CLEARY GOTTLIEB Alert Memo

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Supreme Court Rejects Class Arbitration

On April 27, 2010, the Supreme Court held that imposing class arbitration on parties who have not agreed to it is inconsistent with the Federal Arbitration Act, 9 U.S.C. §§ 1 et seq. ("FAA"). The 5-3 opinion delivered by Justice Alito in *Stolt-Nielsen S.A. et al. v. AnimalFeeds Int'l Corp.*[1] also addressed other important issues pertaining to review of arbitral awards.

I. Background to the *Stolt-Nielsen* Case

Stolt-Nielsen arose out of a demand for class arbitration of antitrust claims filed by AnimalFeeds seeking to represent a class of global purchasers of parcel tanker transportation services against Stolt-Nielsen and other parcel tanker shipping companies. The parties agreed that an arbitration panel, applying the American Arbitration Association's Supplementary Rules for Class Arbitrations, would determine whether class arbitration was permitted. In submitting the question to the panel, the parties stipulated that the arbitration clause was "silent" on the issue of class arbitration. In a partial award, the panel found that the arbitration clause in the parties' maritime contract permitted class arbitration.

Stolt-Nielsen petitioned the United States District Court for the Southern District of New York to vacate the award. The district court (Rakoff, J.) ruled in Stolt-Nielsen's favor, holding that the award was made in "manifest disregard" of the law because the arbitrators did not conduct a proper choice-of-law analysis. *Stolt-Nielsen SA v. AnimalFeeds Int'l. Corp.*, 435 F. Supp. 2d 382, 385-86 (S.D.N.Y. 2006). Had the arbitrators done so, the district court held, they would have applied federal maritime law and found that class arbitration was not permissible in light of custom and usage in the industry.

The United States Court of Appeals for the Second Circuit reversed, holding that courts may vacate arbitration awards for "manifest disregard" only in those rare instances in which "the arbitrator knew of the relevant [legal] principle, appreciated that this principle controlled the outcome of the disputed issue, and nonetheless willfully flouted the governing law by refusing to apply it." *Stolt-Nielsen SA v. AnimalFeeds Int'l. Corp.*, 548 F.3d 85, 95 (2d Cir. 2008) (internal citation and quotation marks omitted). Applying this standard,

[1] *Stolt-Nielsen S.A. et al. v. AnimalFeeds Int'l Corp.*, Docket No. 08-1198, 559 U.S. __ (2010) (available at http://www.supremecourt.gov/opinions/09pdf/08-1198.pdf). Justice Sotomayor did not participate in the consideration or decision of the case.

the Second Circuit found that the arbitration panel did not manifestly disregard any choice of law rules, rule of federal maritime law, or New York state law purportedly excluding the possibility of class arbitration.

II. The Supreme Court's Decision

The Supreme Court reversed the judgment of the Second Circuit, holding that the arbitration award should be vacated because the arbitrators, in interpreting the arbitration clause to permit class arbitration, had "exceeded their powers" under FAA § 10(a)(4).

According to the Court, FAA § 10(a)(4) applies in those cases where an arbitrator "strays from interpretation and application of the agreement and effectively dispense[s] his own brand of industrial justice." (internal quotations omitted). The Court criticized the panel for "proceed[ing] as if it had the authority of a common-law court to develop what it viewed as the best rule to be applied" when the arbitration clause does not provide "express consent" to class arbitration. It thus held that the arbitrators exceeded their powers in this case because "what the arbitration panel did was simply to impose its own view of sound policy regarding class arbitration." The Court concluded that the FAA's requirement to enforce the parties' agreement prohibited such a result: "[a]n implicit agreement to authorize class-action arbitration . . . is not a term that the arbitrator may infer solely from the fact of the parties' agreement to arbitrate."[2]

In articulating the appropriate rule, the Court emphasized the need for consent to class arbitration. The Court explained that the purpose of the FAA is to give effect to the parties' intent and to enforce private agreements to arbitrate according to their terms – including those governing *with whom* the parties choose to arbitrate. With this foundation laid, the Court set forth its holding:

> From these principles, 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 party *agreed* to do so. . . . Even though the parties are sophisticated business entities, even though there is no tradition of class arbitration under maritime law, and even though AnimalFeeds does not dispute that it is customary for the shipper to choose the charter party that is used for a particular shipment, the panel regarded the

[2] Concluding that the award should be vacated, the Court did not "direct a rehearing by the arbitrators" under FAA § 10(b), but instead proceeded to "decide the question that was originally referred to the panel" – whether the silent arbitration clause in this case permitted class arbitration. In doing so, the Court clarified that its decision in *Green Tree Financial Corp. v. Bazzle*, 539 U.S. 444 (2003), did not provide the rule to be applied in determining whether class arbitration is permitted where the contract is silent on the issue. The Court explained that the only question addressed by the *Bazzle* plurality was the question of *who* (the court or arbitrator) should decide whether the contract was indeed silent on the issue of class arbitration – a question that was not at issue here given the parties' agreement that the arbitration agreement was silent. By stressing the absence of a majority position on this issue in *Bazzle*, however, the majority opinion in *Stolt-Nielsen* may have opened the door to further development of the issue.

> agreement's silence on the question of class arbitration as dispositive. The panel's conclusion is fundamentally at war with the foundational FAA principle that arbitration is a matter of consent. (emphasis in original)

The Court's holding was bolstered by its conclusion that class arbitration is not a mere procedural issue presumptively for the arbitrator to decide. Rather, the Court stated that "class-action arbitration changes the nature of arbitration to such a degree that it cannot be presumed the parties consented to it by simply agreeing to submit their disputes to an arbitrator." It cited to the loss of such benefits of bilateral arbitration as "lower costs, greater efficiency and speed, and the ability to choose expert adjudicators to resolve specialized disputes," which the parties to an arbitration agreement expect to obtain in return for "forgo[ing] the procedural rigor and appellate review of the courts." It also emphasized the lack of any presumption of privacy or confidentiality in class arbitrations and the potential for the arbitrator's award to adjudicate the rights of absent parties. The Court also noted that "the commercial stakes of class-action arbitration are comparable to those of class-action litigation . . . even though the scope of judicial review is much more limited." Ultimately, the Court concluded that these "fundamental changes brought about by the shift from bilateral arbitration to class-action arbitration" were too much for the FAA to bear where the parties had not agreed to authorize class arbitration.

III. The Future of Class Arbitration and Court Review of Arbitral Awards

The *Stolt-Nielsen* decision is one of the most significant arbitration cases decided by the Supreme Court in recent years. It addresses and resolves several important issues regarding the proper scope of judicial review of arbitral awards and the permissibility of class arbitration. However, questions remain.

- In holding that the arbitrators exceeded their powers when they relied on policy arguments in support of their construction of the parties' agreement, the decision raised questions of whether an award must always be vacated under FAA § 10(a)(4) if the arbitrators interpret a contract based largely on public policy grounds.

- The Court also specifically declined to re-visit the question that it concluded was *not* definitively decided in *Bazzle*: whether the court or the arbitrator must decide in the first instance whether a contract permits class arbitration, where there is no agreement between the parties on that issue.

- In addition, the Court did not address whether the "manifest disregard" standard survives its decision in *Hall Street Assocs., L.L.C. v. Mattel, Inc.*, 552 U.S. 576 (2008), as an independent ground for vacatur of an arbitral award. This is so even though manifest disregard was the standard upon which both of the lower court decisions were based.

Other questions remain as well, including whether an arbitrator's decision to permit class arbitration is properly subject to immediate judicial review, and the standard a court should apply in choosing whether to direct a rehearing by the arbitrators or to decide the question originally referred to the panel. Until the Supreme Court decides to tackle these questions in the context of other cases, it will be up to the lower courts and the litigants before them to navigate these arbitral waters.

Please feel free to contact any of your regular contacts at the firm or any of our partners and counsel listed under any of the "Practices" section of our website (http://www.clearygottlieb.com) if you have any questions.

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