Client Alert

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Minimizing Class Action Exposure: The Power of Mandatory Arbitration Clauses

As class actions and other forms of litigation continue to plague corporate America as a major cost of doing business, businesses should be cognizant of one potent antidote that has repeatedly received judicial approval: mandatory arbitration clauses. The Supreme Court's recent decision in *American Express v. Italian Colors Restaurant*, -- U.S. --, 133 S.Ct. 2304 (2013), illustrates the extent to which mandatory arbitration agreements with class action waivers can significantly limit corporate liability in the face of class action lawsuits. Moreover, recent trends in jurisprudence have made it easier than ever to put arbitration provisions into effect.

The Power of Mandatory Arbitration Clauses

Arbitration is a form of private dispute resolution that takes place outside the formal judicial system. Businesses often prefer the option, as it is frequently quicker and less expensive than traditional litigation.

The Federal Arbitration Act ("FAA") provides that arbitration agreements are "valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract." This principle is the foundation of the current federal policy strongly favoring arbitration and, as a federal law, displaces any contrary state authority. Parties to a contract with a mandatory arbitration provision can force each other to litigate their claims through arbitration, rather than through the courts. Indeed, lawsuits are routinely thrown out of court when one of the parties moves to compel the other to comply with such a provision.

Modifying Arbitration Provisions to Maximize their Effectiveness

One of the advantages to arbitration is the flexibility of the process. The parties are free to lay down their own ground rules. When those ground rules are incorporated into the parties' contract, they are just as enforceable as the underlying requirement to arbitrate. Indeed, the Supreme Court has explained that "[t]he principal purpose of the FAA is to ensure that private arbitration agreements are enforced according to their terms." Thus,

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parties are free to limit the issues subject to arbitration and to require that any arbitration proceed according to specific rules. *AT&T Mobility LLC v. Concepcion*, 131 S.Ct. 1740, 179 L.Ed.2d 742 (2011).

One particularly effective ground rule is a prohibition on "class arbitration." Class arbitration is the term for class action litigation prosecuted through the arbitration process, rather than through the courts. A company that includes in its contracts an arbitration clause that prohibits class arbitration, effectively insulates itself from any potentially disastrous class action lawsuits that might arise from the parties' relationship.

Given that class action lawsuits are often used as a means to bring lawsuits that individual plaintiffs would find financially infeasible or unrewarding, the Supreme Court's recent decision in *American Express v. Italian Colors Restaurant* illustrates the effectiveness of this strategy.

The case revolved around an antitrust dispute between American Express ("Amex") and some of the merchants who accept its cards. The merchants alleged that Amex used its monopoly power to force them to accept credit cards at rates approximately 30% higher than the fees for competing credit cards. The merchants brought their class action lawsuit in federal court, but their agreements with Amex contained a mandatory arbitration clause prohibiting class arbitration.

Amex moved to compel each merchant to arbitrate its claims individually. The merchants complained, however, that doing so would make it economically impossible to bring their claims. They estimated that it might cost as much as $1 million to prove Amex's antitrust violations, but that each merchant's potential recovery would be less than $40,000. Only by joining their claims together would make financial sense to bring suit, particularly since the agreement's confidentially provision would prevent them from sharing the cost of preparing their individual cases.

The Court, however, rejected the merchants' challenge outright. While the arbitration provision might have been unenforceable if it prohibited the merchants from ever asserting their claims, or even if it made the filing and administrative fees attached to arbitration so high as to make access to arbitration impracticable, "the fact that it is not worth the expense involved in proving a statutory remedy does not constitute the elimination of *the right to pursue* that remedy." Thus, as Justice Kagan explained in her dissent, "Amex has insulated itself from antitrust liability — even if it has in fact violated the law."

Conclusion

Arbitration agreements present a potential opportunity for businesses to minimize their exposure not only to ordinary litigation related expenses,

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but also to potential class action lawsuits. To maximize the effectiveness of their arbitration provisions and establish proper safeguards, businesses need to consider their own business realities and tailor their arbitration agreements and business practices accordingly. Such provisions are not necessarily "one size fits all."

If you would like to discuss mandatory arbitration clauses or other methods of limiting your corporate exposure to legal action, please contact the Olshan attorney with whom you regularly work or either of the attorneys listed below.

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