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REPORT FROM WASHINGTON

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The Supreme Court Considers Whether Class Arbitration is Permitted When the Arbitration Clause is Silent on the Issue

December 10, 2009

The United States Supreme Court yesterday heard oral argument in *Stolt-Nielsen SA, et al. v. Animal Feeds*, No. 08-1198, to decide whether, under the Federal Arbitration Act ("FAA"), an arbitration panel exceeded its authority by issuing an award imposing class arbitration on parties whose arbitration clause governed by federal maritime law is silent on that issue. Although a similar question was presented in a prior case, *Green Tree Financial Corp. v. Bazzle,* 539 U.S. 444 (2003), the Court did not reach the issue at that time. The Court now appears poised to resolve this important question.

The Court also has the opportunity to decide whether the "manifest disregard" doctrine remains a viable ground to challenge the enforceability of arbitral awards. Under the doctrine, courts have vacated arbitral awards when the arbitrator issuing the award knew of a well-defined, clearly applicable legal rule that controlled the outcome, yet refused to apply it or ignored it altogether. In a recent decision, *Hall Street Associates LLC v. Mattel Inc*, 522 U.S. 576 (2008), however, the Supreme Court held that courts may *only* rely on the grounds enumerated in section 10 to vacate an arbitral award. Section 10 does not explicitly list "manifest disregard" as a ground for vacating an award, resulting in a split among lower courts on whether the doctrine survives *Hall Street Associates* that is ripe for clarification by the Court.

BACKGROUND

Plaintiff Animalfeeds International Corp. entered into independent bilateral "charter" agreements with the Defendants, Stolt-Nielsen and other oceanic shipping companies. Pursuant to the agreements, Defendants agreed to ship Plaintiff's cargo of specialty liquid via their ocean tankers. The agreements contained a standard arbitration clause that required any dispute between the parties to be submitted to arbitration.

In September 2003, Plaintiff filed a class action suit against Defendants, alleging that Defendants engaged in a global conspiracy to restrain competition in the world market for parcel tanker shipping services for specialty liquids in violation of federal antitrust laws, and thereby caused Plaintiff and all other parties that were direct purchasers of such services from Defendants to overpay for the shipment. Defendants then sought to compel arbitration. Although the district court denied the motion, the Second Circuit Court of Appeals reversed, holding that Plaintiff's antitrust claim against Defendant fell within the scope of the arbitration clauses in the standardized agreements at issue and accordingly ordering arbitration.

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JUSTICE BREYER

In May 2005, in accordance with the American Arbitration Association's Supplementary Rules for Class Arbitrations, Plaintiff filed a demand for class arbitration. Under the Rules, prior to addressing the merits of the case, arbitrators must initially decide whether the clauses at issue were intended to provide for class arbitration. Despite Defendants' arguments to the contrary, the arbitrators held that the clauses in the agreements between Plaintiff and Defendants, though silent, permitted class arbitration of Plaintiff's claims and the claims of the parties Plaintiff represented.

Defendants moved to vacate the award in the Southern District of New York on the ground that the panel's decision was made in "manifest disregard" of the law. Specifically, they argued that it is a rule that federal maritime contracts be interpreted based on custom and usage. Because the arbitration clauses at issue were part of standard contract forms developed and widely used for thirty years that have never been understood in the industry to manifest an intent for class action arbitration, the arbitrators, by refusing to find this custom and usage dispositive, manifestly disregarded a well-defined, clearly applicable legal rule that controlled the outcome. Judge Rakoff of the Southern District agreed, and vacated the construction award allowing class arbitration.

On appeal, the Second Circuit first addressed the issue of whether, in light of *Hall Street Associates*, the "manifest disregard" doctrine was a ground for vacatur entirely separate from the grounds enumerated in section 10 of the FAA, or whether the doctrine was merely a manner of applying those enumerated grounds. The Second Circuit found the doctrine to be a means to vacate arbitral awards as prescribed by section 10(a)(4) of the FAA because it ensures that arbitrators have not "exceeded their powers, or so imperfectly executed them that a mutual, final, and definite award upon the subject matter submitted was not made." 9 U.S.C. § 10(a)(4). The "manifest disregard" doctrine, the Second Circuit concluded, is "a mechanism to enforce the parties' agreements to arbitrate, rather than as judicial review of the arbitrators' decision." *See* 548 F.3d 85, 95 (2d Cir. 2008).

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JUSTICE SCALIA

Reversing the lower court, the Second Circuit disagreed on a number of grounds with the district court's rationale for vacating the construction award. Most importantly, the court found that the arbitration panel had not been made sufficiently aware that federal maritime law controlled because Defendants, in written submissions, conceded that the analysis under state and federal maritime law was the same. This concession precluded the conclusion that the arbitrators manifestly disregarded choice-of-law rules. The court added that, regardless of the concession, it was plausible to conclude that the arbitrators did in fact perform analyses to determine whether the outcome would be the same under both state law and federal maritime law.

The Second Circuit also rejected Defendants' claim that the arbitrators manifestly disregarded a well-defined, clearly applicable legal *rule*. The court explained that, while a rule of interpretation requiring consideration of custom and usage is clearly and plainly applicable, that does not mandate that custom and usage governs the outcome of every case: "[C]ustom and usage is more of a guide than a rule . . . it should 'be considered,' 'influence' interpretation, and 'inform the court's analysis' [but] [i]t does not govern the outcome of each case." *Id.* at 97-98. The court concluded that it was improper to vacate

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CHIEF JUSTICE ROBERTS

an award simply because the court may have reached a different conclusion than the arbitrators.

On June 15, 2009, the Court granted Defendants' petition for writ of certiorari. Notwithstanding the parties' significant lower court briefing on the viability of the "manifest disregard" doctrine, the question posed was whether, under the FAA, an arbitration panel exceeded its authority in issuing an award imposing class arbitration on parties whose arbitration clause governed by federal maritime law is silent on that issue.

SUMMARY OF THE ARGUMENT

Defendants began their argument by highlighting a bedrock principle of the FAA: that arbitrators' authority to adjudicate particular claims derives from the consent of the parties. Defendants asserted that, when an arbitration panel concludes that an agreement reveals no intention to submit class action claims to arbitration—*i.e.*, the agreement is "silent" on that issue—such panel cannot order class arbitration because the element of consent required for arbitration under the FAA is missing.

In response, Justice Breyer observed: "When you interpret a contract and it [is silent on an issue], you try to figure out. . .what a reasonable party would have intended." To do this, arbitrators "might look almost to anything under the sun they think is relevant," including public policy, to discern "what [the contract language] means." Justice Scalia echoed a similar sentiment: "The contract either requires [class arbitration] or does not require [class arbitration]. And if the contract is silent, either the court or the arbitrator has to decide, what is the consequence of that silence, in light of the background, in light of implied understandings."

In responding to questions by several Justices as to what they had expected the arbitration panel to decide, Defendants explained that the parties had agreed to submit to the arbitrators the question of whether the parties intended class arbitration, conceding that arbitrators "have plenary authority to apply rules of construction that go to the parties' intent" in answering that question. They also conceded that parties draft agreements with full knowledge of the default legal rules governing the agreement, so if there is a "background rule," the panel could decide that contract silence evidences the parties' intent for such rule to apply. However, Defendants emphasized that here the panel exceeded its bounds by compelling class arbitration in the face of a contract silent on the issue because there was no background rule, in either federal maritime law or state law, that supported that finding.

In response, Justice Stevens asked: "You would agree that if [the arbitrators] phrased their order a little differently and said: We think that the best reading of this agreement is that the parties intended to authorize class arbitration, then you would have no case?" Defendants conceded, under those circumstances, that they would be limited to challenging the award on the ground that the arbitrators manifestly disregarded the law.

Plaintiff seized on the theme established by the Court's questions, and principally argued that "[w]hat the arbitrators did here was interpret the contract as the

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JUSTICE STEVENS

parties asked them to." Any assertion otherwise, according to Plaintiff, is based on a misinterpretation of the construction award.

Justice Scalia questioned Plaintiff's claim: "Where did the arbitrators say [the parties] agreed to permit [class arbitration]?" According to Justice Scalia, a finding that the parties did not agree to prohibit class arbitration was insufficient: "You don't have to agree to prohibit everything in a contract. You have to agree to permit it. That's what contracting is about."

Chief Justice Roberts similarly asked Plaintiff about the fact that Defendants never expressly agreed to class arbitration. He noted: "As I understand what the arbitrators did, they said: Well, they didn't preclude it, and so we get to decide how far our authority goes." But, according to the Chief Justice, "[i]f I agree to arbitrate with A, it doesn't preclude me from arbitrating with B, but nothing in the agreement compels me to do that."

Plaintiff noted that, in the parties' contract, they agreed to "arbitrate any disputes," and asserted that the arbitrators relied on that language in conjunction with the finding that the parties' did not intend to prohibit class arbitration. "[U]nder the 'any disputes' language [the arbitrators found] that there was affirmative general authorization on the part of the arbitrators to choose any procedures, to have [class arbitration] in their toolbox." Because the arbitrators found no intent to prohibit class arbitration, nothing in the rest of the contract offset that affirmative authorization. Justice Scalia then inquired: "You are hanging your whole assertion that these arbitrators not only found that the contract did not prohibit it, but found that the contract positively authorized class action, upon that ['any dispute'] language?"

In rebuttal, Defendants urged the Court to find that the arbitrators did not base their decision on the parties' intent, and reach the question of whether, in failing to do so, arbitrators exceeded their authority under the FAA. Defendants stressed that, were the Court to accept Plaintiff's arguments that the arbitration panel did in fact base its decision on the intent of the parties, then the Court "will not be able to reach the very important fundamental FAA statutory question in this case, and the next generation of lawyers will come before you and your successors to get it answered."

IMPLICATIONS

In *Stolt-Nielson*, the Court is again confronted with the question of whether an agreement to class arbitration may be compelled in the face of an arbitration clause silent on the issue. If the Court were to agree with Defendants' argument, the Court would clarify that only those parties specifically found to have agreed to class arbitration would be bound by it. As observed by Justice Ginsburg, this result may effectively preclude class actions of similar disputes, because, in response to any class action suit filed in court, a defendant with an arbitration clause silent on the issue could compel one-on-one arbitration with the plaintiff representative, and the defendant could avoid class arbitration because the contract was silent and they did not consent. On the other hand, if the Court found for Plaintiff, future parties in such positions may simply draft their contracts to expressly preclude class arbitration.

Although neither the Court nor the parties discussed whether the "manifest disregard" doctrine survives *Hall Street Associates*, this is an important issue on which the Court may provide guidance in this case. A finding that the "manifest disregard" doctrine survives *Hall Street Associates* would leave in place the current judicially-created practice of allowing substantive challenges to arbitral awards under limited circumstances. On the other hand, any decision limiting vacatur to those grounds explicitly numerated in section 10 would further curtail parties' ability to revisit the substance of arbitral awards in subsequent enforcement proceedings.

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