

US: Supreme Court Restricts Arbitrators' Power to Order Class Arbitration

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On 27 April 2010, in a 5–3 decision, the US Supreme Court ruled in Stolt-Nielsen SA v AnimalFeeds International Corp No. 08–1198 (2010) that an arbitration tribunal that compels class arbitration, without concluding that the parties contractually agreed to it (either expressly or as construed under the applicable law), exceeded its powers under the Federal Arbitration Act. Mark Beckett, David McLean, Rachel Thorn, Marc Suskin and Timothy Ho of Latham & Watkins report on a case which will diminish the use of class arbitration in the US, although it will continue to be available at least in some circumstances

THE LAST CLASS ACTION ARBITRATION CASE BEFORE THE COURT

The US Supreme Court last addressed the issue of class arbitration in *Green Tree Financial Corp v Bazzle*, 539 US 444 (2003). In that case the South Carolina Supreme Court, addressing what it characterised as an “adhesive but enforceable franchise contract,” had directed the trial court to determine whether a class arbitration was appropriate by balancing the inefficiencies and inequities that would arise from requiring each plaintiff to proceed individually, with the prejudice a class approach would cause to the drafting party. In *Bazzle*, a plurality of the US Supreme Court concluded that the decision was for the arbitrator to make, and the majority vacated the decision of the South Carolina court and remanded the issue to the arbitrators.

In the wake of *Bazzle* there have been hundreds of class arbitrations in the US – many, it appears, in cases where the arbitration clause did not expressly address the issue. In response to *Bazzle*, the American Arbitration Association promulgated Supplementary Rules for Class Arbitration. In the amicus brief it filed with the court in *Stolt-Nielsen*, the AAA noted that it had administered scores of business, consumer and employment class arbitrations.

THE “SILENT” CLAUSE IN STOLT-NIELSEN

The arbitration clause in *Stolt-Nielsen* did not expressly provide for class arbitration, and in fact, the parties stipulated that the clause was “silent” on the question.

The case centred on a charter party agreement between *Stolt-Nielsen*, a parcel tanker shipping company, and *AnimalFeeds*, a commercial user of fish oil. After a criminal investigation by the US Department of Justice into a price-fixing conspiracy among parcel tanking shippers, *AnimalFeeds* initiated putative class-action litigation. Like many other *Stolt-Nielsen* customers, the charter party agreement *AnimalFeeds* signed was governed by New York law and included a conventional maritime arbitration clause providing for arbitration in New York. Ultimately, *Stolt-Nielsen* successfully compelled arbitration on the basis of this clause. Although the clause did not expressly address class arbitration, *AnimalFeeds* subsequently initiated arbitration proceedings on behalf of a class of “all direct purchasers of parcel tanker transportation services globally for bulk liquid chemicals, edible oils, acids and other specialty liquids” from *Stolt-Nielsen* during the relevant time period.

In evaluating whether to proceed with class arbitration, the arbitral tribunal considered evidence of trade usage proffered by *Stolt-Nielsen* for the proposition that charter party arbitration clauses are invariably bilateral, and surveyed post-*Bazzle* arbitral awards that allowed for class arbitrations. The arbitrators ultimately ordered class arbitration, finding, inter alia, that *Stolt-Nielsen*’s evidence did not

reflect “an inten[t] to preclude class arbitration” and that its arguments would leave “no basis for a class action absent express agreement among all parties and the putative class members.” A district court for the Southern District of New York vacated the award, holding that it was issued in manifest disregard of the law. The Court of Appeals for the Second Circuit subsequently reversed that decision, finding, inter alia, that nothing in New York or maritime law established a rule against class arbitration and the arbitral decision was within the tribunal’s discretion.

THE SUPREME COURT’S DECISION IN STOLT-NIELSEN

In a decision by Justice Samuel Alito, the Supreme Court reversed the appeal court’s ruling, concluding that when arbitrators permit class arbitration on the basis of factors other than party intent, and choose instead to resolve the question on policy grounds reserved to courts, they exceed their powers under the Federal Arbitration Act. Emphasising the core principle of contractual consent, the court reasoned that the purpose of the FAA was to ensure the enforcement of arbitration agreements according to their terms. Since arbitration is a matter of contract, the parties may “structure their arbitration agreements as they see fit,” the court said, quoting *Mastrobuono v Shearson Lehman Hutton*, 514 U.S. 52, 57 (1995), and may limit the issues and the parties with whom they choose to arbitrate. Based on these precepts, “it follows that a party may not be compelled under the FAA to submit to class arbitration unless there is a contractual basis for concluding that the parties agreed to do so.”

Thus, when facing an arbitration clause that is silent on an issue, the court in *Stolt-Nielsen* ruled that the arbitrators’ proper role is to analyse the parties’ agreement and ascertain their actual intent. Because the contract at issue in *Stolt-Nielsen* evidenced no agreement as to class arbitration, the arbitrators were required to identify and apply “a rule of decision derived from the FAA or other maritime or New York law,” to resolve the issue. The court found that the tribunal had instead proceeded “as if it had the authority of a common-law court to develop what it viewed as the best rule to be applied in such a situation.” Ultimately, the court concluded that the arbitrators had simply imposed their own policy preferences on the parties and so exceeded their powers under the FAA.

Justice Ruth Bader Ginsburg, in a dissent joined by two other justices, disagreed, characterising the arbitrator’s determination as a procedural decision that should be afforded broad judicial deference. The dissent also emphasised that the class the arbitrators recognised was simply all the other customers who had signed similar arbitration provisions – so that *Stolt-Nielsen* would not be arbitrating with any party with whom it did not have an arbitration agreement.

The majority, however, saw the question of class arbitration as an entirely different type of decision. “Class-action arbitration,” wrote the court, “changes the nature of arbitration to such a degree that it cannot be presumed that the parties consented to it by simply agreeing to submit their disputes to an arbitrator.” Effects noted included a procedure involving hundreds or thousands of opposing parties rather than one, a lack of privacy and confidentiality and an ultimate decision that would bind absent parties. The court also noted that, while the commercial stakes of class arbitration are akin to those of class-action litigation, the scope of judicial review for class arbitration “is much more limited.” Accordingly, the Court concluded that the differences in the two modes of 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.”

For these reasons, the court concluded that the tribunal had exceeded its powers under section 10(a)(4) of the FAA. In avoiding reliance on the “manifest disregard” standard, the court sidestepped the question of whether that basis, which is not expressly referred to in the FAA, survived the court’s decision in *Hall Street Associates, LLC v Mattel, Inc*, 552 U. S. 576 (2008).

Significantly, the court did not elaborate on the type of findings that would allow arbitrators to conclude that the parties had agreed on class arbitration: “We have no occasion to decide what contractual basis may support a finding that the parties agreed to authorise class-action arbitration.” The dissent noted that this issue was left open and also asserted that the majority had suggested that “a contractual basis” could be established even in the absence of express language. The dissent

also suggested that the majority's emphasis on the fact that the parties were "sophisticated business entities" meant that the court's "affirmative-authorisation requirement" did not apply to "contracts of adhesion presented on a take-it-or-leave-it basis," like the type at issue in the *Bazzle* decision.

IMPACT AND OPEN QUESTIONS

Since most arbitration clauses do not expressly permit class arbitration, most parties advocating a class approach will have to demonstrate intent through contract interpretation or default principles of contract law. While the decision does leave the door open to a finding of intent even in the absence of express language allowing a class action, the likelihood is that it will be difficult for parties to show such intent and that class arbitrations will not be widely available. However, the decision leaves open a number of important issues:

* The court has recognised the arbitrability of antitrust claims since its decision in *Mitsubishi Motors Corp v Soler Chrysler-Plymouth*, 473 US 614 (1985). Does the likelihood that class action arbitrations will be largely unavailable mean there will be no meaningful remedy for widely dispersed, small-value arbitration claims? The court suggested that when the arbitrators weighed these types of considerations, they were impermissibly imposing their "own conception of sound policy." The dissent observed that a number of courts had "invalidated contractual bans on, or waivers of, class arbitration" on just these grounds.

What if a state court determined that, as a matter of state law, the presumption should be that class arbitration is allowed in such cases? Would this run afoul of the court's restrictive contractual theory of the FAA? One seeming paradox of the court's present treatment of class arbitration is that, while the *Bazzle* plurality gave the class issue to the arbitrators, *Stolt-Nielsen* emphasised that in making that determination the arbitrators could not act like courts. What if a state court determined that arbitrators could weigh these issues as a matter of state law? Given the ubiquity of arbitration clauses in consumer contracts, it is likely the Court will be facing issues like this in the future.

An important related question is: if unconscionability or a similar doctrine might invalidate such a clause, who decides this issue – the court or the arbitrators? Later this term, the court will decide *Rent-A-Center, West, Inc v Jackson*, 581 F.3d 912 (9th Cir. 2009), cert. granted, 130 S. Ct. 1133 (US 2010), which may shed light on the question of whether a court must address the enforceability of an arbitration clause claimed to be unconscionable even if the parties gave that power to the arbitrators.

* The FAA is often invoked positively, as a basis for enforcing an arbitration agreement by compelling arbitration. In *Stolt-Nielsen* the Supreme Court emphasised that the FAA was also restrictive, in that it prevented compelling arbitration beyond the agreement of the parties. This view of the FAA as imposing limitations on agreements to arbitrate is not one that has recently enjoyed much currency in lower courts and may have application to other contexts, such as the proliferation of theories requiring non-signatories to arbitrate.

* Another question will be whether the court's reliance on Section 10(a)(4) of the FAA and the "exceeding powers" standard will spawn additional challenges on this basis for other arbitral "procedural" decisions. The Section 10(a)(4) standard was better suited to the court's critique, which was that the arbitrators had simply adopted their own standards rather than disregarded the law, much like amiable compositeurs. The court's opinion may nonetheless have the effect of popularising this more obscure basis, especially in light of the uncertain future of the manifest disregard standard (an issue the court will inevitably have to face in the coming years).

* Although this was an international arbitration (since *Stolt-Nielsen* is a non-US company), the court did not have occasion to consider the issue of whether a class arbitration award is enforceable outside of the US.

Parties wishing to avoid class action arbitrations should consider including express language to that effect in their arbitration agreements. Such a clause has a high likelihood of being enforced in business contracts. However the class arbitration issue has not been fully resolved and subsequent cases will probably raise the issue of whether the clause is enforceable in other circumstances.