. Educ. Fin. Partners*, 611 F.3d 124 (2d Cir. 2010); *In re Am. Express Merchants' Litig.*, 634 F.3d 187 (2d Cir. 2011).

⁴ *Sutherland v. Ernst & Young LLP*, 10-cv-3332, 2011 U.S. Dist. LEXIS 26889 (S.D.N.Y. Mar. 3, 2011).

⁵ 179 L. Ed. 2d 742 (2011).

⁶ 36 Cal. 4th 148 (2005) ("*Discover Bank*").

⁷ *Stolt-Nielsen*, 130 S. Ct. at 1765.

⁸ *Id.* at 1766.

⁹ *Id.* at 1764.

¹⁰ *Id.* at 1775.

¹¹ 611 F.3d at 127.

¹² *Id.*

¹³ *Id.* at 134-140.

¹⁴ *Id.* at 141.

¹⁵ *Id.* In *Jock v. Sterling Jewelers, Inc.*, 725 F. Supp. 2d 444 (S.D.N.Y. 2010), the court followed the same reasoning as in *Fensterstock*. Because the parties' arbitration agreement did not mention classwide arbitration at all, *Jock* held that the arbitration panel exceeded its powers by ordering classwide arbitration in that case. *Jock*, 725 F. Supp. 2d at 450-51.

¹⁶ 634 F.3d at 188-191.

¹⁷ *Id.*

¹⁸ *Id.* at 198-99. The court considered that under the antitrust statutes, fees and expenses would be shifted to the winner of the case. *Id.* However, the court found that the fee shifting provision was inadequate because of the low expert witness reimbursement rate and because "plaintiffs must include the risk of losing, and thereby not recovering any fee, in their evaluation of their suit's potential costs." *Id.* at 199 (citations and internal quotations omitted).

¹⁹ 531 U.S. 79 (2000).

²⁰ *Id.* at 82.

²¹ *Id.* at 90-91.

²² *Amex*, 634 F.3d at 193.

²³ *Id.* at 199.

²⁴ *Id.* at 200.

²⁵ *Sutherland v. Ernst & Young LLP*, 10-cv-3332, 2011 U.S. Dist. LEXIS 26889, at **1-2 (S.D.N.Y. Mar. 3, 2011).

²⁶ *Id.* at **2-3.

²⁷ *Id.* at **11-19.

²⁸ *Id.* at **6-8.

²⁹ *Sutherland*, 2011 U.S. Dist. LEXIS 26889, at *11. The court explained that the plaintiff's maximum recovery was "an actual overtime loss of approximately \$1,867.02, with potentially liquidated damages of an equal amount under the FLSA," but her attorneys' fees during arbitration would exceed \$160,000, not including costs. *Id.* at **11-12. The court also explained that although the FLSA provides for recovery of reasonable attorneys' fees, the applicable arbitration agreement stated that the decision to award attorneys' fees and the amount of attorneys' fees was left to the discretion of the arbitrator. *Id.* at *16. Thus, the court decided that plaintiff could not necessarily expect to receive full reimbursement for her attorneys' fees. *Id.* at *17.

³⁰ *Id.* at **8-10.

³¹ *Id.* at *20.

³² Section 2 of the FAA provides in relevant part:

A written provision in any maritime transaction or a contract evidencing a transaction involving commerce to settle by arbitration a controversy thereafter arising out of such contract or transaction . . . shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract. 9 U.S.C. § 2.

³³ 36 Cal. 4th at 162-63.

³⁴ *Concepcion*, 179 L. Ed. 2d at 753-54.

³⁵ *Id.* at 754.

³⁶ *Id.* at 758.

³⁷ *Id.*

³⁸ *Amex*, 634 F.3d at 198-99.

³⁹ *Concepcion*, 179 L. Ed. 2d at 753-54.