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US Supreme Court Rejects Non-Consensual Class Arbitration

Aren Goldsmith (Cleary Gottlieb Steen & Hamilton LLP) · Tuesday, May 4th, 2010

On April 27, 2010, the United States Supreme Court held in Stolt-Nielsen S.A. v Animalfeeds International Corp., that under the Federal Arbitration Act, 9 U.S.C. §§ 1-16 ("FAA"), "[A] party may not be compelled . . . to submit to class arbitration unless there is a contractual basis for concluding that the party agreed to do so". Slip. Op. 20 (emphasis in original).

The practical import of Court's recent decision will likely be to heighten significantly the hurdle to be cleared before class arbitration procedures are upheld under the FAA. In addition, the Court has effectively opened the door to challenges by parties now being forced to participate in class arbitrations on the basis of anything less than a finding of consent consistent with what the Court has declared is required under the FAA. Parties bringing such challenges will no doubt include those whose attempts to opt out of class procedures through contractual "waivers" have been deemed unenforceable on various public policy grounds. Indeed, on May 3, 2010, the Court vacated and remanded for further consideration in light of *Stolt-Nielsen* a decision of the United States Court of Appeals for the Second Circuit declining to enforce such a "waiver" as unconscionable. *See In re American Express Merchants' Litigation*, 554 F.3d 300 (2d Cir. 2009) (finding that to enforce the clause at issue would grant *de facto* immunity from antitrust liability).

These developments will no doubt come as welcome news to many users of international arbitration, particularly those based outside of the United States whose legal systems view class procedures as incompatible with due process requirements. Thanks to the *Stolt-Nielsen* decision, which puts into place a substantive standard limiting any claimed procedural discretion with respect to any attempted imposition of class procedures, international parties under agreements subject to the FAA (including the New York Convention), will now be in a position to insist upon a finding, grounded in contractual analysis, that such procedures were an intended term of their agreement to arbitrate.

While the Court's ultimate holding in *Stolt-Nielsen* is likely to come as very good news to many, the decision raises a number of important questions concerning the future of class arbitration and court review thereof in the United States courts. The issues described below are not by any means exhaustive.

First, the majority opinion raises questions as to the level of deference that will be shown by United States courts in the future toward arbitral decisions involving class arbitration. In particular, the majority decision appears to remove class procedures from the sphere of deference traditionally afforded to matters of arbitral procedure. To understand why this is the case, it is necessary to

consider how the majority characterized an earlier decision regarding class arbitration in Green Tree Financial Corp. v. Bazzle, 539 U.S. 444 (2003).

There, a plurality of the Court deemed the question of whether the parties' agreement authorizes class arbitration to be one of a procedural nature for the arbitral tribunal to resolve. Id. at 452-53. In *Stolt-Nielsen*, the majority took great pains to emphasize that the plurality opinion in *Bazzle* neither settled "for the Court" the question of "who should decide" whether class action is authorized under a contract, nor provided the standard for resolving the underlying issue. *Stolt-Nielsen* at 15-16. Ultimately, the Court declined to resolve this question because the parties to the litigation *sub judice* had entered into a form of submission agreement referring the question to the arbitral tribunal, a decision the Court left undisturbed.

However, in going on to rule that class procedures cannot be authorized in contracts based solely upon the existence of an agreement to arbitrate, the Court placed a significant substantive limitation upon the discretion that would ordinarily be enjoyed by any arbitral tribunal deciding what the *Bazzle* plurality considered to be a matter of "arbitration procedure" (once again, an open question remains as to whether arbitral tribunal or court should decide whether an agreement is "silent" as to the availability of class procedures). In this sense, the Court has cabined *Bazzle*, deeming class procedures to be ontologically different, and thereby requiring any arbitral tribunal visiting the question to respect additional safeguards, i.e. performing a contractual analysis in search of affirmative intent, before procedural deference will attach.

While the Court declined to say what exact principles would justify a finding of consent (*Stolt-Nielsen* at 23, n. 10), any arbitral tribunal deciding a petition for class certification will have to take particular care to justify its analysis in terms recognized under ordinary contract law principles.

Second, the decision is interesting in relation to what it says (and does not say) about the standard of review that is to be applied in adjudicating a motion for vacatur (setting aside) under the FAA. In particular, the Court referred to but did not decide the status of "manifest disregard", see Wilko v. Swan, 346 U.S. 427, 436-37 (1953) ("[T]he interpretations of the law by the arbitrators in contrast to manifest disregard are not subject, in the federal courts, to judicial review for error in interpretation"), after Hall Street Associates, L.L.C. v. Mattel, Inc., 552 U.S. 576, 585 (2008) (which held that the grounds enumerated under the FAA for vacatur are exclusive, but did not decide the status of "manifest disregard"). Frustrating the hopes of many who sought clarification of the exact grounds on which an award may be vacated under the FAA, the Court declined to decide whether "manifest disregard" "survives . . . as an independent ground for review or as a judicial gloss on the enumerated grounds for vacatur set forth at 9 U.S.C. §10?. *Stolt-Nielsen* at 7, n.3.

Because Section 10 of the FAA governs vacatur of awards under the New York Convention, a resolution of the existing split of authority in the United States courts as to the status of "manifest disregard" (for further discussion of this issue see Gary Born's post here) would have been welcome.

While declining to decide the status of "manifest disregard", the Court in *Stolt-Nielsen* did observe that if the standard meant "kn[owing] of the relevant [legal] principle, appreciat[ing] that this principle controlled the outcome of the disputed issue, and nonetheless willfully flout[ing] the governing law by refusing to apply it", as advocated by the party seeking to uphold the class certification, that standard was satisfied on the facts presented. *Stolt-Nielsen* at 7 n.4. In short, the

Court found that the arbitral tribunal, faced with a situation in which the parties had stipulated that no agreement existed between them on class arbitration, had committed an error sufficient to vacate under Section 10(a)(4) of the FAA (based upon the Court's finding that the arbitrators "exceeded their powers"), because the arbitral tribunal failed to perform a choice of law analysis to identify and apply a contractual rule of decision for resolving the issue.

Instead, in the view of the Court's majority, "what the arbitration panel did was simply to impose its own view of sound policy regarding class arbitration". Id. at 7. This, the Court found, was inconsistent with a substantive requirement under the FAA that arbitration must be based upon consent, and that a decision to refer a dispute to class procedures could not be inferred in the absence of some contractual basis for finding such consent.

Many will debate whether majority fairly characterized the distinguished arbitral tribunal's analysis. From the Court of Appeals' perspective, the arbitral tribunal did more than pure "policy" analysis because it considered whether New York or federal maritime law contained any clear "custom or usage" or rule of decision requiring a finding that a "silent" clause should be construed as precluding authorization of class procedures. 548 F.3d 85, 97-99 (2d Cir. 2008). In her dissenting opinion, Justice Ginsburg agreed, characterizing the majority's analysis on this point as a form of "de novo review", inappropriate where "[t]he arbitrators here not merely 'arguably', but certainly, construe[d] . . . the contract' with fidelity to their commission". *Stolt-Nielsen* at 10 (Gibsburg, J. dissenting).

However such debates are resolved, future litigants seeking to find a way around *Stolt-Nielsen* for clauses that do not expressly govern class procedures are likely to argue implicit consent under traditional contract law principles. For instance, arguments of implied consent may be seen on the basis of the parties' selection of institutional rules, such as the AAA's "Supplementary Rules for Class Arbitrations", authorizing class arbitration proceedings (although, the same rules provide that "the arbitrator shall not consider the existence of these Supplementary Rules . . . to be a factor either in favor of or against permitting the arbitration to proceed on a class basis"(Rule 3)).

Similarly, arguments may be seen on the basis of the parties' selection of substantive or procedural law permitting (explicitly or implicitly) class arbitration, for instance based upon the selection of state law that declines to enforce class arbitration "waivers" as contrary to public policy.

Such arguments will have to overcome the fact that the majority in *Stolt-Nielsen* clearly requires something affirmative in nature to satisfy the FAA's substantive requirements – whether indirect references suffice will no doubt be the subject of future litigation.

Third, the decision forces companies to think about how best to protect themselves from class arbitration, if this is their preference. Given that it is impossible to say how the debates described above will play out, international entities that find themselves party to agreements providing for arbitration under rules permitting class arbitration or for arbitration to take place in jurisdictions where the law of the seat permits class arbitrations, should remain vigilant.

One solution would be to attempt to amend existing agreements or to ensure that future agreements make clear that the parties do not wish to be subject to class procedures. Whether such provisions will be upheld, however, is another open question in the United States courts, particularly in connection with adhesion contracts not negotiated by "sophisticated parties" (indeed, Justice Ginsburg argues in her dissent that the majority's rationale would not appear to apply to such

contracts). As noted above, courts in several United States jurisdictions have refused to enforce "waiver" provisions on a number of different policy grounds; some have even deemed such provisions not to be severable, thereby rendering the arbitration clauses in which such "waivers" are contained unenforceable (potentially leaving the party who manages to negotiate "waivers" of class arbitration faced with a pyrrhic victory).

Given the complex federal nature of the American judicial system, analyzing a party's best options for managing these choices and risks is no easy matter. At a minimum, however, it appears safe to say that parties seeking to minimize exposure to the risk of class arbitration should avoid (to the greatest extent possible) agreeing to arbitrate under rules allowing for such procedures or in a jurisdiction the laws of which have been construed to prohibit the enforcement (as a general matter) of "waivers" of class arbitration.

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*The views expressed here are those of the author alone and should therefore in no way be construed as expressed on behalf of Cleary Gottlieb Steen & Hamilton LLP or any of the firm's clients.

This entry was posted on Tuesday, May 4th, 2010 at 4:01 pm and is filed under Arbitration Agreements, Commercial Arbitration, North America
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