Kluwer Arbitration Blog

Did the U.S. Supreme Court, in its Stolt-Niesen Decision, Make it Easier for Courts to Vacate Arbitration Awards?

Margaret Moses (Loyola University Chicago School of Law) · Tuesday, December 14th, 2010 · Institute for Transnational Arbitration (ITA), Academic Council

Stolt-Nielsen v. Animal Feeds, 130 S. Ct. 1758 (2010), is an extraordinary case. In Stolt-Nielsen, the U.S. Supreme Court vacated the award of a distinguished arbitral tribunal essentially because the tribunal did not reach the result favored by the Supreme Court.

In *Stolt-Nielsen*, charterers were arbitrating against shipping companies, alleging violations of antitrust law. The issue was whether the arbitration could proceed as a class arbitration. All of the arbitration agreements in the international maritime contracts between the various parties were silent on this question. Before the hearing, the parties entered into a Supplemental Agreement to be bound by Rules 3 through 7 of the American Arbitration Association's Supplementary Rules for Class Arbitrations. Rule 3 contains a requirement that as a threshold matter, the arbitrators must decide whether, under the arbitration agreement, the arbitration can proceed as a class arbitration. After a hearing solely on this issue, the tribunal ruled that the arbitration agreements permitted class arbitration, even though the agreements were silent on this point. Upon rendering its decision, the tribunal stayed the arbitration to permit Stolt-Nielsen to challenge the award.

The Supreme Court's *Stolt-Nielsen* decision must be viewed not only in response to the two lower court decisions handed down after the award issued, but also with reference to the Court's earlier decision in *Hall Street Associates v. Mattel, Inc*., 552 U.S. 576 (2008). In *Hall Street*, the Court had held that a party agreement that provided for a review of an arbitration award by a court for errors of fact or law was not enforceable. The exclusive grounds for vacating an award were the narrow grounds explicitly set forth in the Federal Arbitration Act ("FAA"), and parties could not add or change grounds by agreement. FAA grounds do not include a basis for setting aside an award on the merits. Moreover, the Court in *Hall Street* had also appeared to find that the judge-created doctrine of "manifest disregard of the law" was not a separate and independent ground for vacating an award, although it was perhaps a gloss on grounds contained in the statute.

When Stolt-Nielsen's challenge to the tribunal's award reached the federal district court, the Hall Street case had not yet been decided. The district court determined that because the evidence before the tribunal had shown that in maritime arbitrations peculiar to the shipping industry, there had never been class arbitrations, such custom and usage was "tantamount to an established rule of maritime law," 435 F. Supp. 2d at 385. The judge then vacated the award on the ground that the tribunal had manifestly disregarded the law.

The Hall Street decision had come down by the time the case was appealed to the Second Circuit. The appellate court reversed the district court decision. The Second Circuit believed that the manifest disregard standard had survived Hall Street as a gloss on other sections of the FAA. Nonetheless, it held that the standard was quite narrow, and that the tribunal had not manifestly disregarded the law. Moreover, the Second Circuit ruled that under the FAA, the tribunal had not exceeded its powers — one of the express statutory grounds for vacatur – because it had decided the exact question that the parties had presented to it for decision.

The conservative majority of Supreme Court, which was hostile to class arbitrations, was faced with a difficulty. On what grounds could it reverse the Second Circuit and cause the award to be vacated? Because the Court had held in *Hall Street* that the narrow grounds for vacatur set forth in the FAA were exclusive, it was not obvious how it could set aside the award, particularly without the help of the manifest disregard doctrine. On what other theory could the majority vacate the tribunal's decision that class arbitration was permitted when the arbitration agreement was silent on that subject?

The Supreme Court began its reasoning by noting that the decision of the arbitral tribunal could not be vacated for legal error. It stated that petitioners must clear a high hurdle because showing error, even serious error, is simply not enough to obtain vacatur. Nonetheless, Court proceeded to vacate the award. To do this, it drew upon a standard from labor arbitration rather than from commercial arbitration. Citing a labor arbitration case, the Court said, "[i]t 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." 130 S. Ct. at 1767, citing *Major League Baseball Players Assn. v. Garvey*, 532 U.S. 504, 509 (2001) (per curiam). The labor arbitration standard has been considered a more flexible standard because labor arbitration awards are vacated more frequently in the U.S. than commercial arbitration awards.

Having relied upon a labor arbitration standard – one that does not appear to be very different from a finding that the arbitrator improperly applied the law — the Court then attempted to connect the cited labor case to commercial arbitration. It found that the labor arbitration standard was essentially the same as the ground for vacatur found in FAA §10 (a)(4) — that the arbitrators exceeded their powers — because, according to the Court, "the task of the arbitrator is to interpret and enforce a contract, not to make public policy." 130 S. Ct. at 1767. The Court's interpretation is unusual and without precedent. Section 10(a)(4) has never previously been interpreted as meaning that if arbitrators consider public policy, they have exceeded their powers. Rather, the provision has always been understood to mean that arbitrators exceeded their powers if they reached a decision beyond the scope of the parties' arbitration agreement. In *Stolt-Nielsen*, however, the tribunal did not appear to exceed its powers because it decided exactly the question that the parties presented to it for decision. Yet, in holding that the tribunal exceeded its powers by focusing on policy instead of on interpretation of the contract (a view challenged by the dissent), the Court suggests a new way to vacate on the ground of arbitrators' exceeding their powers, if a court believes their decision to be wrong on the merits.

Despite reaching the same result as the district court, which had found the award to be in manifest disregard of the law, the Supreme Court continued to vacillate about the validity of the manifest disregard doctrine. The majority asserted that the Court was not deciding whether the doctrine had survived its decision in Hall Street, either as an independent ground or as a judicial gloss on the enumerated statutory grounds. However, the Court nonetheless stated that if the standard for manifest disregard was that the arbitrators knew the relevant legal principle and yet willfully

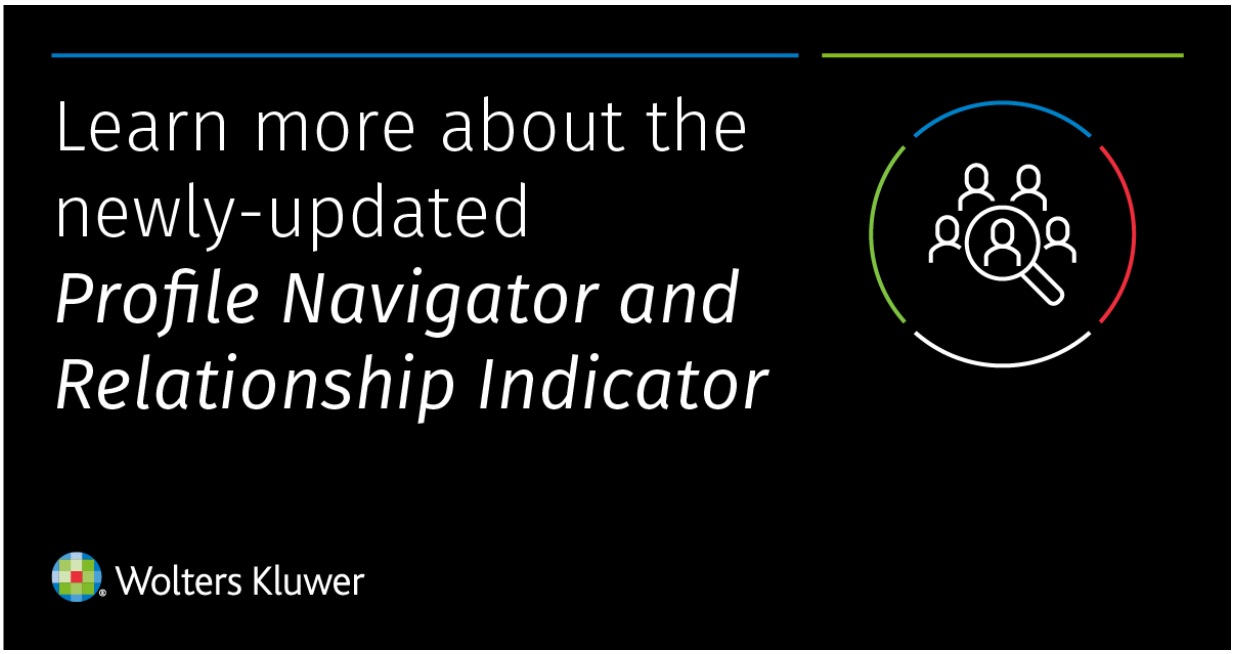
flouted the law, then that standard had been satisfied in Stolt-Nielsen. Thus, the Court apparently believed that the tribunal deliberately flouted the law in answering affirmatively rather than negatively the parties' question about whether class arbitration was permitted. As a consequence, even though the Court claimed not to decide if manifest disregard had survived *Hall Street*, the case result suggests that the Court may have actually broadened the applicability of the doctrine. In finding that both the manifest disregard standard and the labor arbitration standard for vacating awards were satisfied in *Stolt-Nielsen*, and that the labor arbitration standard equated to arbitrators' exceeding their powers, the Court conflated three standards, and created thereby a broader standard for reviewing and vacating awards than has typically been applied in commercial arbitration cases.

Stolt-Nielsen raises the concern that U.S. judges can now more easily vacate awards on grounds beyond those found in the FAA, such as when an arbitrator "strays from interpretation… and dispenses his own brand of industrial justice," 130 S.Ct. at 1767. Thus, judges can interfere more easily with the parties' expectations of finality. Regardless of whether one believes the arbitral tribunal's decision was right or wrong, it is quite troubling to find in *Stolt-Nielsen* a new pathway for U.S. courts to vacate an arbitration award on the merits when it thinks the arbitrators got it wrong.

To make sure you do not miss out on regular updates from the Kluwer Arbitration Blog, please subscribe here. To submit a proposal for a blog post, please consult our Editorial Guidelines.

Profile Navigator and Relationship Indicator
Includes 7,300+ profiles of arbitrators, expert witnesses, counsels & 13,500+ relationships to uncover potential conflicts of interest.

Learn how **Kluwer Arbitration** can support you.



This entry was posted on Tuesday, December 14th, 2010 at 7:10 am and is filed under Arbitration Awards, Class arbitration, Manifest Disregard Doctrine, North America
You can follow any responses to this entry through the Comments (RSS) feed. You can leave a response, or trackback from your own site.