# US Supreme Court *Italian Colors* Decision Raises the White Flag on the Effective Vindication Rule

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The arcane subject of arbitrability has become an unlikely hit. After years of making do as a warm-up act, it unexpectedly moved to centre stage. Arbitrability made the leap to the bright lights because of its key role in the current judicial re-examination of the social utility of class action litigation. In a series of recent decisions that uphold restrictions on class arbitration, the US Supreme Court shifted the balance in favour of arbitrating claims individually and away from litigating them on a class-wide basis. However, reviews have been mixed. In the recent opinion *American Express Co v Italian Colors Restaurant*,[1] a majority of the Court trumpets the enforcement of contract provisions requiring the arbitration of claims on a non-class basis as fulfilling arbitration's central purpose of providing a streamlined procedure for the adjudication of claims. But the dissent darkly warns that the public should "not be fooled" and that in the hands of the majority, rather than facilitating the redress of injuries, "arbitration threatens to become more nearly the opposite—a mechanism easily made to block the vindication" of "federal claims and insulate wrongdoers from liability".[2]

## 1. Recent US Supreme Court Decisions Point towards Adjudication of Claims in Individual Arbitrations

While *Italian Colors* was pending in the lower courts, the Supreme Court issued two important decisions that substantially redefined the scope of class arbitration. In *Stolt-Nielsen SA v AnimalFeeds International Corp*,[3] the majority of the Court held class arbitration improper when the arbitration provision was "silent" on the use of the procedure. Then in *AT&T Mobility LLC v Concepcion*,[4] the majority held that the Federal Arbitration Act (FAA)[5] pre-empted state law barring enforcement of a class-arbitration waiver. Under federal pre-emption principles, state law must yield when it conflicts with federal law, such as the FAA. In broad outline, FAA s.2 allows a party to challenge the enforceability of an arbitration provision under general state law contract principles such as unconscionability, but pre-empts such challenges that by application would only affect the enforceability of an arbitration provision.[6] Both of these decisions received close examination by the lower court in *Italian Colors*,[7] but they also fundamentally altered the judicial landscape by sharply limiting claimants' ability to bring class-wide arbitration or challenge the enforceability of arbitration provisions containing class action waivers.

Not unexpectedly, claimants tried to sidestep these Court rulings. To avoid the broad sweep of federal pre-emption, claimants simply asserted claims under federal law. Unless specifically provided otherwise, federal claim statutes enjoy equal dignity to the FAA and are not subject to pre-emption. *Italian Colors*, which involved the arbitrability of federal antitrust claims, became the subject of intense interest because its consideration by the Court squarely put at issue the next difficult question of what decision mechanism should

[1] 133 S.Ct. 2304 (2013).
[2] *American Express Co v Italian Colors Restaurant* 133 S.Ct. 2304 (2013) at 2320.
[3] 559 U.S. 662 (2010).
[4] 131 S.Ct. 1740 (2011).
[5] 9 U.S.C. s.1 ff.
[6] For example, in *Doctor's Ass'n Inc v Casarotto* 517 U.S. 681, 687 (1996), the United States Supreme Court held that the FAA pre-empted a Montana state law that required notice of the arbitration provision in underlined capital letters on the first page of the contract. Under federal law, compliance with the notice provision could not serve as a defence to arbitration because the state law requirement uniquely applied to arbitration clauses.
[7] See *American Express Co v Italian Colors Restaurant* 133 S.Ct. 2304, 2307–2308.

apply in the event of a conflict between two federal statutes, here the federal antitrust laws and the Federal Arbitration Act.

## 2. The Court's Prior Discussion as to Vindication of Federal Statutory Rights under the "Prospective Waiver Doctrine"

Before *Italian Colors*, the Court had provided only vague guidance on how to reconcile conflicts between vindicating rights under the FAA and other federal statutes. The Court briefly addressed this issue in *Mitsubishi Motors Corp v Soler Chrysler-Plymouth, Inc*,[8] which involved an antitrust dispute between a Japanese car manufacturer and a Puerto Rican car dealer. The Court ultimately compelled arbitration of the federal claims arising from this international transaction. But, in what became a famous footnote (referenced by number in the title of at least one law review article),[9] the Court cautioned that if the arbitration provision acted as a "prospective waiver of a party's right to pursue statutory remedies … we would have little hesitation in condemning the agreement as against public policy".[10] This so-called "prospective waiver doctrine" provided some cursory guidance as to how to draw the line in the event of a conflict between a claim seeking to vindicate a federal statutory right and the policies upholding the enforcement of arbitration provisions embodied in the FAA.

Although the Court elaborated on the doctrine in later decisions, it did not provide definitive guidance and lower courts continued to reach different conclusions on its proper application. Of relevance to *Italian Colors*, 15 years later, the Court took up the issue again in *Green Tree Financial Corp-Alabama v Randolph*.[11] This case arose from Ms Randolph's financing of the purchase of a mobile home using Green Tree. Notwithstanding an arbitration provision in her loan agreement, Ms Randolph filed a class action lawsuit seeking recovery of a relatively modest sum under two federal statutes. Acting pursuant to the FAA, Green Tree filed a motion to compel arbitration of these federal claims. In response, Ms Randolph argued that it would be a financial hardship for her to arbitrate because the arbitration fees for claims of this size were generally $5,000 and the average arbitrator's daily fee was $700. However, unlike in *Italian Colors*, which as discussed below documented the likely costs with expert testimony, Ms Randolph simply contended that she would be likely to incur these costs. The Supreme Court concluded that Ms Randolph was relying on "unfounded assumptions" and refused to invalidate the arbitration provision based on such "speculati[on]".[12] Notably, for the subsequent consideration of this decision in *Italian Colors*, the Court based its decision on evidentiary grounds. The Court's holding did not reject the concept of a party mounting a challenge to the enforceability of an arbitration provision based on the cost of the arbitration, or limit the application of the prospective waiver doctrine to contracts that contain an express waiver of the future right to assert a federal cause of action.

## 3. *Italian Colors* Decided the Unresolved Question of Whether an Arbitration Provision Prevents the "Effective Vindication" of a Federal Statutory Right

*Italian Colors* involved a dispute between American Express and its merchant clients who contended that the credit card company used monopoly power to force the merchants to

[8] 473 U.S. 614 (1985).

[9] Joseph R. Brubaker and Michael P. Daly, "Twenty-Five Years of the 'Prospective Waiver' Doctrine in International Dispute Resolution: Mitsubishi's Footnote Nineteen Comes to Life in the Eleventh Circuit" (2010) 64 U. Miami L. Rev. 1233.

[10] 473 U.S. at 637 n.19.

[11] 531 U.S. 79 (2000).

[12] *Green Tree Financial Corp-Alabama v Randolph* 531 U.S. 79 (2000) at 91–92 n.6.

pay credit card fees that allegedly were approximately 30 per cent higher than the fees charged by competing credit cards.[13] The merchants, including Italian Colors Restaurant, brought class action claims under the federal antitrust laws, including a claim for treble damages under the Clayton Act.[14] However, the merchants were parties to a standard-form arbitration agreement that prohibited class arbitration (including any form of joinder or consolidation of claims or parties), and contained a confidentiality provision that prevented the merchants from informally working together to produce a common expert report.[15] Relying on the parties' arbitration agreement, American Express moved to compel individual arbitration of the merchants' claim under the FAA.[16] In opposition to the motion to compel arbitration, the merchants submitted the declaration of an economist who estimated that the cost for expert analysis of the economic-related issues to establish an antitrust claim would be at least several hundred thousand dollars and might exceed $1 million.[17] The economist also testified that the maximum recovery for each merchant in the putative class would be $12,850 ($38,549 if trebled).[18] For the purposes of its consideration, the majority essentially acknowledged that even with the possibility of treble damages, the antitrust laws would not provide an "affordable procedural path" to vindicate the merchants' claim on an individual basis.[19]

By accepting a case for certiorari in which expert testimony established that the cost of adjudicating the federal claims individually would be cost prohibitive, the Court sharpened the issue for decision and dramatically raised the stakes of its final decision. In *Green Tree*, the Court suggested that "large arbitration costs" could preclude a litigant from "effectively vindicating her federal statutory rights in the arbitral forum".[20] But in that case, the Court did not reach the issue because it determined that the possibility that the claimant would incur prohibitive costs was too speculative to justify invaliding the arbitration agreement.[21] By submitting an uncontested expert declaration on the cost of individual arbitration, *Italian Colors* eliminated the evidentiary issues and focused the inquiry on the narrower question of whether the prohibitive costs of conducting a single-party arbitration of a complex antitrust claim could be considered to prevent that party from vindicating a federal statutory right.

As between vindicating the claimants' remedies of the antitrust laws and the respondent's rights under the FAA, consistent with other recent rulings limiting class arbitration, the majority tipped in favour of the FAA. The majority opinion narrowly interpreted *Mitsubishi* and *Green Tree*, as addressing barriers at the outset of the process to assert a federal statutory claim.[22] To the majority, an agreement prospectively waived a party's right to pursue a statutory remedy if the agreement outright forbad the future assertion of such a claim, or if the filing and administrative fees were so high as to make access to the arbitration forum impracticable. But if the case could get under way, the majority rejected challenges to the arbitration provision such as those asserted by Italian Colors Restaurant based on the expense involved in pursuing and proving the elements of the federal statutory remedy.

Kagan J., joined by three other justices, issued a strongly worded dissent. She accused the majority of adopting a fact-specific resolution to the case that ignored decades of precedent. Likewise reviewing the Court's earlier decisions in *Mitsubishi* and *Green Tree*, Kagan J. tartly stated that these decisions established "what in some quarters is known as

[13] *American Express Co v Italian Colors Restaurant* 133 S.Ct. 2304 (2013) at 2306–2308.
[14] *American Express Co v Italian Colors Restaurant* 133 S.Ct. 2304 (2013) at 2307.
[15] *American Express Co v Italian Colors Restaurant* 133 S.Ct. 2304 (2013) at 2316–2317 n.3.
[16] *American Express Co v Italian Colors Restaurant* 133 S.Ct. at 2304 (2013) 2307–2308.
[17] *American Express Co v Italian Colors Restaurant* 133 S.Ct. at 2304 (2013) 2316–2317.
[18] *American Express Co v Italian Colors Restaurant* 133 S.Ct. at 2304 (2013) 2316–2317.
[19] *American Express Co v Italian Colors Restaurant* 133 S.Ct. at 2304 (2013) 2309–2310. See also 2316–2317 and n.3 (cost of bringing an individual antitrust claim prohibitive because "[n]o rational actor would bring a claim worth tens of thousands of dollars if doing so meant incurring costs in the hundreds of thousands").
[20] *Green Tree Financial Corp-Alabama v Randolph* 531 U.S. 79 (2000) at 90.
[21] *Green Tree Financial Corp-Alabama v Randolph* 531 U.S. 79 (2000) at 91.
[22] *American Express Co v Italian Colors Restaurant* 133 S.Ct. 2304 (2013) at 2310–2316.

a principle"[23]—all but stating that the majority's opinion addressing these earlier cases was not principled. She also lashed out at the majority's "weirdly idiosyncratic" distinction between the types of costs that foreclose consideration of a federal claim.[24] Kagan J. saw no basis to delineate between the cost of filing the arbitration and the cost of conducting it. Above all, Kagan J. believed that the majority opinion opens the door for parties to include "procedural bars" that would make pursuit of a federal statutory claim a "fool's errand".[25] In her view, the decision rendered the effective vindication rule a dead letter and allowed parties to use the FAA as a "foolproof way of killing off valid claims".[26]

The erosion of the effective vindication rule by *Italian Colors* does not mark the end of class action litigation in the United States. But as a companion to the Court's earlier decision in *Concepcion*,[27] which expanded the scope of federal pre-emption, it continues the Court's trend of limiting the basis for challenges to the enforceability of agreements to arbitrate claims on an individual basis. As other countries around the world begin to experiment with class adjudication, the Court seems determined to reverse the trend in the United States. To be seen is whether this new course will promote the use of arbitration to provide redress as the majority envisions, or insulate wrongdoers from liability as the dissent forewarns.

[23] *American Express Co v Italian Colors Restaurant* 133 S.Ct. 2304 (2013) at 2317–2318.
[24] *American Express Co v Italian Colors Restaurant* 133 S.Ct. 2304 (2013) at 2318.
[25] *American Express Co v Italian Colors Restaurant* 133 S.Ct. 2304 (2013) at 2313.
[26] *American Express Co v Italian Colors Restaurant* 133 S.Ct. 2304 (2013) at 2315.
[27] *AT&T Mobility LLC v Concepcion* 131 S.Ct. 1740 (2011).