Recent Development In Arbitration Case Law From The United States Supreme Court

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Editor Fowler, Calvin W. "Woody", Jr., Pope, Joseph R., James D. Smith

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The Supreme Court decided *Stolt-Nielson v. AnimalFeeds International Corp.* on April 27, 2010. It ruled that a party could not be forced to submit to class arbitration absent an affirmative agreement by the parties, a holding which will certainly impact businesses that utilize arbitration clauses. While the Court ultimately finds that silence does not equate to consent to class arbitration, the Court may also be opening the doors to more judicial involvement in arbitration disputes.

Stolt-Nielson v. AnimalFeeds International Corp. **(No. 08-1198)**

"Silence is often misinterpreted, but never misquoted," says the old adage. Before the Court in *Stolt-Nielson*, 130 S. Ct. 1758 (Apr. 27, 2010), was the question of whether a trio of arbitrators had misinterpreted contractual silence to mean consent to class arbitration. In a decision addressing several issues relevant to the interpretation and enforceability of arbitration agreements--including the appealability of a "clause construction award" issued by an arbitrator, an arbitrator's ability to decide disputes based on public policy choices, the correct interpretation of the Court's decision in *Green Tree Financial Corp. v. Bazzle*, 539 U.S. 444 (2003), and the appropriate standard under the Federal Arbitration Act for interpreting a contract provision that is silent on an issue--the Court ultimately found that class arbitration cannot be imposed upon parties that had remained silent on the issue. According to the Court, silence cannot equate to consent to a procedure as onerous and uncertain as mass arbitration proceedings.

Background of the Case

Stolt-Nielson was launched as a class action in the District Court for the District of Connecticut charging numerous ocean carriers (including Stolt-Nielson) with a price-fixing conspiracy. Those proceedings ended when the Second Circuit found that the parties' transactions were governed by contracts (maritime charter parties) with enforceable arbitration clauses governed the parties' transactions and that the named cargo-shipping plaintiffs' (including AnimalFeeds') antitrust claims were arbitrable. *JLM Indus., Inc. v. Stolt-Nielsen S. A.*, 387 F. 3d 163, 175 (2d Cir. 2004). AnimalFeeds then filed a demand for class arbitration of the antitrust conspiracy claims. Stolt-Nielson contested AnimalFeeds' right to proceed on behalf of a class, but agreed in a supplemental agreement to submit that threshold dispute to a panel of arbitrators. The parties further stipulated that the arbitration agreements were silent with respect to the issue of class arbitration. According to the supplemental agreement, the parties agreed to choose three arbitrators and instruct them to "follow ... Rul[e] 3 ... of the American Arbitration Association's Supplementary Rules for Class Arbitrations." Rule 3, in turn, directed the panel to "determine ... whether the applicable arbitration clause permits the arbitration to proceed on behalf of ... a class."

After considering the parties' arguments and evidence, including testimony from expert witnesses regarding arbitration customs and usage in the maritime trade, the arbitrators issued a "clause-construction award," stating that the arbitration clause allowed for class arbitration. The panel concluded that the agreement evinced no intent to preclude class arbitration and found persuasive numerous post-Bazzle arbitration decisions that had construed "a wide variety of clauses in a wide variety of settings as allowing for class arbitration." As Stolt-Nielson's evidence did not show an "inten[t] to preclude class arbitration," and because Stolt-Nielson's contention would leave "no basis for a class action absent express agreement among all parties and the putative class members," the panel found that the arbitration provisions should be read to allow class arbitration. AAA Rule 3, Supplementary Rules for Class Arbitrations, requires a partial, final award to determine "whether the applicable arbitration clause permits the arbitration to proceed on behalf of or against a class (the 'Clause Construction Award')." The arbitrator must stay that decision for at least 30 days to allow a party to seek a court order confirming or vacating that award.

Stolt-Nielson filed a petition under 9 U.S.C. ? 10(a)(4)--which authorizes a district court to "make an order vacating the [arbitration] award upon the application of any party to the arbitration . . . where the arbitrators exceeded their powers"--to vacate the arbitrators' "award" in the District Court for the Southern District of New York. The district court vacated the award, concluding that the arbitrators rendered their decision in "manifest disregard" of the law insofar as the arbitrators failed to conduct a choice-of-law analysis. Had the arbitrators done so, the district court found, they would have applied the rule of federal maritime law requiring that contracts be interpreted in light of custom and usage. The Second Circuit reversed, concluding that because Stolt-Nielson had cited no authority applying a federal maritime rule of custom and usage against class arbitration, the arbitrators' decision was not in manifest disregard of the law.
The Supreme Court granted certiorari and reversed.

The Limited Role of the Arbitrator

During the arbitration, AnimalFeeds made three arguments in support of construing the arbitration clause as permitting class actions: (1) because the clause is silent on the issue of class treatment,

and without express prohibition, class arbitration may proceed under *Bazzle*; (2) the clause should be construed as permitting class arbitration as a matter of public policy; and (3) the clause would be unconscionable and unenforceable if read to preclude class arbitration.

The arbitration panel expressly rejected AnimalFeeds' first argument and did not address its final argument; thus, the arbitration panel's decision necessarily rested on Animal Feeds' public policy argument. In the Court's view, the panel's public policy based decision was *ultra vires*. Continuing its critique, the Court noted that the panel had committed four errors: (1) it had relied on what it perceived as a post-*Bazzle* consensus among arbitrators that class action arbitration was beneficial as a matter of policy; (2) it summarily dismissed court cases denying consolidation of arbitrations; (3) it rejected undisputed evidence that the type of maritime contract at issue in the case had never been the basis of a class action; and (4) it rejected undisputed expert evidence that "sophisticated, multinational commercial parties of the type that are sought to be included in the class would never intend that the arbitration clauses would permit a class arbitration." Thus, rather than attempting to discern a "default rule" of construction under either the FAA, maritime law, or New York law, "the panel 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."

The Court's conclusion clarifies that an arbitrator's authority extends only to interpreting contractual language, and ascertaining and applying established legal doctrine. It may not veer from that task in an attempt to reconcile competing legal principles and policy.

The Panel's Misinterpretation of*Bazzle*

None of the Supreme Court's arbitration cases has caused more confusion than *Bazzle*, and the Court found that the Stolt-Nielson arbitration panel's decision was a product of this confusion.

Bazzle concerned contracts between a commercial lender and its customers. These contracts contained arbitration provisions that did not expressly mention class arbitration. An arbitrator nevertheless conducted class arbitration in two separate proceedings and entered awards for the customers totalling $19 million. The Supreme Court of South Carolina affirmed the arbitrator's decision by finding that a trial court could order class-wide arbitration after balancing potential inequities and inefficiencies of requiring each aggrieved party to proceed on an individual basis against "resulting prejudice to the drafting party." The South Carolina Supreme Court went on to find that the arbitration provision was indeed "silent regarding class wide arbitration," and that class wide arbitration may proceed when the arbitration agreement is silent on the issue.

While the Supreme Court reversed the South Carolina Supreme Court, no single rationale commanded a majority. Before the Court were three issues: (1) which decision maker (court or arbitrator) decides whether the contracts in question were silent on the issue of class arbitration; (2) what standard the appropriate decisionmaker should apply in determining whether a contract allows class arbitration (*i.e.,* does the FAA entirely preclude class arbitrations, does the FAA permit class arbitrations in certain circumstances, or is the question left to state law?); and (3) did the lower courts properly order class arbitration in this case?

The plurality decided only the first question, finding that the arbitrator should decide whether the contracts were silent on the issue of class arbitration. The plurality noted that, "[i]n certain limited circumstances," involving "gateway matters, such as whether the parties have a valid arbitration agreement at all or whether a concededly binding arbitration clause applies to a certain type of controversy," it is assumed "that the parties intended courts, not arbitrators," to make the decision. But the plurality opined that the question whether a contract with an arbitration clause forbids class arbitration "does not fall into this narrow exception." The plurality therefore vacated the decision of the South Carolina Supreme Court and remanded the case for the arbitrator to decide whether the contracts were indeed "silent." The plurality did not decide either the second or the third question.

In an opinion concurring in part and dissenting in part, Justice Stevens concurred in the judgment but only because there otherwise would have been "no controlling judgment of the Court." He did not endorse the plurality's rationale. He also declined to take a definitive position on the first question, writing only that "[a]rguably the interpretation of the parties' agreement should have been made in the first instance by the arbitrator." He indicated, however, that he would have affirmed the decision of the State Supreme Court on the ground that "the decision to conduct a class-action arbitration was correct as a matter of law." Accordingly, his analysis bypassed the first question noted above and rested instead on his resolution of the second and third questions. Thus, Bazzle did not yield a majority decision on any of the three questions.

Turning to the case before it, the Court noted that the parties erred in concluding that *Bazzle* requires that an arbitrator, not the court, decide whether a contract permits class arbitration. The Court, however, did not decide this issue because the parties had assigned the question to the arbitration panel.

The Court also took notice that the parties erroneously believed that *Bazzle* established the standard to be applied by a decision maker in determining whether a contract may be interpreted to allow class arbitration. The panel began its discussion by stating that the parties "differ regarding the rule of interpretation to be gleaned from [the *Bazzle*] decision." The panel continued: "Claimants argue that *Bazzle* requires clear language that forbids class arbitration in order to bar a class action. The Panel, however, agrees with Respondents that the test is a more general one--arbitrators must look to the language of the parties' agreement to ascertain the parties' intention whether they intended to permit or to preclude class action."

Contrary to the parties' positions and the panel's conclusion, however, *Bazzle* did not establish "the rule to be applied in deciding whether class arbitration is permitted." The Court then turned to that question.

Interpreting Silence

The Court reasoned that, while state law usually guides the interpretation of an arbitration agreement, the FAA imposes certain rules, including the precept that "arbitration is a matter of consent, not coercion." This rule correlates with the principle that an arbitrator's authority is derived from the parties' agreement to submit their dispute to private dispute resolution.

Underscoring the consensual nature of arbitration, the Court noted that parties are generally free to decide how best to structure their arbitration agreements. To that end, they may decide what issues they will arbitrate, what rules will govern, and who will resolve their dispute. As a logical extension, the parties may also "specify with whom they choose to arbitrate their disputes."

Building upon a foundation that parties are free to form arbitration agreements as they see fit and that courts must give effect to their decision, the Court ruled 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, the test is not whether the parties agreed to eliminate the availability of class arbitration, but, rather, whether the parties agreed to *allow* class arbitration. In other words, silence does not equate to acquiescence.

The Court acknowledged that, in certain contexts, the parties might agree implicitly to allow an arbitrator to use traditional methods of contract interpretation to "give effect to the parties' agreement." This is consistent with the general rule of contracts law that, "When the parties to a bargain sufficiently defined to be a contract have not agreed with respect to a term which is essential to a determination of their rights and duties, a term which is reasonable in the circumstances is supplied by the court." The Court distinguished such a context from the one where an arbitration agreement is silent on the question of class arbitration, because the nature of class arbitration so differs from bilateral arbitration that the parties' silence on the issue cannot be interpreted as implicit consent to class adjudication. According to the Court, "In bilateral arbitration, parties forgo the procedural rigor and appellate review of the courts in order to realize the benefits of private dispute resolution: lower costs, greater efficiency and speed, and the ability to choose expert adjudicators to resolve specialized disputes." In contrast, in a class action arbitration, the arbitrator chosen by the parties "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." Similarly, under the AAA Class Rules, "the presumption of privacy and confidentiality" that applies in bilateral arbitrations does not apply in class arbitrations. Furthermore, the arbitrator's award no longer binds only the parties to a single transaction, but adjudicates the rights of absent parties as well, and the financial stakes of class arbitration are far greater, especially given the limited scope of judicial review to arbitration awards.

Dissent

Justice Ginsburg, joined by Justice Stevens and Justice Breyer, dissented. The dissent first argued that the case was not ripe because the "clause-construction award" was not a final order and thus not appealable. In the dissent's view, the arbitration panel's decision "was abstract and highly interlocutory" and the panel had failed to "decide whether the particular claims AnimalFeeds advanced were suitable for class resolution ... much less did it delineate any class or consider whether, "if a class is certified ... members of the putative class should be required to 'opt in' to the proceeding."

The dissent next argued that since the parties had expressly submitted the issue--whether the arbitration clause permitted class arbitrations--to the arbitration panel to decide, they were bound by the arbitration panel's decision. And the majority's use of *de novo* review to find that the

arbitration panel had made an erroneous decision on the class arbitration issue conflicted with the FAA, which authorizes a court to vacate an arbitration panel's decision "only in very unusual circumstances."

The dissent next pointed to what it viewed as "stopping points" to the scope of the majority opinion. First, it noted the majority did not "insist on express consent to class arbitration." Thus, class arbitration may be ordered "if there is a contractual basis for concluding that the part[ies] agreed to submit to class arbitration." Second, "by observing that the parties here are sophisticated business entities" the dissent posited that the majority "apparently spares from its affirmative-authorization requirement contracts of adhesion presented on a take-it-or-leave-it basis."

Implications

While many have haled *Stolt-Nielson* a major victory for businesses seeking to avoid the enormous costs associated with class action litigation, upon further review, there may be some cause for concern.

While the decision establishes the rule that class arbitration is not available absent an affirmative agreement by the parties to allow it, the Court leaves room for parties to argue that industry custom or the governing state law that applies to the contract may affirmatively establish that the parties agreed to class arbitration. The parties in *Stolt-Nielson* stipulated that "no agreement" existed on the issue of class arbitration. Parties that wish to pursue class arbitrations will not stipulate to that fact in the future.

Additionally, because the decision rested on the factual predicate that the parties were "sophisticated entities," the Court failed to address the issue of whether arbitration clauses silent on the issue of class action treatment or that contain class action waivers, will bar class actions arising out of consumer contracts. Indeed, because the Court addressed the narrow issue of "whether imposing class arbitration on parties whose arbitration clauses are silent on that issue is consistent with the [FAA]," the Court did not address whether the arbitration clause was unconscionable as a matter of state law.

Lastly, by accepting appellate review of the "clause construction award" and asserting an arguably more robust standard of review than prescribed by statute, the Court may have signaled a greater willingness to interject itself into arbitration disputes. Certainly, one of the benefits of arbitration is avoiding the time, expense, and formality of a judicial forum. A more expansive use of interlocutory review and an eagerness to second-guess an arbitrator's decision on contract interpretation, even under the guise that the arbitrator relied on an amorphous public policy standard, may frustrate the efficiency goals of arbitration. Because if searching judicial review awaits after an arbitrator has issued an award, arbitration becomes nothing more than an academic exercise that may be more cost efficient to skip altogether. The Court's reliance on 9 U.S.C. ? 10(a)(4) (regarding an arbitrator exceeding her powers) also may give courts more authority to review how the arbitrator interpreted the parties' intent under the contract (e.g., relying on an arbitrator's formulation of "public policy" is improper).

About the Authors

Calvin W. "Woody" Fowler Jr. is a shareholder in the Richmond, VA office of Williams Mullen. Woody is chair of the firm's Litigation Section. His practice focuses on several types of complex commercial litigation, including consumer class actions, insurance coverage disputes and breach of contract/business tort claims. Woody is a member of DRI and the DRI Commercial Class Action SLG. He can be reached at .

James D. Smith James Smith is a partner in the Phoenix office of Bryan Cave LLP and is a member of DRI's Commercial Litigation Committee's Class Action Specialized Litigation Group. His practice focuses on class action defense, commercial litigation, and antitrust litigation. He frequently represents clients in consumer fraud, unfair business practices, antitrust, and RICO class actions across the country. He can be reached at .

Joseph R. Pope is an associate in the Richmond, VA office of Williams Mullen. His practice focuses on appellate litigation, complex commercial litigation, and antitrust. Joseph is a member of the Appellate Advocacy Committee and the Commercial Class Action SLG. He can be reached at .

Related People

- Calvin W. "Woody" Fowler, Jr. – 804.420.6442 – wfowler@williamsmullen.com

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