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REPORT FROM WASHINGTON

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The Supreme Court Vacates Arbitrators' Decision Allowing Class Arbitration Based Solely On Arbitrators' Own Policy Views

April 30, 2010

INTRODUCTION

In its decision in *Stolt-Nielsen SA v. AnimalFeeds Int'l Corp.*, No. 08-1198, issued on April 27, the United States Supreme Court held that an arbitration panel exceeds its authority under Section 10(a)(4) of the Federal Arbitration Act ("FAA") when it compels class arbitration without evidence of specific consent to such form of arbitration. Finding a fundamental difference between a traditional dispute between two parties to a contract and a class arbitration involving potentially hundreds or thousands of parties, the Court held that compelling class arbitration on parties when they did not agree to it is inconsistent with the FAA. Deciding the issue left open in *Green Tree Financial Corp. v. Bazzle,* 539 U.S. 444 (2003), the Court also set forth the standard to be applied under the FAA when determining whether a contract may permissibly be interpreted to allow class arbitration, and applied that standard here to an arbitration clause silent on the issue of class arbitration.

BACKGROUND

Plaintiff AnimalFeeds International Corp. entered into independent bilateral "charter party" 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 requiring any dispute between the parties to be submitted to arbitration.

In September 2003, following a criminal investigation by the government on related charges, 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. Other charterers brought similar suits, which ultimately were consolidated by the Judicial Panel on Multidistrict Litigation in the District of Connecticut. In one of the pending cases, Defendants sought to compel arbitration and the District Court for the District of Connecticut determined that the claims were not subject to arbitration. 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. This determination was not at issue before the Supreme Court.

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In May 2005, in accordance with the American Arbitration Association's Supplementary Rules for Class Arbitrations (the "Rules"), Plaintiff AnimalFeeds filed a demand for class arbitration. Under the Rules, which were developed by the AAA after the Supreme Court's decision in *Bazzle,* an arbitrator is required to decide if the contractual clauses at issue were intended to provide for class arbitration before turning to the merits of the case. AnimalFeeds and Defendants entered into a supplemental agreement providing for the question of class arbitration to be submitted to a panel of three arbitrators. As part of this proceeding, they stipulated that the arbitration clause was "silent" was respect to class arbitration.

The arbitration panel heard argument and evidence on this issue including whether *Bazzle*, and post-*Bazzle* decisions which seemed to favor class arbitration, mandated class arbitration under the charter agreements. Other evidence included the testimony of various defense experts on custom and usage within maritime law on the question of intent to agree to class arbitration, as well as arguments about the proper law to apply in deciding the issue – whether it be the FAA, New York law, or maritime law. The arbitration panel thereafter determined that the charter agreements were subject to class arbitration.

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 both New York law and general maritime law permit evidence of "custom and usage" to determine intent, and as testified to by various maritime experts, the standard contract forms used in the federal maritime industry for thirty years had never been understood to manifest an intent to agree to class arbitration. By refusing to find this custom and usage dispositive, Defendants argued, the arbitrators 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.

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. 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." 548 F.3d 85, 97-98 (2d Cir. 2008). The court concluded that it was improper to vacate an award simply because the court may have reached a different conclusion than the arbitrators.

In June 2009, the Court granted Defendants' petition for writ of certiorari.

“In this case, we must conclude that what the arbitration panel did was simply to impose its own view of sound policy regarding class arbitration.”

OPINION OF THE COURT

SUMMARY OF THE DECISION

In an opinion by Justice Alito, joined by Chief Justice Roberts and Justices Scalia, Kennedy, and Thomas, the Supreme Court reversed the Second Circuit's decision and held that imposing class arbitration on parties who have not agreed to authorize class arbitration is inconsistent with the FAA.

The Court emphasized that the FAA's purpose is to ensure that private agreements to arbitrate are enforced according to their terms. The Court explained that, consistent with this purpose, parties are generally free to structure an arbitration agreement as they see fit, and the arbitrators derive their powers solely from that agreement. "From these principles," the Court wrote, "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 party *agreed* to do so." Thus, if an arbitration panel compels class arbitration without evidence that they intended to agree to such form of arbitration, for instance because the panel thinks it is good policy to do so, the panel's decision may be vacated under Section 10(a)(4) of the FAA on the ground that the arbitrators "exceeded their authority."

The Court reaffirmed that review of arbitration awards is very deferential and that a party seeking to establish that arbitrators exceeded their authority under Section 10(a)(4) must "clear a high hurdle" and establish more than "even a serious error": "It is only when [an] arbitrator strays from interpretation and application of the agreement and effectively 'dispense[s] his own brand of industrial justice' that his decision may be unenforceable." In this case, however, the Court was convinced that "what the arbitration panel did was simply to impose its own view of sound policy regarding class arbitration." The Court reasoned that the arbitration panel's decision to impose class arbitration could not have been based on the parties' intent because the parties had stipulated that their contracts were silent and that there was no agreement between the contracting parties on that issue. According to the Court, this stipulation "left no room for an inquiry regarding the parties' intent" based on the language in the contracts or any other evidence, and the only task for the panel was to look to the governing law to identify the rule that applied in the stipulated circumstance. "Instead of identifying and applying a rule of decision derived from the FAA or either maritime or New York law," the Court found, "the arbitration panel imposed its own policy choice and thus exceeded its powers."

Accepting that the arbitration panel relied on arbitral decisions construing a variety of clauses as allowing for class arbitration, the Court explained that the panel "did not mention whether any of these decisions were based on a rule derived from the FAA or on maritime or New York law." Instead, the panel had asked only whether there was a good reason not to follow what the panel perceived to be the post-*Bazzle* consensus among arbitrators created by the arbitral decisions that class arbitration is beneficial. By believing it had the authority to implement its policy views, and by regarding the parties' silence on the issue as the dispositive fact, the Court found that the panel had acted in a way that was "fundamentally at war with the foundational FAA principle that arbitration is a matter of consent."

The Court highlighted the arbitration panel's rejection of Defendants' submissions as to the parties' intent, as evidenced by industry custom and usage, as further proof that its decision was not based on a determination of that intent. The submissions the panel found unpersuasive included undisputed evidence that the arbitration clauses at issue were common in the industry and had never been interpreted to permit class arbitration at the time the parties contracted, expert testimony from four experienced maritime arbitrators that sophisticated parties like the ones involved in the case would never have intended the arbitration clauses to permit class arbitration, and court cases from New York and general maritime law recognizing the relevance of industry custom and practice.

The Court accepted that the arbitrators made "a few references to intent," but that "none of these shows that the panel did anything other than impose its own policy preference."

"While the interpretation of an arbitration agreement is generally a matter of state law, the FAA imposes certain rules of fundamental importance, including the basic precept that arbitration is a matter of consent, not coercion."

OPINION OF THE COURT

The Court then found that, under Section 10(b) of the FAA, it had the authority either to direct a rehearing by the arbitrators or to decide the question that was originally referred to the panel. Because there was "only one possible outcome on the facts before us," the Court decided the question itself, thereby reaching the issue left open in *Bazzle*, namely, what standard should apply in determining whether a contract silent on the question of class certification allows for class arbitration. The Court also noted that *Bazzle* does not require an arbitrator, rather than a court, to determine whether a contract permits class arbitration because only a plurality in *Bazzle* addressed that question, and observed that, as a general matter, *Bazzle* appeared to have "baffled the parties at their arbitration proceeding."

According to the standard established by the Court, although construction of arbitration agreements is "generally a matter of state law," the FAA "imposes certain rules of fundamental importance," including "the basic precept that arbitration is a matter of consent, not coercion." Applying this standard to the facts, the Court began with the basic rule that when parties have a "bargain sufficiently defined to be a contract," but have not agreed with respect to "a term which is essential to a determination of their rights and duties," then "a term which is reasonable in the circumstances is supplied by the court." Thus, "[i]n certain circumstances, it is appropriate to presume that parties that enter into an arbitration agreement implicitly authorize the arbitrator to adopt such procedures as are necessary to give effect to the parties' agreement." The Court therefore reaffirmed the autonomy of parties to contract as they see fit, and its decision should not call into question that an agreement to a broad arbitration clause in the context of a traditional bilateral dispute may implicitly authorize the arbitrators to adopt all necessary procedures to give effect to the parties' agreement.

But, according to the Court, class arbitrations are fundamentally a different kettle of fish: "the differences between bilateral and class action arbitration are too great for arbitrators to presume, consistent with their limited powers under the FAA, that the parties' mere silence on the issue of class-action arbitration constitutes consent to resolve their disputes in class proceedings." Undergirding the Court's concern, based upon its precedents and the contractual nature of arbitration, was "that parties may specify *with whom* they choose to arbitrate their disputes." The Court observed: "Consider just some of the fundamental changes brought about by the shift from bilateral arbitration to class-action arbitration. An arbitrator chosen according to an agreed upon procedure . . . no longer resolves a single dispute between the parties to a single agreement, but instead resolves many disputes between hundreds or perhaps even thousands of parties."

Justice Ginsburg, with whom Justices Stevens and Breyer joined, dissented. The majority prematurely addressed the question left open in *Bazzle*, Justice Ginsburg wrote, and indulged in *de novo* review to overturn a ruling of experienced arbitrators. She concluded: "For arbitrators to consider whether a claim should proceed on a class basis, the Court apparently demands contractual language one can read as affirmatively authorizing class arbitration." Justice Ginsburg noted, however, that the Court's opinion "does not insist on express consent to class arbitration," but only on a "contractual basis" to conclude that the parties agreed.

"When an arbitration clause is silent on the question, may arbitration proceed on behalf of a class? The Court prematurely takes up that important question and, indulging in de novo review, overturns the ruling of experienced arbitrators."

JUSTICE GINSBURG, dissenting

Justice Sotomayor took no part in the consideration or decision of the case.

IMPLICATIONS

In *Stolt-Nielsen*, the Court held that parties are not subject to class arbitration if they did not intend to be bound by class arbitration. In so holding, the Court's opinion provides parties seeking to avoid class arbitration with ammunition to argue that, based on the applicable controlling law, arbitrators exceed their powers to order such arbitration in the absence of clear contractual language or intent. As Justice Ginsburg noted, however, the Court's majority decision has a number of "stopping points" and other facts that may be unique to the case that could serve as grounds for distinguishing it and limiting its holding. In all events, the Court's reaffirmation of the parties' autonomy to contract as they see fit should mean that courts—in the context of a traditional *bilateral* dispute—will continue to take an expansive view of arbitrators' authority to adopt all necessary procedures to give effect to an agreement where parties have agreed to a broad rather than limited arbitration clause.

Also noteworthy, the Court in a footnote expressly declined to reach the question of whether the "manifest disregard of law" doctrine survives the Court's decision in *Hall Street Associates LLC v. Mattel Inc*, 522 U.S. 576 (2008), as a ground for review independent from the grounds in Section 10 of the FAA or in some other fashion. The Court did add, however, that if one assumes that the doctrine applied, it would be satisfied in the case at hand. The Court's preference for relying upon Section 10 of the FAA in this case suggests either that the "manifest disregard" doctrine may have a short life expectancy or that the Court in the future may seek to harmonize the meaning of "manifest disregard" with the standard employed under Section 10(a)(4) to decide whether arbitrators exceeded their powers.

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