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Arbitration and the U.S. Supreme Court: Class Actions, Manifest Disregard, and the Ongoing Debate over U.S. Judicial Review of Arbitral Awards

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Businesses likely to end up as defendants in multiple-plaintiff proceedings may find much to be thankful for in the U.S. Supreme Court's recent decision in *Stolt-Nielsen S.A. v. AnimalFeeds International Corp.*[1] But the price of this victory remains to be seen, given what some might perceive as the interventionist road the Court took to vacate the arbitral ruling at the heart of the case. Although *Stolt-Nielsen* may appear striking at first glance, however, upon further examination it seems unlikely to have a significant impact on the scope of judicial review of most arbitral awards.

Majority Opinion

In the long-awaited decision in *Stolt-Nielsen*, the Court, by a 5-3 vote, with Justice Samuel Alito writing for the majority,[2] held that the arbitral panel that had issued a preliminary order authorizing class treatment of antitrust claims against Stolt-Nielsen arising out of a maritime charter party contract did not have the power to issue that award under the Federal Arbitration Act (FAA).[3] The parties had stipulated before the arbitration began that the two-party (or "bilateral") arbitration clause at issue was "silent" on the question of whether class treatment was permitted. According to the Court, in light of the "fundamental changes brought about by the shift from bilateral arbitration to class-action arbitration," and arbitrators' "limited powers under the FAA," class arbitration could not be imposed based merely on the arbitrators' finding that there was no "inten[t] to preclude class arbitration."[4] The Court ruled that the parties' stipulation that they had reached "no agreement" on the propriety of class treatment was dispositive of the issue, and, as a matter of law, no arbitral panel could reach another conclusion consistent with "the foundational FAA principle that arbitration is a matter of consent."[5]

What makes *Stolt-Nielsen* appear particularly striking is that the Court reversed the arbitral panel's decision despite the fact that the parties had expressly and unambiguously agreed to submit the question of class treatment to a panel of three arbitrators acting under the so-called "Class Rules" of the American Arbitration Association (AAA),[6] which require an arbitrator to decide as a threshold matter whether the applicable arbitration clause permits the arbitration to proceed on a class basis. This aspect of the case moved Justice Ruth Bader Ginsburg to write in

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her dissent, "[t]he Court acts without warrant in allowing Stolt-Nielsen essentially to repudiate its submission of the contract-construction issue to the arbitration panel, and to gain, in place of the arbitrators' judgment, this Court's *de novo* determination."[7] Nonetheless, after acknowledging that petitioners would need to "clear a high hurdle" to obtain a reversal of the arbitral panel's ruling, the Court ruled that this standard had been met because, in its view, the panel had failed to "identify[] and apply[] a rule of decision derived from the FAA or either maritime or New York law," but instead had "imposed its own policy choice and thus exceeded its powers."[8] Indeed, the Court refused even to remand the class-treatment decision to the arbitral panel for further consideration. Instead, the Court concluded that there was "only one possible outcome on the facts," and it conclusively vacated the class-action arbitral order, leaving the arbitration to proceed on a bilateral basis.[9]

Stolt-Nielsen's Significance

The decision in *Stolt-Nielsen* is unquestionably one of the Court's most significant cases—if not *the* most significant case—in the arbitration field since its 2008 decision in *Hall Street Associates. LLC v. Mattel, Inc.*,[10] in which the Court declared that the statutory grounds for judicial review of arbitration awards provided by the FAA are exclusive. The decision in *Hall Street* was understood in many quarters as providing strict limits on the extent to which U.S. courts acting under federal law could review arbitral awards. Indeed, the *Hall Street* decision led the Fifth Circuit Court of Appeals to go so far as to reject the notion that U.S. courts can overturn arbitral awards, consistent with the FAA, based on a judicial determination that an arbitral award was issued in "manifest disregard of the law," holding that *Hall Street* now forecloses such judge-made standards for review.[11] And on April 30, 2010, three days after the Court handed down *Stolt-Nielsen*, the Eleventh Circuit joined the Fifth Circuit in holding that "manifest disregard of the law" could not form the basis for a legal challenge to the validity of an arbitral award.[12]

Review of Arbitral Awards

Stolt-Nielsen raises the immediate question of whether, by reaching out to overturn what was arguably a considered decision of an arbitral panel, the Court erased the limits on review of arbitral awards it had confirmed only two years before in *Hall Street*. Whatever one thinks of the correctness of the Court's reasoning in *Stolt-Nielsen*, however, a careful reading of the majority's opinion suggests that the decision will almost certainly not have a meaningful impact on the standard of review of arbitral awards under the FAA, at least outside the class arbitration context.

There are at least two reasons to think that *Stolt-Nielsen* will not—and, in any case, should not—give rise to a new wave of judicial intervention and intrusive review of arbitration awards, which by their very design are intended to finally resolve disputes in a manner that provides an alternative to court litigation. First, as previously noted, the majority opinion in *Stolt-Nielsen* makes clear that parties seeking vacatur of an arbitration award "must clear a high hurdle," and that the existence of "an error—or even a serious error" in the reasoning underlying an award will be insufficient to clear that hurdle.[13] Quoting decisions from the labor arbitration context, the *Stolt-Nielsen* majority goes on to stress that "'[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.'"[14] This high

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standard for judicial intervention to overturn an arbitral award should continue to deter judicial challenges to arbitration decisions.

Second, the decision in *Stolt-Nielsen* is significantly driven by the Court's reluctance to endorse what it perceived as the policy arguments behind the arbitral panel's conclusion that it was appropriate to accord class action treatment to the antitrust claims brought by AnimalFeeds on behalf of itself and other shippers, which arose out of allegations that Stolt-Nielsen had participated in a worldwide cartel to set prices in the market for parcel tankers. In concluding that the panel decision to authorize class treatment of antitrust claims against Stolt-Nielsen was "fundamentally at war with the foundational FAA principle that arbitration is a matter of consent," the Court criticized the arbitral panel's decision for having endorsed class action treatment "[e]ven 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 [i.e., the contract form, including the applicable arbitration clause] that is used for a particular shipment."[15]

The Court went on to stress that the benefits of arbitration, namely "lower costs, greater efficiency and speed, and the ability to choose expert adjudicators to resolve specialized disputes," are "much less assured" in the case of class arbitrations.[16] Noting the possibility that an arbitrator hearing class claims might be called upon to "resolve[] many disputes between hundreds or perhaps even thousands of parties," the Court observed that, under the AAA Class Rules, "the presumption of privacy and confidentiality" would not apply, the resulting award would bind absent parties, and the award would also expose respondents to the potentially enormous "commercial stakes" of class-wide relief without the various protections and rights of appellate review that are available in court.[17]

Viability of Manifest Disregard Doctrine

Although *Stolt-Nielsen* probably does not herald a significant expansion of the standards for judicial review of arbitral awards, litigants and lower courts will most assuredly be sorting through the Court's language in *Stolt-Nielsen* for some time to come. One thing that seems clear is that *Stolt-Nielsen* has kept alive the judicial debate over the viability of the "manifest disregard" doctrine, a debate that reveals itself in different approaches taken by the circuit courts concerning the continued viability and meaning of the doctrine.[18] Because the district court opinion in *Stolt-Nielsen* was based on a finding of "manifest disregard," the Court had an opportunity to address these questions. Unfortunately, however, the Court avoided them, explicitly stating that "[w]e do not decide whether 'manifest disregard' survives our decision in [*Hall Street*]."[19] Further litigation over the confusing and costly "manifest disregard of the law" standard will likely continue until the Court directly addresses that standard's validity and role.

Non-Signatories

Another potential effect of *Stolt-Nielsen* may be to alter the arguments available in disputes concerning whether non-signatories to arbitration agreements may nonetheless be required to arbitrate in a particular circumstance, for reasons of corporate or other legal or factual relationships to the parties or the disputes at

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issue.[20] By focusing heavily on the importance of consent and the fact that "parties may specify *with whom* they choose to arbitrate their disputes," [21] *Stolt-Nielsen* will undoubtedly give rise to new arguments in the lower courts that expansion of the circle of parties beyond those that have formally executed an agreement to arbitrate is prohibited by the FAA, as the statute has been interpreted in *Stolt-Nielsen*. As in *Stolt-Nielsen*, however, each such case will continue turn on its own facts and, in particular, whether those facts justify a finding of consent or other legal basis for requiring a non-signatory to arbitrate.

Class-Action Waiver Cases

Finally, it should come as no surprise that *Stolt-Nielsen* may significantly affect the status of other class-arbitration cases, as well as the status of certain other cases that involve the interplay between arbitration and class actions in other contexts. Indeed, the week after the Court decided *Stolt-Nielsen*, it granted certiorari and then vacated and remanded the Second Circuit's judgment in the long-running *American Express Merchants' Litigation* for further consideration in light of *Stolt-Nielsen*,[22] a determination that implies the Court was convinced that *Stolt-Nielsen* may well have a dispositive impact on the case.[23]

American Express involves a class-action waiver provision incorporated into contracts the credit-card issuer American Express had entered into with thousands of businesses. In its opinion, the Second Circuit held the waiver to be unenforceable as "incompatible with the federal substantive law of arbitration," based on its ruling that enforcement of the waiver would effectively prevent plaintiffs from enforcing their rights under the Sherman Act.[24] Yet if American Express's counterparties are considered to be "sophisticated parties" in the same manner as AnimalFeeds, *Stolt-Nielsen*'s emphasis on the importance of consent as a "foundational FAA principle" could well dictate a different result in *American Express* and similar class-action waiver cases, where it is beyond dispute that the arbitration clauses in question contain no consent to class arbitration or other forms of class adjudication. In *American Express*, if the Second Circuit stands its ground, it is likely that the case will be back in the Supreme Court relatively quickly.

In another development with potentially significant implications for the enforceability of class-action waivers—although with little potential to affect more broadly the scope of judicial review of arbitral awards—on May 24, 2010, the Supreme Court granted certiorari in *AT&T Mobility LLC v. Concepcion*, to address the question of whether the FAA preempts state law principles that would otherwise lead to the invalidation of a class-action waiver in an arbitration clause as unconscionable.[25]

In *Concepcion*, the Ninth Circuit found that a class-action waiver provision in a consumer cell phone contract was unconscionable, and thus unenforceable, under California law.[26] The court then disagreed with AT&T's argument that the FAA preempted California law on this issue, finding that "[t]he FAA 'does not bar federal or state courts from applying generally applicable state contract law principles and refusing to enforce an unconscionable class action waiver in an arbitration clause.'"[27] As the court went on to explain, although the FAA will preempt state law grounds that invalidate an arbitration clause where such grounds are not applicable to a contract in general, the FAA will not preempt a generally applicable contract defense that invalidates an arbitration clause.[28] Assuming the Supreme Court addresses the

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issue in this case in the manner it seems to be presented by the Ninth Circuit, the Court's decision could have a substantial impact in jurisdictions where state unconscionability doctrines have been successfully invoked to nullify class-action waivers in arbitration clauses.

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[1] No. 08-01198, 599 U.S. ___, 2010 BL 92476 (Apr. 27, 2010).

[2] The majority also included Chief Justice John Roberts and Justices Anthony Kennedy, Antonin Scalia, and ClarenceThomas. Justice Ruth Bader Ginsburg, joined by Justices John Paul Stevens and Stephen Breyer, dissented. Justice Sonia Sotomayor did not participate in the decision.

[3] 9 U.S.C. §§ 1-16.

[4] *Stolt-Nielsen*, supra note 1, at *20, *22-*23.

[5] *Id.* at *20.

[6] These rules are formally known as the American Arbitration Association's Supplementary Rules for Class Arbitrations (effective as of October 8, 2003).

[7] *Stolt-Nielsen*, supra note 1, at *6 (Ginsburg, J., dissenting).

[8] *Stolt-Nielsen*, supra note 1, at *7, *12.

[9] *Id.* at *12.

[10] 552 U.S. 576 (2008).

[11] *See Citigroup Global Mkts., Inc. v. Bacon*, 562 F.3d 349, 353-55 (5th Cir. 2009).

[12] *Frazier v. CitiFinancial Corp., LLC*, 604 F.3d 1313 (11th Cir. 2010).

[13] *Stolt-Nielsen*, supra note 1, at *7.

[14] *Id.* (quoting *Major League Baseball Players Ass'n v. Garvey*, 532 U.S. 504, 509 (2001) (per curiam)).

[15] *Id.* at *20.

[16] *Id.* at *21-*22.

[17] *Id.* at *22-*23.

[18] *See, e.g.*, *Frazier*, supra note 12, at *22-*24 (noting the different approaches to the "manifest disregard" test taken by the Fifth and First Circuits, the Second and Ninth Circuits, and the Sixth Circuit).

[19] *Stolt-Nielsen*, supra note 1, at *7 n.3.

[20] *See, e.g.*, *Sourcing Unlimited, Inc. v. Asimco Int'l, Inc.*, 526 F.3d 38, 47-48 (1st Cir. 2008); *JP Morgan Chase & Co. v. Conegie*, 492 F.3d 596, 600 (5th Cir. 2007); *Am. Bankers Ins. Group, Inc. v. Long*, 453 F.3d 623, 627-30 (4th Cir. 2006); *CD Partners, LLC v. Grizzle*, 424 F.3d 795, 798-800 (8th Cir. 2005); *JLM Indus., Inc. v. Stolt-Nielsen S.A.*, 387 F.3d 163, 177-78 (2d Cir. 2004).

[21] *Stolt-Nielsen*, supra note 1, at *19 (emphasis in original).

[22] *In re Am. Express Merchants' Litig.*, 554 F.3d 300 (2d Cir. 2009), *vacated and remanded for further consideration in light of Stolt-Nielsen S.A. v. AnimalFeeds, Inc.*, No. 08-01473, 2010 BL 98084 (U.S. May 3, 2010).

[23] In addressing the meaning of a "grant, vacate and remand" order, the Court has noted that such an order "is appropriate when 'intervening developments . . . reveal a reasonable probability that the decision below rests upon a premise that the lower court would reject if given the opportunity for further consideration, and where it appears that such a redetermination may determine the ultimate outcome.'" *Wellons v. Hall*, 130 S. Ct. 727, 731, 175 L. Ed. 2d 684, 688 (2010) (quoting *Lawrence v. Chater*, 516 U.S. 163, 167 (1996) (per curiam)).

[24] *See In re Am. Express Merchants' Litig.*, supra note 22, at 312, 319–20.

[25] *See Laster v. AT&T Mobility LLC*, 584 F.3d 849 (9th Cir. 2009), *cert. granted sub nom AT&T Mobility LLC v. Concepcion*, No. 09-00893, 2010 BL 115513 (U.S. May 24, 2010).

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[26] *Id.* at 855–56.

[27] *Id.* at 856 (quoting *Shroyer v. New Cingular Wireless Serv., Inc.*, 498 F.3d 976, 987 (9th Cir. 2007)).

[28] *Id.* at 857. In support of this proposition, the court noted that "[t]he FAA provides that arbitration clauses 'shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract'" *Id.* (quoting 9 U.S.C. § 2).

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