The Practice: The Not-So-Effective Vindication Decision; The U.S. Supreme Court’s Ruling in Italian Colors and its Aftermath Are a Big Blow to Class Action Bar

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In one of the most closely watched classwide arbitration cases on last term's docket, the U.S. Supreme Court in American Express Co. v. Italian Colors Restaurant was asked whether the "effective-vindication rule" required access to class arbitration in federal antitrust litigation when an individual plaintiff's claim was too small to be litigated separately. In a 5-3 decision (with Justice Sonia Sotomayor not participating) the court- led by its conservative wing-responded with a resounding "no."

The court's majority in Italian Colors advanced the conservatives' harsh approach to classwide arbitration and represented a major setback for the plaintiffs' class action bar. Critics immediately attacked the decision as a pro-corporate, anti-plaintiff, anti-class action, denial-of-access-to-justice, ideologically based decision. Justice Elena Kagan dissented, joined by justices Stephen Breyer and Ruth Bader Ginsburg.

Merely six weeks after issuance of the Italian Colors decision, the U.S. Court of Appeals for the Second Circuit applied and extended the Italian Colors holdings to litigation under the Fair Labor Standards Act (FLSA) in Sutherland v. Ernst & Young LLP. The Second Circuit determined that Italian Colors abrogated the district court's previous basis for
invalidating a class action waiver provision in an arbitration clause promulgated by Ernst & Young. The Second Circuit therefore concluded that the district court had erred in denying Ernst & Young's motion to compel arbitration.

The Sutherland decision is significant because it heralds the Second Circuit's recognition of the Italian Colors repudiation of class action waivers, as well as the evisceration of the effective-vindication rule, which that court previously championed in several decisions.

In addition, the Sutherland decision extends the Italian Colors principles from Rule 23 antitrust class actions to FLSA wages and overtime litigation. By extending the Italian Colors holdings to FLSA litigation, the Sutherland decision embodies a further encroachment on plaintiffs' access to classwide arbitration.

Ironically, in rejecting the Ernst & Young class action waiver, the U.S. District Court for the Southern District of New York had relied on several Second Circuit precedents in the underlying American Express litigation, which precedents the Supreme Court reversed.

The Italian Colors dispute arose out of an AmEx contract with hundreds of retail merchants. Merchants that wished to offer consumers an AmEx payment option were required to agree to an "honor all cards" policy: that is, to accept AmEx charge cards as well as its credit cards. Italian Colors Restaurant, which signed a contract with this provision, filed a class action in the Southern District alleging that AmEx's policy constituted an unlawful tying agreement under the Sherman Antitrust Act.

The merchants alleged that AmEx had monopoly power, forcing them to accept ordinary credit cards at 30 percent higher rates than the fees for identical bankissued cards in competing networks. Each merchant agreement included an arbitration provision requiring bilateral, rather than classwide, arbitration.

AmEx moved to compel arbitration, but the plaintiffs resisted, arguing that the arbitration clause precluded them from effectively vindicating their federal statutory rights under the Sherman Antitrust Act in the arbitral forum. The plaintiffs contended that the small amount of each of their claims made the costs of arbitration prohibitive because each needed a detailed antitrust market study to prevail on the tying claim.

EXPERT TESTIMONY

The plaintiffs' expert testified that the cost of obtaining the necessary study was between $300,000 and $1 million, which greatly exceeded the potential median damages of $5,252 for individual plaintiffs. The plaintiffs argued that they were effectively prevented from vindicating their federal statutory rights in arbitration. Nonetheless, the district court granted the defendant's motion to compel arbitration, dismissed the plaintiffs' lawsuits, and rejected the plaintiffs' "prohibitive costs" and effective-vindication arguments.

The Second Circuit heard AmEx appeals three times, and declined to enforce the class action waiver. The court concluded that the Supreme Court's intervening decisions in Stolt-Nielsen S.A. v. AnimalFeeds International Corp. and AT&T Mobility LLC v. Concepcion did not undermine the effective-vindication rule. The Second Circuit held that arbitration agreements providing for bilateral arbitration were unenforceable if the claimants could demonstrate that the cost of individually arbitrating their dispute would be prohibitive.

The Supreme Court, in an opinion by Justice Antonin Scalia, reversed, holding that the Federal Arbitration Act (FAA) did not permit district courts to invalidate a contractual waiver of classwide arbitration based on the effective-vindication rule.

EXPENSE OF PROVING REMEDY
Construing the effective-vindication exception as mere dictum derived from the court's 1985 decision in Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth Inc., the majority noted that the fact that it might not be worth the expense to prove a statutory remedy did not foreclose the right to pursue the remedy.

Relying on its Concepcion decision as dispositive and indicating that decision "all but resolves this case," Scalia rejected the argument that classwide arbitration was necessary to prosecute claims that otherwise might slip through the legal system. The majority further indicated that congressional approval of Federal Rule of Civil Procedure 23 did not establish an entitlement to class proceedings to vindicate statutory rights.

The court reiterated that arbitration agreements are a matter of contract law and must be rigorously enforced according to their terms, even for claims alleging violation of a federal statute. The FAA's mandate to enforce arbitration might only be "overridden by a contrary congressional command."

Finding no such contrary congressional command in the Sherman Antitrust Act, the court held that AmEx's agreement needed to be enforced according to its terms specifying bilateral arbitration only.

THE ERNST & YOUNG CASE

Stephanie Sutherland brought a class action lawsuit in the Southern District of New York pursuant to the FLSA against her former employer Ernst & Young, to recover overtime wages. Sutherland's employment-offer letter included a mandatory arbitration clause and a confidentiality agreement that contained an alternative dispute-resolution policy. The terms of the agreement barred both civil lawsuits and any class or collective proceedings in arbitration.

After Sutherland filed her FLSA lawsuit, Ernst & Young filed a motion to dismiss and to compel arbitration of her claims on an individual basis in accordance with the terms of the arbitration agreement. Sutherland responded that the provision requiring individual arbitration was unenforceable because the requirement prevented her from effectively vindicating her rights under the FLSA. The district court, relying on the Second Circuit's analysis in its various AmEx decisions, refused to enforce Ernst & Young's class action waiver provision.

On appeal after the Supreme Court's June 20 decision in Italian Colors, the Second Circuit completely reversed course. Consistent with that decision, the Second Circuit first examined whether the FLSA contained a "contrary congressional command" barring waivers of class arbitration. Because the text of the FLSA does not evince an intention to preclude a waiver of class action procedure, the court then proceeded to Sutherland's effective-vindication argument.

The court held that the Italian Colors decision compelled the conclusion that Sutherland's class action waiver was not rendered invalid by virtue of the fact that her claim was economically not worth pursuing on an individual basis. The court reasoned that the fact that it may not be worth the expense in proving a statutory remedy does not constitute elimination of the right to pursue that remedy.

Therefore, the Second Circuit held that the effective-vindication doctrine could not be used to invalidate class action waiver provisions where the recovery that the plaintiff seeks is exceeded by the cost of individual arbitration. Consequently, Sutherland's arguments were insufficient to invalidate Ernst & Young's class action waiver provision in the arbitration agreement.

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