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Client Alert

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US Supreme Court Rules in Stolt-Nielsen that Arbitrators May Not Impose Class Arbitration Without a Contractual Basis

On April 27, 2010, in a 5-3 decision, the US Supreme Court ruled in *Stolt-Nielsen S.A. v. AnimalFeeds International Corp.* No. 08—1198 (2010) (the Opinion) that an arbitration tribunal that compelled class arbitration without concluding that the parties contractually agreed to permit it (either expressly or as construed under the applicable law) exceeded its powers under the Federal Arbitration Act (FAA). The net effect of this case will be to diminish the use of class arbitration in the United States, although it will continue to be available at least in some circumstances.

> "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 parties agreed to do so.'"

The Last Class Action Arbitration Case Before the Court

The Court last addressed the issue of class arbitration in *Green Tree Financial Corp. v. Bazzle*, 539 U.S. 444 (2003). The arbitration clause at issue in that case was silent on the availability of class action arbitration. In addressing what it characterized as an "adhesive but enforceable franchise contract," the South Carolina Supreme Court directed the trial court to determine whether a class arbitration was nonetheless appropriate by balancing the inefficiencies and inequities in requiring each plaintiff to proceed individually versus proceeding as a class, while weighing the prejudice a class approach would cause to the drafting party.

A plurality of the US Supreme Court concluded that the question of class arbitration was one for the arbitrators and, with the addition of one additional justice, vacated the decision of the South Carolina Supreme Court and remanded the issue to the arbitrators.

In the wake of *Bazzle* there have been hundreds of class arbitrations in the US, many, it appears, in cases where the arbitration clause did not expressly address the issue. In response to *Bazzle*, the American Arbitration Association (AAA) promulgated Supplementary Rules for Class Arbitration. In the amicus brief it submitted in *Stolt-Nielsen*, the AAA noted that it had administered scores of business, consumer and employment class arbitrations.

The "Silent" Clause in *Stolt-Nielsen*

The arbitration clause in *Stolt-Nielsen* also did not expressly provide for class arbitration, and in fact, the parties stipulated that the clause was "silent" on the question.

Stolt-Nielsen involved a charter party

agreement between Stolt-Nielsen, a parcel tanker shipping company, and AnimalFeeds, a commercial user of fish oil. After a criminal investigation by the US Department of Justice into a price-fixing conspiracy among parcel tanking shippers, AnimalFeeds initiated a putative class-action lawsuit. Like many other Stolt-Nielsen customers, the charter party agreement AnimalFeeds signed was governed by New York law and included a conventional maritime arbitration clause providing for arbitration in New York. Ultimately, Stolt-Nielsen successfully compelled arbitration on the basis of this clause. Although the clause did not expressly address class arbitration, AnimalFeeds initiated arbitration proceedings on behalf of a class of "[a]ll direct purchasers of parcel tanker transportation services globally for bulk liquid chemicals, edible oils, acids and other specialty liquids from [Stolt-Nielsen]… at any time during the period from August 1, 1998 to November 30, 2002." (Opinion at p. 3.)

In evaluating whether to proceed with a class arbitration, the arbitral tribunal considered evidence of trade usage proffered by Stolt-Nielsen (for the proposition that charter party arbitration clauses are invariably bilateral) and surveyed post-*Bazzle* arbitral awards that allowed class arbitrations. The arbitrators ultimately ordered class arbitration, finding, among other things, that Stolt-Nielsen's evidence did not reflect "an inten[t] to preclude class arbitration" and that its arguments would leave "no basis for a class action absent express agreement among all parties and the putative class members." (Opinion at p. 4.) A district court for the Southern District of New York vacated the award, holding that it was issued in manifest disregard of the law. The Court of Appeals for the Second Circuit subsequently reversed, finding that nothing in New York or maritime law established a rule against class arbitration and the decision was within the tribunal's discretion.

The Supreme Court's Decision in *Stolt-Nielsen*

In a decision by Justice Samuel Alito, the Supreme Court reversed, concluding that when arbitrators permit class arbitration based on factors other than party intent, and choose instead to resolve the question on policy grounds reserved to courts, they exceed their powers under the FAA. Emphasizing the core principle of contractual consent, the Court reasoned that the purpose of the FAA was to ensure the enforcement of arbitration agreements according to their terms. Since arbitration is a matter of contract, the parties may "'structure their arbitration agreements as they see fit'" (Opinion at p.19, *quoting Mastrobuono v. Shearson Lehman Hutton*, 514 U.S. 52, 57 (1995)), and may limit the issues and the parties with whom they choose to arbitrate. Based on these precepts, "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 parties *agreed* to do so." (Opinion at p. 20, emphasis in original.)

Thus, when facing an arbitration clause that is silent on an issue, the Court in *Stolt-Nielsen* ruled that the arbitrators' proper role is to analyze the parties' agreement and ascertain their actual intent with respect to the issue at hand. Because the contract at issue in *Stolt-Nielsen* evidenced no agreement as to class arbitration, the arbitrators were required to identify and apply "a rule of decision derived from the FAA or other maritime or New York law," to resolve the issue. (Opinion at p. 12.) The Court found that the tribunal had instead 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." (Opinion at p. 9.) Ultimately, the Court concluded that the arbitral tribunal's decision simply imposed the arbitrators' own policy

preferences on the parties and so exceeded their powers under the FAA.

In a dissent joined by two other justices, Justice Ruth Bader Ginsburg disagreed, characterizing the arbitrators' determination as a procedural decision that should be afforded broad judicial deference. The dissent also emphasized that the class recognized by the arbitrators was simply other customers, all of whom had signed contracts with similar arbitration provisions, and thus that the arbitration would only involve parties with whom Stolt-Nielsen had already consented to arbitrate.

The majority, however, saw the question of class arbitration as an entirely different type of decision. "[C]lass-action arbitration," wrote the Court, "changes the nature of arbitration to such a degree that it cannot be presumed that the parties consented to it by simply agreeing to submit their disputes to an arbitrator." (Opinion at p. 21.) These effects included a procedure involving hundreds or thousands of opposing parties rather than one, the lack of private and confidential proceedings, and the fact that the arbitrator's decision would bind absent parties. The Court also noted that while the commercial stakes of class-action arbitration are akin to those of class-action litigation, the scope of judicial review for class arbitration "is much more limited." (Opinion at p. 23.) Accordingly, the Court concluded that the differences in the two modes of 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." (Opinion at p. 23.)

For these reasons, the Court concluded that the tribunal had exceeded its powers under Section 10(a)(4) of the FAA. In avoiding reliance on the "manifest disregard" standard, the Court sidestepped the question of whether the standard, which is not expressly referred to in the FAA, survived the Court's decision in *Hall Street Associates, L. L. C. v. Mattel, Inc.*, 552 U. S. 576 (2008). (Opinion at p. 7, fn. 5.)

Significantly, the Court did not elaborate on the type of findings that would allow arbitrators to conclude that the parties had agreed to class-action arbitration: "We have no occasion to decide what contractual basis may support a finding that the parties agreed to authorize class-action arbitration." (Opinion at p. 23, fn. 10.) The dissent noted that this issue was left open and also asserted that the majority had suggested that "a contractual basis" could be established even in the absence of express language. (Dissent at p. 12-13.) The dissent also suggested that the majority's emphasis on the fact that the parties were "sophisticated business entities" meant that the Court's "affirmative-authorization requirement" did not apply to "contracts of adhesion presented on a take-it-or-leave-it basis," like the type at issue in *Bazzle*. (Dissent at p. 13.)

Impact and Open Questions

Since most arbitration clauses do not expressly permit class arbitration, most parties advocating a class approach will have to demonstrate intent through contract interpretation or default principles of contract law. While the decision leaves the door open to a finding of intent even in the absence of express language allowing class arbitration, this showing will often be difficult to make and consequently class action arbitrations are likely to diminish significantly.

However, the decision leaves open a number of important issues:

1. The Court has recognized the arbitrability of antitrust claims since its decision in *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth*, 473 U.S. 614 (1985). Does the likelihood

that class action arbitrations will be largely unavailable mean there will be no meaningful remedy for widely dispersed, small-value arbitration claims? The *Stolt-Nielsen* Court suggested that when the arbitrators weighed these types of considerations, they were improperly imposing their "own conception of sound policy." (Opinion at p. 11, fn. 7.) The dissent addressed this issue by observing that a number of courts had "invalidated contractual bans on, or waivers of, class arbitration" on just these grounds. (Dissent at p.11, fn. 10.) What if a state court determined as a matter of state law that class arbitration is presumptively allowed in such cases? Would this run afoul of the Court's restrictive contractual theory of the FAA?

One seeming paradox of the Court's present treatment of class arbitration is that while the *Bazzle* plurality gave the class issue to the arbitrators, *Stolt-Neilsen* emphasized that in making that determination the arbitrators could not act like courts. What if a state court determined that arbitrators could weigh these issues as a matter of state law? Given the ubiquity of arbitration clauses in consumer contracts, it is likely the Court will be facing issues like this in the future.

An important related question is that if unconscionability or a similar doctrine might invalidate such a clause, who decides this issue, the court or the arbitrators? Later this term, the Court will decide *Rent-A-Center, West, Inc. v. Jackson*, 581 F.3d 912 (9th Cir. 2009), *cert. granted*, 130 S. Ct. 1133 (U.S. 2010), which may shed light on the question of whether a court must address the enforceability of an arbitration clause claimed to be unconscionable even if the parties gave that power to the arbitrators.

2. The FAA is often invoked positively, as a basis for enforcing an arbitration agreement by compelling arbitration. The *Stolt-Neilsen* Court emphasized that the FAA was also restrictive, in that it prevented compelling arbitration beyond the scope of the parties' agreement. This view of the FAA as imposing limitations on agreements to arbitrate is not one that has recently enjoyed much currency in lower courts and may have application to other contexts, such as the proliferation of theories under which non-signatories are required to arbitrate.
3. Another question will be whether the Court's reliance on Section 10(a)(4) of the FAA and the "exceeding powers" standard to vacate the award will spawn additional challenges on this basis for other arbitral "procedural" decisions. The Section 10(a)(4) standard was better suited to the Court's critique, which was that the arbitrators had simply adopted their own standards, much as they would do acting as *amiable compositeur* or *ex aequo et bono*, rather than disregarded the law. The Court's opinion may nonetheless have the effect of popularizing this less utilized basis for review, especially in light of the uncertain future of the manifest disregard standard (an issue the court will inevitably have to face in the coming years).
4. Although this was an international arbitration (since Stolt-Nielsen is a non-US company), the Court did not have the occasion to consider the potentially difficult issue of whether a class arbitration award is enforceable outside of the United States.

Parties wishing to avoid class action arbitrations should consider including express language to that effect in their arbitration agreements. Such a clause has a high likelihood of being enforced in contracts between sophisticated entities (like the contracts at issue in *Stolt-Neilsen*). However the class arbitration issue has not been fully resolved and subsequent cases will probably present the issue of whether such clauses can be enforced in other circumstances.

If you have any questions about this *Client Alert*, please contact one of the authors listed below or the Latham attorney with whom you normally consult:

David J. McLean
+1.973.639.7276
david.mclean@lw.com
New Jersey

Mark D. Beckett
+1.212.906.2921
mark.beckett@lw.com
New York

Rachel W. Thorn
+33.1.40.62.20.48
rachel.thorn@lw.com
Paris

Marc R. Suskin
+212.906.1687
marc.suskin@lw.com
New York

Timothy Ho
+212.906.4670
timothy.ho@lw.com
New York
