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IN FOCUS

September 13, 2024

The Federal Arbitration Act and Class Action Waivers

Arbitration agreements have become ubiquitous and are used in a wide range of contexts, including business-to-business contracts, employment contracts, collective bargaining agreements, and consumer contracts. For example, arbitration agreements can be found in contractual terms of service for credit cards, cell phones, online retailers, social media platforms, and ridesharing apps, as well as in warranty terms printed on product packaging. Arbitration agreements typically waive the parties' right to litigate disputes in court and instead require them to submit disputes to a neutral third party for a binding decision. These arbitration agreements often contain a provision that waives each party's right to bring claims in a class action lawsuit or class action arbitration, limiting each party to arbitrating the individual party's claims.

The Federal Arbitration Act (FAA; 9 U.S.C. §§ 1 et seq.) generally makes covered arbitration agreements enforceable in state and federal courts. This In Focus provides background on arbitration and the FAA, and briefly examines select Supreme Court decisions that address class action waivers and the ability to arbitrate on a classwide basis under the FAA.

Arbitration

The terms of an arbitration agreement can be customized to address such issues as what types of disputes are subject to arbitration, how the arbitrator or arbitrators are selected, the location and format of the arbitral hearing, and the procedural rules that will govern the proceeding.

Arbitral proceedings may differ from court proceedings in a number of ways. First, arbitration is typically less formal than litigating in court, although the specific procedures can vary widely based on the choices the parties make in their agreement. For example, whereas parties litigating in court usually have to comply with formal rules of civil procedure and evidentiary rules, arbitration agreements often forgo application of such rules. The type and scope of fact discovery permitted in arbitration also is often more limited than that available in litigation. Second, whereas court proceedings are generally open to the public and court filings are usually publicly available, arbitration hearings are usually private, and the parties may be contractually obligated to keep the proceedings and arbitration award confidential. Third, cases in court are often assigned at random to generalist judges, but in arbitration the parties may have a direct role in choosing the arbitrator who will adjudicate the dispute, and parties often select arbitrators with specialized experience. Also, whereas a trial court's judgments are generally subject to review by an appellate court with authority to correct erroneous rulings, arbitration awards under the FAA are usually not reviewable by courts except on very narrow statutory grounds that focus on arbitrator misconduct rather than legal or factual errors.

The Federal Arbitration Act

Enacted in 1925, the FAA provides that written arbitration agreements in "a contract evidencing a transaction involving commerce . . . shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract." The Supreme Court has explained that Congress enacted the FAA to "overrule the judiciary's longstanding refusal to enforce agreements to arbitrate . . . and [to] place such agreements upon the same footing as other contracts." Courts therefore generally must "rigorously" enforce the agreements according to their terms. Although the FAA's savings clause permits courts to apply "generally applicable contract defenses such as fraud, duress, or unconscionability" to invalidate arbitration agreements, the FAA preempts state laws that "disfavor" arbitration or interfere with its "fundamental attributes."

Arbitration Agreements and Class Action Waivers

A class action is a procedure used to aggregate the claims of numerous individuals or entities into a single litigation or arbitration. In a series of sharply divided opinions, the Supreme Court has interpreted the FAA as making class action waiver provisions in arbitration agreements generally enforceable, even when a plaintiff's claims for damages might be too small to justify the expense of arbitrating on an individual basis. The Court has also held that parties to an arbitration agreement under the FAA may not be compelled to arbitrate on a classwide basis unless the agreement affirmatively provides for class procedures.

AT&T Mobility LLC v. Concepcion

In *AT&T Mobility LLC v. Concepcion*, 563 U.S. 333 (2011), the Supreme Court held that the FAA preempted a state from "conditioning the enforceability of certain arbitration agreements on the availability of classwide arbitration procedures." Under a California judicial rule established in *Discover Bank v. Superior Court*, 36 Cal.4th 148 (2005), courts applying California law often deemed class action waiver provisions in standard-form consumer contracts "unconscionable" and thus unenforceable. One of the central concerns expressed by the California Supreme Court in *Discover Bank* was that class action waivers could thwart what the U.S. Supreme Court has identified as "the policy at the very core of the class action mechanism." Whereas "small recoveries do not provide the incentive for any individual to bring a solo action prosecuting his or her rights," a "class action solves this problem by aggregating the relatively paltry potential recoveries into something worth someone's (usually an attorney's) labor." Applying

the *Discover Bank* rule, the U.S. Court of Appeals for the Ninth Circuit held that a class waiver provision in an AT&T cell phone contract was unconscionable, and that the FAA did not preempt the California judicial rule, which applied equally to class action waivers in arbitration agreements and in other contracts.

The Supreme Court held that the FAA preempted California's *Discover Bank* rule. The Court explained that, although Section 2 of the FAA "preserves generally applicable contract defenses," it nonetheless preempts such defenses where they pose an obstacle to accomplishing the FAA's objectives. Focusing on the FAA's text, the Court reasoned that the FAA's primary purpose is to make arbitration agreements enforceable according to their terms "so as to facilitate streamlined proceedings." In the Court's view, because class arbitration necessarily requires procedural formality, it "sacrifices the principal advantage of arbitration—its informality—and makes the process slower, more costly, and more likely to generate procedural morass than final judgment." The Court thus concluded that California's *Discover Bank* rule interfered with "fundamental attributes of arbitration" and was preempted under the FAA. Additionally, in addressing the argument that small value claims would "slip through the legal system" without class proceedings, the Court explained that "States cannot require a procedure that is inconsistent with the FAA, even if it is desirable for unrelated reasons."

American Express Co. v. Italian Colors Restaurant

In *American Express Co. v. Italian Colors Restaurant*, 570 U.S. 228 (2013), the U.S. Supreme Court held that a class action waiver in an arbitration agreement is enforceable under the FAA even "when the plaintiff's cost of individually arbitrating a federal statutory claim exceeds the potential recovery." The U.S. Court of Appeals for the Second Circuit had held a class action waiver in an arbitration agreement invalid because it impeded the vindication of federal statutory rights, insofar as a class action was "the only economically feasible means" for the plaintiffs to enforce their rights under the federal antitrust laws. The court found that the cost of proving the antitrust violations would greatly exceed an individual plaintiff's potential recovery, because the maximum recovery for an individual plaintiff would be $38,549, but proving the antitrust violation would require an economic analysis costing "at least several hundred thousand dollars."

In reversing the Second Circuit, the Supreme Court first explained that the antitrust laws do not mention class actions or otherwise evince congressional intent to "'preclude a waiver' of class-action procedure." The Court next explained that the judge-made "effective vindication" exception to the FAA applies when a contract prospectively waives a party's "right to pursue" a federal statutory remedy. According to the Court, the doctrine would cover an arbitration agreement "forbidding the assertion of certain statutory rights," and also potentially cover "filing and administrative fees attached to arbitration that are so high as to make access to the forum impracticable." In the Court's view, however, "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." The Court also reasoned that requiring courts to assess the cost of proving a statutory remedy prior to enforcing a class waiver provision would itself "destroy the prospect of speedy resolution that arbitration . . . was meant to secure."

Epic Systems Corporation v. Lewis

In *Epic Systems Corporation v. Lewis*, 584 U.S. 497 (2018), the Court held that the National Labor Relations Act (NLRA) does not limit the enforceability of class action or collective action waivers in employment agreements subject to the FAA. Although Section 7 of the NLRA guarantees employees the right to "engage in . . . concerted activities for the purpose of collective bargaining or other mutual aid or protection," the Court interpreted that provision as focusing on "the right to organize unions and bargain collectively," and not the right to bring class or collective legal actions.

Stolt-Nielsen S.A. v. AnimalFeeds International Corp. and *Lamps Plus, Inc. v. Varela*

In addition to addressing the enforceability of class action waivers under the FAA, the Supreme Court has also addressed when a party may be compelled to arbitrate on a classwide basis under an agreement that does not contain a class waiver. In *Stolt-Nielsen S.A. v. AnimalFeeds International Corp.*, 559 U.S. 662 (2010), the Court held that a party to an arbitration agreement under the FAA may not be required to arbitrate on a classwide basis when the agreement is "silent" on the availability of class procedures. Emphasizing that arbitration under the FAA is "a matter of consent," the Court explained that there must be an affirmative contractual basis for concluding that a party has agreed to class action arbitration. The Court reasoned that the "fundamental" differences between individual arbitration and class action arbitration are "too great for arbitrators to presume . . . that the parties' mere silence on the issue of class-action arbitration constitutes consent to resolve their disputes in class proceedings." Whereas *Stolt-Nielsen* addressed arbitration agreements that are *silent* as to class arbitration, in *Lamps Plus, Inc. v. Varela*, 587 U.S. 176 (2019), the Court followed similar reasoning in ruling that parties also may not be compelled to arbitrate on a class basis when their agreement is *ambiguous* with respect to class arbitration.

Considerations for Congress

The use of arbitration agreements to foreclose consumers, employees, and businesses from bringing class actions remains a central issue in debates over the FAA's scope and application. A number of bills introduced in the 118th Congress would amend the FAA to limit or bar enforcement of arbitration agreements and class action waivers in certain contexts. For example, the FAIR Act of 2023, H.R. 2953, would provide that pre-dispute arbitration agreements and class action waivers are not valid or enforceable with respect to certain employment, consumer, antitrust, and civil rights disputes. The Protecting Older Americans Act of 2023, S. 1979, as reported by the Senate Judiciary Committee, would more narrowly give plaintiffs the right to invalidate pre-dispute arbitration agreements and class action waivers with respect to cases related to age discrimination disputes.

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