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Can Arbitrators Order Class Arbitration if the Arbitration Clause in a Maritime Agreement Is Silent on the Issue?

CASE AT A GLANCE

In this case, an arbitration panel held the maritime contracts at issue permitted class arbitration. The respondents had successfully argued that, because the arbitration clauses were silent on the question, arbitration on behalf of a class could proceed. The petitioners, however, contend that because the arbitration clauses were silent, the parties did not intend to permit class arbitration. The Supreme Court has now agreed to review the Second Circuit's ruling upholding the arbitrators' decision.

Stolt-Nielsen S.A. et al. v. Animalfeeds International Corp.
Docket No. 08-1198

Argument Date: December 9, 2009
From: The Second Circuit

by Jay E. Grenig
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ISSUE

When the arbitration clause in a maritime agreement is silent with respect to class arbitration, may the arbitrator require the matter be submitted to class arbitration?

FACTS

The petitioners (collectively Stolt-Nielsen) are predominantly foreign corporations operating parcel tankers that carry bulk chemical and other specialty liquids in individual tanks that can be separately chartered. The respondent Animalfeeds International Corp. is a multinational corporation that sells and ships animal feed internationally. Stolt-Nielsen and Animalfeeds entered into several shipping contracts providing for oceanic transportation of Animalfeeds' cargo. The contracts contained arbitration clauses but were silent with respect to class arbitration.

Animalfeeds claims Stolt-Nielsen is engaged in a global conspiracy to restrain competition in the world market for parcel tanker shipping services in violation of federal antitrust laws. Animalfeeds seeks to proceed in court on behalf of a class of all direct purchasers of parcel tanker transportation services. It filed suit in the U.S. District Court for the Eastern District of Pennsylvania in 2003. After the action was transferred to the District of Connecticut, Stolt-Nielsen moved to compel arbitration. The district court denied the motion. The Second Circuit reversed, holding the parties' transactions were governed by contracts with enforceable agreements to arbitrate. *JLM Indus., Inc. v. Stolt-Nielsen SA,* 387 F.3d 163, 183 (2d Cir. 2004).

The parties then agreed the arbitrators "shall follow and be bound by Rules 3 through 7 of the American Arbitration Association's Supplementary Rules for Class Arbitrations (as effective Oct. 8, 2003)." Rule 3 of the Supplementary Rules provides:

> Upon appointment, the arbitrator shall determine as a threshold matter, in a reasoned, partial final award on the construction of the arbitration clause, whether the applicable arbitration clause permits the arbitration to proceed on behalf of or against a class (the "Clause Construction Award").

The arbitration panel received evidence on the question of whether the contracts permitted or precluded class arbitration. Animalfeeds argued that, because the arbitration clauses were silent, arbitration on behalf of a class could proceed. Stolt-Nielsen's position was that, because the arbitration clauses were silent, the parties did not intend to permit class arbitration.

On December 20, 2005, the arbitration panel issued a Clause Construction Award deciding that the agreements permitted class arbitration. The panel based its decision largely on the fact that, in all 21 published clause construction awards issued under Rule 3 of the Supplementary Rules, the arbitrators had interpreted silent arbitration clauses to permit class arbitration. The panel did not certify a class or decide whether the arbitration should proceed as a class action.

Stolt-Nielsen petitioned the district court to vacate (set aside) the Clause Construction Award. The court granted the petition, concluding the award had been made in manifest disregard of the law. According to the district court, the arbitrators had "failed to make any meaningful choice-of-law analysis." *Stolt-Nielsen SA v. Animalfeeds Int'l Corp.,* 435 F.Supp.2d 382 (S.D.N.Y. 2006).

On appeal, the U.S. Court of Appeals for the Second Circuit reversed the district court. The Second Circuit held the arbitration panel had not manifestly disregarded the law by failing to engage in a choice-of-law analysis and by expressly identifying federal maritime law as

governing the interpretation of charter party language. 548 F.3d 85 (2d Cir. 2008). The Second Circuit explained the "manifest disregard" doctrine allows a reviewing court to vacate an arbitration award only in those exceedingly rare instances in which some egregious impropriety on the part of the arbitrators is apparent. The court stated that only if an arbitrator's decision strains credulity or does not rise to the standard of "barely colorable" may a court conclude the arbitrator willfully flouted the governing law by refusing to apply it. The Second Circuit returned the case to the district court with instructions to deny the petition to vacate the arbitration panel's decision. The U.S. Supreme Court granted review of the Second Circuit's decision. 129 S.Ct. 2793 (2009).

CASE ANALYSIS

The central purpose of the Federal Arbitration Act (9 U.S.C. § 1 et seq.) is to ensure that private agreements to arbitrate are enforced according to their terms. The Federal Arbitration Act does not mandate arbitration under any particular set of procedures; instead, the act leaves it to the parties to decide the nature and scope of their arbitration and the rules under which it will be conducted. Arbitrators derive their power only from the parties' agreement. In this case, the parties stipulated that their arbitration agreements were silent on the question of class arbitration. They differ on the legal implications of that silence.

By adopting Animalfeeds's position that class arbitration should be imposed as a matter of public policy even in the absence of any agreement by the parties allowing it, Stolt-Nielsen argues, the arbitration panel did not base its clause construction award on the actual intent of the parties, but rather on what it selected as a background rule of law to govern in the absence of party agreement. According to Stolt-Nielsen, imposing class arbitration where the parties have not explicitly agreed to it cannot be reconciled with the Supreme Court's mandate that arbitration under the Federal Arbitration Act is a matter of consent, not coercion. Stolt-Nielsen says that unexpected and involuntary class arbitration fundamentally alters the risks and benefits of the original arbitral bargain.

The petitioners also claim that imposing class arbitration transforms inherently limited commercial disputes into sprawling, high-stakes matters that the parties never agreed to resolve without the safeguards afforded by actual litigation. Stolt-Nielsen says that imposing class arbitration substantially alters many of the expected benefits of arbitration, such as flexibility, expedition, confidentiality, the parties' right to select different arbitrators to resolve particular disputes, and the promise of reliable, mutual repose once a dispute has been resolved.

It is the position of Stolt-Nielsen that uncertainty as to enforcement and finality is particularly acute in the context of international arbitration, because many countries do not allow class proceedings and may refuse to recognize the binding effect of class awards. Stolt-Nielsen asserts that imposing class arbitration in an international maritime case would be at odds with established practice in the rest of the world. It argues the point is not that class arbitration is necessarily unworkable in all circumstances, but that it is so different from traditional, bilateral arbitration that it may not properly be imposed under the guise of enforcing a conventional arbitration agreement that is silent on the issue.

Stolt-Nielsen contends this case presents no occasion for departing from the Federal Arbitration Act's central mandate that arbitration agreements be enforced only in accordance with their terms. First, it says the Supreme Court has made clear that efficiency or similar policy considerations provide no basis for going beyond the agreement of the parties. Second, the petitioners claim class proceedings (in arbitration or litigation) are not necessary to vindicate Animalfeeds' rights under the Sherman Antitrust Act.

Finally, Stolt-Nielsen stresses this case presents none of the issues that might arise in the context of consumer contracts of adhesion. It explains that all contracts are construed based on their own terms and context, and some consumer contracts may be properly construed, using conventional intent-based tools, to contemplate class arbitration—for example, by construing an ambiguous contract against a more sophisticated or economically dominant drafter. Alternatively, if true contractual silence results in the unavailability of class arbitration, Stolt-Nielsen says traditional principles such as fraud, duress, or unconscionability could lead a court to void an arbitration provision entirely under Section 2 of the Federal Arbitration Act.

Stolt-Nielsen asserts the parties in this case are sophisticated multinational corporations who negotiated international commercial shipping charters using industry forms typically designed and selected by charterers or their brokers (not by shipping companies). The finished forms reflect individual negotiations between the parties and have been in use for decades without any history of class arbitration. Under these circumstances, Stolt-Nielsen declares that arbitrators may not impose class arbitration on the basis of a contract that all agree reflects no agreement to permit it.

Claiming the Federal Arbitration Act forbids forcing parties into a class arbitration to which they never consented, Stolt-Nielsen argues that arbitrators who permit class arbitration without party consent have exceeded the powers conferred on them by the parties' agreement, and therefore federal courts must vacate their award.

Animalfeeds responds that what is at issue here is the preliminary decision of a unanimous panel of three experienced arbitrators who held that the parties' broad arbitration clause—requiring arbitration of "any dispute arising from the making, performance or termination of the contract"—permits the civil cases for restitution to be arbitrated on a class-wide basis. Animalfeeds explains that the parties' Supplemental Agreement assigned the task of construing the arbitration clause to the arbitrators.

According to Animalfeeds, parties agreeing to arbitrate trade away much of the value of ordinary judicial review. Instead, they agree to accept very minimal review of any matter delegated to the arbitrators. Thus, matters committed to arbitrators are subject to being set aside only on narrowly circumscribed statutory grounds on appeal—ordinary legal error does not suffice. Animalfeeds then argues the arbitrators did not exceed their powers in this case because they decided precisely what the parties had asked them to decide: whether the contract permits class arbitration.

According to Animalfeeds, class proceedings are not incompatible with arbitration. The respondent says hundreds of class proceedings have been successfully administered by major institutional arbitration service providers, including the American Arbitration

Association. The association administers these proceedings pursuant to the specialized sets of class arbitration rules they developed in response to the Supreme Court's ruling in *Green Tree Financial Corp. v. Bazzle,* 539 U.S. 444 (2003).

Animalfeeds asserts that, under the Supreme Court's decisions, state contract law governs interpretation of an arbitration clause, even when federal law creates the substantive claim. Animalfeeds explains the arbitrators permissibly held that, under traditional contract rules, a clause broadly providing for the arbitration of "any disputes" authorizes class arbitration, even though the clause itself was silent on the issue.

The respondents claim Stolt-Nielsen is seeking to have the arbitrators' ruling set aside, based on a proposed new Federal Arbitration Act–based rule barring class arbitration unless the contract specifically mentions class proceedings with approval. Animalfeeds says the Supreme Court has never read the Federal Arbitration Act as imposing any such limitation, and it should not do so now. Instead, Animalfeeds argues the statutory reference to interpretation of contracts "in accordance with their terms" requires resort to ordinary principles of state contract law, which it says is precisely what the arbitrators did here.

According to Animalfeeds, there is no justification for the Supreme Court to create a new federal maritime version of the petitioners' proposed rule. It reasons that the interests Stolt-Nielsen identifies with maritime arbitration are not specific to it, but broadly apply to arbitration in most international and domestic settings, and thus warrant no special rule. Animalfeeds argues that in agreeing to a broad arbitration clause without incorporating any specific procedural rules, Stolt-Nielsen took the risk that the arbitrators might apply rules it did not like.

Animalfeeds argues the established rule of contract interpretation requiring that contracts be read so as to serve the public interest adds support to the arbitrators' decision. It says that foreclosing class arbitration under broad arbitration clauses would lead either to the inefficiencies and unfairness of multiple, separate arbitrations on common issues, or, more realistically, make it untenable for would-be class members to proceed individually. Animalfeeds claims the enormous costs of duplicating the complex proof of antitrust injury in individual arbitrations would discourage most claimants from proceeding, resulting in dramatic under-enforcement of the Sherman Act.

Finally, Animalfeeds asserts the petition to vacate the arbitrators' decision is not ripe. Pointing out that the arbitrators have issued only an interim interpretation and have not decided whether to certify any class, Animalfeeds says that allowing review of the arbitrators' interim decision at this preliminary stage would turn on its head the Federal Arbitration Act's purpose of providing streamlined and simplified proceedings.

SIGNIFICANCE

Because the parties to an arbitration agreement have agreed to submit their dispute to arbitration to enhance efficiency, reduce costs, or maintain control over who would settle their disputes, the vacating of an arbitral award is unusual. According to the Supreme Court, the judicial review provisions of the Federal Arbitration Act should be seen as the substance of a national policy favoring arbitration with just the limited review needed to maintain arbitration's essential virtue of resolving disputes straightaway. *Hall Street Assoc., L.L.C. v. Mattel, Inc.,* 128 S.Ct. 1396 (2008). In *Hall Street,* the Supreme Court rejected the attempt of parties to an arbitration agreement to contract for expanded judicial review of arbitration awards. The Supreme Court concluded that the grounds for vacating an arbitration award set forth in the Federal Arbitration are exclusive.

The Court did not resolve the question of whether, under the Federal Arbitration Act, a court may vacate an arbitration award for manifest disregard of the law. Since *Hall Street,* courts have addressed the question of whether the manifest disregard doctrine survived *Hall Street.* Some have concluded that the doctrine did not, while others have suggested that manifest disregard is a judicial gloss on the specific grounds for *vacatur* enumerated in Section 10 of the Federal Arbitration Act.

A class arbitration is an arbitration proceeding brought by one or more claimants on behalf of many others who have a common legal claim. Class arbitrations have become more common in the last twenty years, and in *Green Tree Financial Corp. v. Bazzle,* 539 U.S. 444 (2003), the Supreme Court addressed the relationship between class actions and arbitration for the first time. *Bazzle* held that, when an arbitration clause in question does not clearly preclude class arbitration, the issue is one of state-law contract interpretation to be resolved by the arbitrator. Following *Bazzle,* four circuits have held it is for the arbitrator to determine whether a contract authorizes class arbitration, and two more have relied on *Bazzle* to assign to arbitrators similar issues, such as whether a clause permits consolidation.

This case presents the Supreme Court with the opportunity to clarify whether *Hall Street* precludes vacating an arbitration award on the ground of manifest disregard of the law. It also presents an opportunity to address a question not addressed in *Bazzle*—whether the Federal Arbitration Act prohibits class-action procedures from being imposed when the agreement does not provide for class-action arbitration.

It will be interesting to see whether the Supreme Court limits its decision to maritime arbitration agreements such as those at issue in this case, or whether it addresses the broader issues of manifest disregard of the law and whether the Federal Arbitration Act prohibits class-action procedures in all arbitrations under the Act—including consumer arbitration.

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PREVIEW of United States Supreme Court Cases, pages 133–136.

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