

U.S. Supreme Court Limits Class Arbitration

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Introduction

When parties have not agreed to arbitrate their disputes, they cannot be forced to arbitrate. This is hardly a surprising conclusion, and the critical importance of consent to arbitrate disputes is a well-accepted feature of arbitration jurisprudence around the world.

The U.S. Supreme Court's April 27, 2010 decision in *Stolt-Nielsen S.A. v. AnimalFeeds International Corp.*, No. 08-1198, 2010 WL 1655826 (U.S. Apr. 27, 2010) applies this fundamental precept in what has become a highly controversial context – namely, to “class action” arbitration. In *Stolt-Nielsen*, the Court held that where an arbitration agreement is silent on the question of whether class arbitration is authorized, the parties' consent to class arbitration may not be inferred absent evidence of the parties' intent or a governing rule of law authorizing that inference.

The Dispute

The *Stolt-Nielsen* case arose out of a shipping contract (and therefore, under maritime law). AnimalFeeds International Corp. (“AnimalFeeds”) used Stolt-Nielsen S.A. and other shipping companies (“Petitioners”) to ship its products around the world. AnimalFeeds brought an antitrust class action lawsuit against Petitioners for price-fixing. Because the parties' shipping contract contained an arbitration clause, the U.S. Court of Appeals for the Second Circuit eventually held that these claims were subject to arbitration. AnimalFeeds then served Petitioners with a demand for class arbitration.

The parties then entered into a supplemental agreement, pursuant to which the threshold question of “whether the applicable arbitration clause permits the arbitration to proceed on behalf of or against a class” would be decided by a panel of three arbitrators in accordance with the plurality opinion in *Green Tree Financial Corp. v. Bazzle*, 539 U.S. 444 (2003).¹ Significantly, in the *Stolt-Nielsen* arbitration, the parties “stipulated that the arbitration clause was ‘silent’ with respect to class arbitration,” and it was undisputed that this stipulation meant that “no agreement had been reached on that issue.” The arbitrators issued a partial final award, which held that the arbitration clause allowed for class arbitration but stayed the arbitration to allow the parties to seek judicial review.

The District Court vacated the award, concluding that the arbitrators' decision was in manifest disregard of the law because the arbitrators failed to conduct a choice-of-law analysis. AnimalFeeds appealed, and the Second Circuit reversed, holding that because petitioners had cited no maritime or

New York law precluding class arbitration, the arbitrators' decision was not in manifest disregard of the law.²

The Supreme Court reversed in a 5-3 ruling written by Justice Alito. The majority opinion began by emphasizing that arbitration "is a matter of consent, not coercion." Against this backdrop, the Court articulated four specific factors – all focusing on the lack of any evidence of an agreement by the parties to engage in class arbitration – in finding that the arbitrators' partial award must be vacated.

First, the Court observed that the parties' stipulation before the arbitrators that the arbitration clause was "silent" on the issue of class arbitration demonstrated that there was no agreement on the issue of class arbitration. Given this stipulation and its meaning, there was no room for the arbitrators (who, under *Bazzle*, were responsible for determining intent) to conclude (by parol evidence or otherwise) that the parties intended their arbitration clause to permit class arbitration.

Second, the majority reasoned that, in the absence of the parties' manifestation of intent, "the only task that was left for the panel, in light of the parties' stipulation, was to identify the governing rule applicable in a case in which neither the language of the contract nor any other evidence established that the parties had reached any agreement on the question of class arbitration." The only possible sources of such a governing rule, the Court observed, would be the Federal Arbitration Act ("FAA") itself or one of the two bodies of law the parties claimed were governing – federal maritime law or New York law. The Court concluded that the award could not be upheld on the basis of a governing rule, however, because the arbitrators did not consider whether the FAA, federal maritime law or New York law provided such a rule of decision.

Third, the Court found that "[r]ather than inquiring whether [the FAA, maritime law, or New York law] contain[s] a 'default rule' permitting an arbitration clause to allow class arbitration absent express consent, the panel proceeded as if it had a common-law court's authority to develop what it viewed as the best rule to be applied in such a situation." The Court, however, held that arbitrators, unlike judges, have "no general charter to administer justice for a community which transcends the parties." In concluding that the arbitration clause allowed for class arbitration, "the arbitration panel imposed its own policy choice and thus exceeded its powers."

Fourth, the Court concluded that although it is appropriate in some circumstances "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," arbitrators may not infer an implicit agreement to authorize class-action arbitration "solely from the fact of [the parties'] agreement to arbitrate." In reaching this decision, the majority noted the drastic differences between "bilateral" and class arbitration, including: (i) an arbitrator no longer resolves a single dispute between parties to a single agreement but instead resolves numerous disputes between numerous parties involving numerous agreements; (ii) the confidentiality inherent in bilateral arbitrations does not exist in class arbitrations; (iii) "[t]he arbitrator's award no longer purports to bind just the parties to a single arbitration agreement, but adjudicates the rights of absent parties as well;" and (iv) the commercial stakes in class arbitration are comparable to those of class-action litigation even though the scope of judicial review is much more limited. Given these substantial differences, the Supreme Court reasoned that arbitrators cannot "presume, consistent with their limited powers under the Federal Arbitration Act (the 'FAA'), that the parties' mere silence on the issue of class-action arbitration constitutes consent to resolve their disputes in class proceedings." The Court observed:

An implicit agreement to authorize class-action arbitration, however, is not a term that the arbitrator may infer solely from the fact of the parties' agreement to arbitrate. The differences between simple bilateral and complex class action arbitration are too great for such a presumption.

The Court found that, given its conclusion that the arbitrators exceeded their powers under the FAA by permitting class arbitration, it was required to either remit the question to the panel for rehearing or decide the issue itself. As to this choice, the Court observed that because "we conclude that there can be only one possible outcome on the facts before us [i.e., vacatur of the award for lack of arbitral jurisdiction], we see no need to direct a rehearing by the arbitrators."

Looking Ahead

Although the Court's decision in *Stolt-Nielsen* leaves no question that class arbitration will not be permitted absent either (a) some evidence that the parties agreed to permit it or (b) an inference of such an agreement supplied by governing law where the agreement is silent, the specific impact of the decision will depend upon its interpretation by lower courts. Under a broad reading of *Stolt-Nielsen*, class arbitration will no longer occur in the United States unless the parties' arbitration provision explicitly permits class arbitration. This is an unlikely scenario under current practice, and one to which corporate parties negotiating arbitration provisions are unlikely to agree. Under a more narrow reading of *Stolt-Nielsen*, class arbitrations will continue to be permitted, despite the failure of the arbitration clause to explicitly address the question of class arbitration, in situations in which either (a) the arbitrators interpret the parties' arbitration clause as authorizing class arbitrations or (b) the governing law provides a default rule authorizing class arbitration when the arbitration clause is "silent" on the issue.

There are several scenarios in which lower courts may, consistently with *Stolt-Nielsen*, find it possible to permit class arbitration despite the absence of a clear agreement. For instance, an arbitrator could find that parties who, post-*Bazzle*, have agreed to arbitrate under the American Arbitration Association's post-2003 arbitration rules (which expressly provide rules for class arbitration) have, through their agreement to use those rules, agreed to permit class arbitration. Such an outcome would be consistent with the growing body of jurisprudence in which U.S. courts have held that parties' agreements to arbitrate under rules incorporating certain features are tantamount to a specific agreement to the use of that feature in their arbitrations.³ This very possibility is suggested in footnote 4 of *Stolt-Nielsen*, where the majority distinguishes arbitral awards in which the arbitration clause was construed as allowing class arbitration. As the court observed in that footnote, "all of the arbitral awards were made under the AAA's Class Rules, which were adopted in 2003, and thus none was available when the parties here entered into the [agreement containing the arbitration clause] during the class period ranging from 1998 to 2002."

Another way in which class arbitration might be allowed post-*Stolt-Nielsen* would be if the state law governing the arbitration provided for such an interpretation. The Court suggested that class arbitration would be permissible where authorized under governing law even where the arbitration agreement was "silent" on the issue. Under governing state law, if the default rule when an agreement is "silent" is that the parties will be deemed to have agreed to class arbitration, *Stolt-Nielsen* would not preclude class arbitration. As discussed by the Second Circuit in *Stolt-Nielsen*, at least two states – Pennsylvania and California – follow such an approach.⁴

A further way in which class arbitration could be affected by *Stolt-Nielsen* is reflected in *In re American Express Merchants' Litigation*, 554 F.3d 300 (2d Cir. 2009) *vacated sub nom. Am. Express Co. v. It. Colors Rest.*, No. 08-1473, 2010 WL 1740528 (U.S. May 3, 2010). On May 3, 2010, the U.S. Supreme Court summarily vacated and remanded for reconsideration *Italian Colors* in light of *Stolt-Nielsen*. In *Italian Colors*, the Second Circuit held that the determination as to whether a provision waiving class actions in arbitration was unconscionable was for the courts, not the arbitral tribunal, to decide; following that threshold determination, the Second Circuit found that the waiver was unconscionable. How *Stolt-Nielsen* will be applied to this case is difficult to predict. *Stolt-Nielsen* may not affect the issue of whether it is for the courts or the arbitral tribunal to decide whether a waiver of class arbitration is unconscionable. Given, however, *Stolt-Nielsen's* emphasis that "arbitration is a matter of consent" and 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," the decision arguably suggests that a waiver of class arbitration -- in other words, express manifestation of the parties' intent not to agree to class arbitration -- cannot be deemed unconscionable unless there is a "default rule" under governing law providing for class arbitration. Otherwise, a party who does not want, and does not agree to, class arbitration would be better off remaining "silent" rather than clearly stating its contractual intent that class arbitration is not authorized. It would seem to be a peculiar result if a party could be compelled to submit to class arbitration when the contract expressly waived class arbitration but could not be compelled to submit to class arbitration when the contract was silent on the issue.⁵

Conclusion

Although the Supreme Court's decision in *Stolt-Nielsen* is likely to lead to debate on a number of issues, at base the decision underscores the Court's continued willingness to hold parties to their arbitral bargain and its insistence that arbitration agreements are carried out in strict accordance with the parties' agreements and the law governing those agreements. In the wake of the decision, parties negotiating arbitration agreements that could lead to class-based claims should take particular care when designating an arbitral forum, governing law, and other aspects of the terms of any arbitral procedures. In particular, in circumstances where the parties have not addressed the issue of class arbitration in their agreement, the parties' choice of law and surrounding evidence of intent could be outcome-determinative as to whether arbitral jurisdiction exists over class-based claims.



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- ¹ In *Bazzle*, the plurality opinion held that the arbitral tribunal, and not a court, should decide whether contracts providing for arbitration were “silent” on the issue of class arbitration. See *Bazzle*, 539 U.S. at 453. The *Bazzle* court did not, however, rule on the issue of whether (and in what circumstances) class arbitration would be appropriate if the contracts were “silent.”
- ² The lower court decisions in *Stolt-Nielsen* specifically addressed whether the “manifest disregard” doctrine remained available as a ground for vacatur in the wake of the Supreme Court’s decision in *Hall Street Assocs. L.L.C. v. Mattel, Inc.*, 552 U.S. 576 (2008), in which the Court held that the grounds for vacatur set forth in Section 10 of the Federal Arbitration Act are exclusive and may not be expanded by the parties in their arbitration agreement. The Second Circuit, like every other circuit to decide the issue to date, held that “manifest disregard” continues to represent a ground for vacatur, albeit as a “judicial gloss” on Section 10 of the FAA, rather than as a non-statutory doctrine. See *Mastec N. Am. Inc. v. MSE Power Sys. Inc.*, No. 08-CV-168, 2008 WL 2704912 (N.D.N.Y. July 8, 2008); *Stolt-Nielsen*, 548 F.3d at 95. We reported on these decisions in prior editions of Stay Current. See “Supreme Court Denies Certiorari in Three Cases Concerning Judicial Review of Arbitral Awards,” *Stay Current*, October 2009; “Second Circuit Decision Clarifies and Bolsters Arbitrators’ Authority,” *Stay Current*, February 2010. The Supreme Court did not address the Second Circuit’s holding on this point in its *Stolt-Nielsen* decision.
- ³ See, e.g., *Contec Corp. v. Remote Solution Co.*, 398 F.3d 205, 208 (2d Cir. 2005) (“[W]here parties explicitly incorporate rules that empower the arbitrator to decide issues of arbitrability, the incorporation serves as clear and unmistakable evidence of the parties’ intent to delegate such issues [to the Tribunal].”); *Sunoco Inc. v. Honeywell Int’l Inc.*, No. 05CIV7984, 2006 WL 709292, at *3-4 (S.D.N.Y. Mar. 21, 2006) (confirming arbitration award where parties agreed to arbitrate in accordance with rules that gave arbitrators power to rule on the scope of their jurisdiction).
- ⁴ See *Stolt-Nielsen*, 548 F.3d at 101, n.15 (citing *Keating v. Sup. Ct.*, 645 P.2d 1192, 1210 (Cal.1982), *rev’d on other grounds sub nom. Southland Corp. v. Keating*, 465 U.S. 1 (1984); *Dickler v. Shearson Lehman Hutton, Inc.*, 596 A.2d 860, 864-65 (Pa. Super. Ct. 1991)).
- ⁵ One possible distinction between *Stolt-Nielsen* and *Italian Colors* is the fact that the arbitration in *Italian Colors* was between two parties who had substantially different bargaining power whereas in *Stolt-Nielsen* the parties were sophisticated, multinational commercial parties. In *Stolt-Nielsen*, the Court noted the evidence that sophisticated, multinational commercial parties “would never intend that the arbitration clauses would permit a class arbitration.” This distinction leaves open the possibility of evidence that unsophisticated, noncommercial parties might intend an arbitration clause to permit class arbitration as well as the possibility that a waiver of class arbitration may be unconscionable when the parties to a bilateral agreement had substantially different bargaining power.