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Featured Article

Class Arbitration after *Stolt-Nielsen*

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The Supreme Court's disruptive April 27, 2010, decision in *Stolt-Nielsen S.A. v. AnimalFeeds International Corp.*, No. 08-1198, 559 U.S. ____, [2010 BL 92476](#) (Apr. 27, 2010), shifted the already unsettled landscape of class arbitration. In *Stolt-Nielsen*, the Court held that the Federal Arbitration Act (FAA), [9 U.S.C. §1-16](#), does not permit an arbitrator to impose his own view of public policy as a rationale for upholding class arbitration treatment of a dispute. This narrow ruling has already inspired a number of wrongheaded analyses predicting the end of class arbitration and suggesting that arbitration agreements must expressly provide for class treatment in order for class arbitration to proceed.

The perils of these analyses are highlighted, from a practical point of view, in the consumer and employment contexts and in adhesion contracts, where potential claimants, often with small claims, enter into standardized contracts which contain arbitration clauses that are "silent" on the availability of class arbitration. In these contexts, to attempt to find a mutual intent is indeed an exercise in impracticability and frustration. If these impractical arguments prevail, vast swaths of potential claimants will have no remedy. They will be forced to arbitration to resolve potentially individual claims for minor amounts, at egregious expense, and be deprived of the recourse available to them via the class treatment. Arbitrators and judges should appreciate the quicksand of these arguments and interpret *Stolt-Nielsen* to permit class arbitration when practicable and permissible under applicable law.

Factual Background

Plaintiff AnimalFeeds International Corp. entered into bilateral "charter party" oceanic shipping contracts with defendant Stolt-Nielsen S.A. Under the "charter party" agreements, Stolt-Nielsen would ship AnimalFeeds' cargo of specialty liquids via its ocean tankers. The "charter party" agreements contained a standard arbitration clause requiring any dispute between the parties to be submitted to arbitration.

In September of 2003, following a criminal investigation by the federal government, AnimalFeeds filed a class action suit against Stolt-Nielsen, alleging that Stolt-Nielsen engaged in a conspiracy to fix prices and restrain competition in the world market for tanker shipping services in violation of federal antitrust laws and thereby caused AnimalFeeds and parties similarly situated to overpay for shipments.

Other companies who chartered Stolt-Nielsen brought similar suits around the country, ultimately consolidated as Multidistrict Litigation in the U.S. District Court for the District of Connecticut. In one of these pending cases, Stolt-Nielsen moved to compel arbitration. The district court held that the claims were not subject to arbitration. This was appealed to the U.S. Court of Appeals for the Second Circuit, which reversed and compelled arbitration. This decision was not reviewed by the Supreme Court.

In May of 2005, AnimalFeeds commenced a class arbitration pursuant to [Rule 1](#) of the American Arbitration Association's (AAA) Supplementary Rules for Class Arbitrations. The rules were developed in response to the 2003 Supreme Court decision in *Green Tree Financial Corp. v. Bazzle*, [539 U.S. 444](#) (2003), which requires an arbitrator to determine the threshold issue of whether parties to an arbitration agreement intended to permit class arbitration. AnimalFeeds and Stolt-Nielsen submitted the class arbitration question to a panel of three arbitrators and stipulated that the arbitration provision was "silent" on the class arbitration question. The parties defined this "silence" to mean that they had reached no agreement on whether to permit class arbitration.

The arbitration panel decided that the "charter party" agreements were subject to class arbitration, after reviewing a number of factors to determine the intent of the parties. It reviewed case law, including *Bazzle* and post-*Bazzle* cases, the "custom and usage" of arbitration provisions within maritime law, and deliberations about which law applies—maritime law, the FAA, or New York state law.

Stolt-Nielsen moved, in the U.S. District Court for the Southern District of New York, to vacate the arbitration panel's decision. Stolt-Nielsen argued that maritime law and New York law permit the review of "custom and usage" to determine the intent of the parties to a contract. Stolt-Nielsen then submitted evidence from maritime law experts that, within the oceanic shipping industry, arbitration provisions such as these are not understood to permit class arbitrations. The Southern District vacated the arbitration panel's decision and held that the arbitrators acted with a "manifest disregard" for the law.

This decision was reversed by the Second Circuit, which held that the arbitration panel had not acted with "manifest disregard" of the law. The Second Circuit relied on

two key factors. First, the Second Circuit noted that the arbitration panel was not presented with the assertion that maritime law controlled the question. Second, the court also disagreed that the custom and usage of maritime law amounted to a legal rule that class arbitration is prohibited. In short, the Second Circuit held that while the Southern District disagreed with the arbitration panel, the panel had not acted in manifest disregard of the law. It is on this issue that the Supreme Court granted Stolt-Nielsen's petition for writ of certiorari in the summer of 2009.

Supreme Court Decision

In a 5-3 opinion written by Justice Samuel Alito, joined by Justices Anthony Kennedy, Antonin Scalia, Clarence Thomas, and Chief Justice John Roberts and in which Justice Sonia Sotomayor took no part, the Court held that the FAA does not permit an arbitrator to use public policy as a rationale to impose class arbitration on parties who have not agreed to authorize class arbitration. The arbitrators, the Court stated, failed to "identify the rule of law that governs" and further failed to ascertain whether applicable law contained a "default rule" pursuant to which the arbitration clause should be construed.

The opinion focused on the foundational premise that arbitration "is a matter of consent, not coercion." "This is because an arbitrator derives his or her powers from the parties' agreement to forgo the legal process and submit their disputes to private dispute resolution." 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. In this case, however, the arbitration panel imposed class arbitration even though the parties concurred that they had reached "no agreement" on that issue.

The Court reasoned that, if an arbitration panel compels class arbitration without evidence of a contractual basis for concluding that the parties agreed to do so and instead makes its decision on what makes "sound policy," the panel's decision is to be vacated under [Section 10\(a\)\(4\)](#) of the FAA on the basis that the arbitration panel "exceeded its powers." The Court relied heavily on the fact that the contracting parties in *Stolt-Nielsen* had previously stipulated that the arbitration agreement was "silent." This silence, according to the Court, meant that the arbitration panel had "no room for an inquiry regarding the parties' intent" and therefore had, in effect, "dispensed [their] own brand of industrial justice" and "imposed its own policy choice and thus exceeded its powers." The Court stated the panel "did not mention whether any of these decisions were based on a rule derived from the FAA or on maritime or New York law." Instead, the panel discussed what it saw as the established post-*Bazze* consensus that class arbitrations are valuable tools in a wide variety of contexts.

The dissent, written by Justice Ruth Bader Ginsburg and joined by Justices John Paul Stevens and Stephen Breyer, is most useful in its identification of two "stopping points in the Court's decision." First, the dissent pointed out that the Court's opinion "does not insist on express consent to class arbitration," but only requires a "contractual basis" to conclude that the parties' intent was to agree to class arbitration. This "contractual basis" was left undefined, in so far as it was not public policy. ("We have no occasion to decide what contractual basis may support a finding that the parties agreed to authorize class-action arbitration.") Second, the dissent pointed out that the Court's opinion relied on the fact that the parties in *Stolt-Nielsen* were sophisticated parties who negotiated the arbitration agreement at arm's length. By highlighting this fact, "the Court apparently spare[d] from its affirmative-authorization requirement contracts of adhesion presented on a take-it-or-leave-it basis."

Practical Implications

The potential implications of the *Stolt-Nielsen* decision are weighty. The Court did not address the implications of "silence" in adhesion contracts, nor did it address the implications of a post-*Bazzle* drafted arbitration clause in both adhesion and consensual agreements.

In practical terms, most arbitration agreements are written in broad and general terms, requiring, for example, that "any dispute" go to arbitration. Many arbitration agreements do not explicitly address class arbitration, and still more expressly prohibit it. Businesses will see the *Stolt-Nielsen* decision as a tool to avoid class arbitration, defy arguments that prohibitions on class arbitrations are unconscionable, and vacate class arbitration clause construction awards on the basis that the decision was in excess of the arbitrators' powers. These arguments from businesses will make vulnerable potential plaintiffs in the consumer and employment contexts. These are the people who are most likely to have small individual claims and who are most likely to have entered into contracts of adhesion. For them, foreclosing class arbitration would be a practical bar to all remedies. Yet, the *Stolt-Nielsen* case, properly understood, does not disturb these plaintiffs' rights to class arbitration.

The facts of *Stolt-Nielsen* are availing. The parties to the arbitration agreement in *Stolt-Nielsen* were sophisticated parties who engaged in arms-length bargaining. The arbitration agreement was "silent" on the question of class arbitration, but, as the Court emphasized, "silent" meant something specific. The parties expressly stipulated to the arbitration panel (and to the Court) that "silent" meant that the parties had reached no agreement on whether to permit class arbitration. While "silent" might suggest to most practitioners simply that the arbitration agreement did not contain

an explicit provision prohibiting or permitting class arbitration, it is vital to understand that this is not how the term "silent" is used in the *Stolt-Nielsen* opinion. In short, the *Stolt-Nielsen* parties *intended to be silent* on the issue of class arbitration.

Importantly, unlike in *Stolt-Nielsen*, adhesion contracts present the weaker party with no opportunity to express *intent*. "Courts and arbitrators must not lose sight of the purpose of the exercise: to give effect to the intent of the parties." This removes the foundation of the *Stolt-Nielsen* analysis in adhesion contracts.

Arbitration agreements that expressly prohibit class arbitration will likely fail to provide shelter for potential defendants in the consumer and employment spheres. There is currently a circuit split on the question of the unconscionability of express prohibitions on class arbitration. In the recent case, *In re American Express Merchants' Litigation*, [554 F.3d 300](#) (2d Cir. 2009), the Second Circuit struck down an arbitration clause "preclud[ing] the signatory from having any claim arbitrated on anything other than an individual basis." The Second Circuit held that, by denying parties the right to pursue small claims as part of a larger class, the arbitration clause imposed an unjust process that was prohibitively expensive and thus unconscionable and unenforceable. The Supreme Court will soon resolve this circuit split: In late May 2010, the Court granted certiorari in *AT&T Mobility v. Concepcion*, [584 F.3d 849](#) (9th Cir. 2009), *cert. granted*, No. 09-893, 560 U.S. ____, [2010 BL 115513](#) (May 24, 2010) (09-893).

Similarly, the custom and usage of class arbitrations in the consumer and employment categories is not the rarity that it was in *Stolt-Nielsen's* maritime law. According to the AAA's amicus brief in *Stolt-Nielsen*, more than 69 percent of its class arbitration cases "can be categorized as disputes between businesses and consumers or employees." Consumer and employment disputes remain the paradigmatic examples of the utility of class actions.

Towards a Default Rule

Stolt-Nielsen leaves courts looking to craft a rule for arbitration agreements that do not expressly permit or prohibit class arbitration. While *Stolt-Nielsen* may provide a ready rule for cases in which "silent" takes the specific meaning stipulated to by its plaintiff and defendant, future defendants will use it to disrupt the class arbitration process when "silent" takes its more common meaning. *Stolt-Nielsen* invites courts to expressly determine a new default rule in consumer, employment, and other adhesion contract disputes in which a standard arbitration provision reads broadly but without explicit permission or prohibition of class arbitration.

A new practical default rule, in which due process, efficiency, and practicality are paramount, must be developed in this context if the holding and rationale of *Stolt-Nielsen* is to survive the test of time. Such a rule will "give effect to the contractual rights and expectations of the parties" while acknowledging the practical differences of contract interpretation necessitated by adhesion contracts and the like, where mutual intent is not a reality. Still other contractual bases, such as the unconscionability of any prohibition on class actions or class arbitrations, may support a clause construction in favor of class arbitration.

A potential default rule for arbitrators and courts to consider in the consumer, employment, and adhesion contexts is that class arbitration is permitted where an arbitration agreement reads in broad and general terms but does not expressly permit or prohibit class arbitration. Moreover, in certain adhesion contracts, the prohibition of class action treatment should be analyzed in the context of litigation efficiency and economic pragmatism. This carves out a space for *Stolt-Nielsen* to continue to permit sophisticated parties to contract in or out of class arbitration without explicit specific terms while protecting the ability of plaintiffs to seek what may be their only practical and viable remedy.

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