Appellate Review of Arbitration Awards after *Stolt-Nielsen*

By Linda L. Morkan

In late April 2010, the U.S. Supreme Court issued *Stolt-Nielsen S.A. v. AnimalFeeds International Corp.*, a headline-grabbing decision on the question of whether a "class action arbitration" can be held under the Federal Arbitration Act (FAA) where the parties' arbitration agreement does not explicitly address the availability of such a unique procedure.[1] This issue had been nominally taken up by the Court in 2003's *Green Tree Financial Corp v. Bazzle*,[2] but the Court was unable to reach a majority decision, issuing instead a plurality opinion remanding the case to the arbitrator for a factual determination on whether the parties' agreement prohibited or permitted class arbitrations.[3] But reach a decision it finally did in *Stolt-Nielsen*, approximately five months after a lively oral argument that saw counsel for the petitioner fielding many more preliminary questions than expected (i.e., addressing issues of ripeness and reviewability). The Court held in a 5–3 decision[4] that the arbitration panel "exceeded its powers" by ordering Stolt-Nielsen to proceed with class arbitration despite the lack of a factual finding that Stolt-Nielsen had ever agreed to arbitrate disputes on a class-wide basis. The majority held that to make such an order was inconsistent with the FAA.[5] "The panel's conclusion is fundamentally at war with the foundational FAA principle that arbitration is a matter of consent."[6]

As important as this holding is to the business community and attorneys who handle class actions, however, *Stolt-Nielsen* is also of interest to appellate lawyers who handle arbitration matters, as much for what was *not* said by the majority as what was.

Arbitration appeals are a special breed. In addition to knowledge of the substantive matters raised, they require an in-depth understanding of the statutory grounds for judicial review of arbitral decisions, as well as the "judicial gloss" that has been applied now and then. As evidenced by the bumpy oral argument in *Stolt-Nielsen*, that case offered perhaps more than its share of roadblocks to review of the ultimate issue, including questions of ripeness, standard of review, and statutory authority. That the Supreme Court so neatly sidestepped those issues and addressed the merits—over the loud objections of the vocal minority—warrants closer examination.

The Underlying Proceedings

AnimalFeeds International Corp. filed a class action against four major maritime shipping companies (collectively "Stolt-Nielsen"), alleging price-fixing. After the action was consolidated with similar pending actions, Stolt-Nielsen sought to compel arbitration based on its standard form contracts.[7] Although the district court denied that motion, the Second Circuit reversed and remanded, holding that the antitrust claims were arbitrable.[8] This was the first round of appeals.

AnimalFeeds thereafter demanded class arbitration. The parties ultimately agreed to submit the question of class arbitrability in accordance with the AAA Supplementary Rules for Class Arbitration. Supplementary Rule 3 empowers an arbitrator to determine "whether the applicable arbitration clause permits the arbitration to proceed on behalf of or against a class."[9] These Supplementary Rules had been adopted following the 2003 *Bazzle* decision, where a plurality of the Court had held that the question whether the arbitration agreement permits class arbitration is generally one of contract interpretation to be decided by the arbitrators, not by the court.[10] In keeping with the then-current understanding of how such a determination was to be made, AnimalFeeds and Stolt-Nielsen submitted a joint stipulation to the arbitration panel that stated that the arbitration clause was "silent" with respect to class arbitration. More specifically, AnimalFeeds's counsel told the panel that the term "silent" did not simply mean that the clause made no express reference to class arbitration. Rather, he said, "[a]ll the parties agree that when a contract is silent on an issue there's been no agreement that has been reached on that issue."[11]

AnimalFeeds argued that class arbitration should be ordered because such a proceeding was not specifically prohibited by the clause, citing to arbitral authorities that held that the "default rule" should favor arbitration in light of silence on the issue. AnimalFeeds also argued that the arbitration clause would have to be found to be unconscionable and unenforceable if it forbade class arbitration.[12]

Stolt-Nielsen's position, however, was that silence could never equal consent: Because arbitration is peculiarly a matter of mutual agreement, it argued, there must be explicit language or evidence that the parties intended to submit themselves to class arbitration. Without one or the other, Stolt-Nielsen reasoned, the arbitrators were without authority to order such a proceeding.[13]

The arbitrators rejected Stolt-Nielsen's arguments. Relying on the fact that some 20-odd other arbitration awards decided under Supplementary Rule 3 interpreted a silent contract as one permitting class arbitration, the arbitrators determined that the agreements at issue should be treated no differently.

Stolt-Nielsen filed a petition with the district court pursuant to the FAA to vacate the arbitrators' decision, initiating what would become the round of appeals culminating in the Supreme Court decision. The FAA requires that a court reviewing an arbitration award grant "great deference" to the panel's decision.[14] Section 10(a) of the act allows vacatur only:

(1) where the award was procured by corruption, fraud, or undue means
(2) where there was evident partiality or corruption in the arbitrators, or either of them

(3) where the arbitrators were guilty of misconduct in refusing to postpone the hearing, upon sufficient cause shown, or in refusing to hear evidence pertinent and material to the controversy; or of any other misbehavior by which the rights of any party have been prejudiced
(4) where the arbitrators exceeded their powers, or so imperfectly executed them that a mutual, final, and definite award upon the subject matter submitted was not made[15]

In addition, as a corollary to or subpart of section 10(a)(4), a party could historically obtain vacatur if he or she could establish that the arbitrator exhibited a "manifest disregard of the law."[16] In any other instance, despite the obviousness or severity of an arbitrator's error, the deferential standard required that the award be confirmed.[17]

In its application to vacate the decision ordering class arbitration, Stolt-Nielsen argued that the arbitrators had manifestly disregarded the applicable law precluding class arbitrations.[18] To vacate an arbitration award for manifest disregard of the law, the Court must find "both that (1) the arbitrators knew of a governing legal principle yet refused to apply it or ignored it altogether, and (2) the law ignored by the arbitrators was well defined, explicit, and clearly applicable to the case."[19] The district court found both prongs satisfied and vacated the arbitration award, holding that the arbitrators failed to properly apply choice-of-law principles. If properly applied, the arbitrators would have determined that the dispute was governed by maritime principles that relied heavily on custom and usage in interpreting contract terms.[20]

Alas, the saloon door was not yet done swinging. AnimalFeeds appealed from the district court to the Court of Appeals for the Second Circuit. The Second Circuit reversed the decision of the district court on the ground that it had improperly applied the "manifest disregard" doctrine, and had failed to give the panel's award the deference that arbitral decisions are due.[21] The Second Circuit held that the panel's decision was *not* in manifest disregard of maritime law given the absence of any clearly defined governing legal principle of which the panel was aware, but refused to apply.[22] Its reversal of the district court's judgment would have reinstated the arbitrators' decision had the Supreme Court not voted to accept review of the case.

The Supreme Court Opinions

No doubt because of the now-shaky standing of the manifest-disregard doctrine after the release of *Hall Street Associates v. Mattel*,[23] Stolt-Nielsen adjusted its appellate arguments in the briefing before the Supreme Court, shifting its focus to a claim that the arbitration panel had "exceeded its powers," one of the statutory grounds explicitly appearing in 9 U.S.C. § 10(a)(4). It worked. A majority of the justices agreed that the ordering of class arbitration on this record was a clear and obvious error.

The majority opinion (authored by Justice Alito and joined by Chief Justice Roberts and Justices Scalia, Kennedy, and Thomas) concluded that the arbitration panel exceeded its powers by "impos[ing] its own view of sound policy regarding class arbitration" rather than analyzing the FAA or state law.[24] The Court held 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," stressing "the foundational FAA principle that arbitration is a matter of consent."[25] Central to the Court's analysis was the concession made by AnimalFeeds's attorney during the arbitration that there had been "no agreement" between the parties on the issue of class arbitration.[26] The Court further explained that, in light of the high stakes of class arbitration and limited judicial review, "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."[27]

The Court further concluded that a remand for rehearing by the arbitrators was unnecessary because, under the undisputed facts of the case, only one outcome was possible, i.e., that the parties had not agreed to arbitrate as a class action.[28] In a footnote, however, the Court left open the argument for future cases that a party might be found to have implicitly agreed to class arbitration, noting that "[w]e have no occasion to decide what contractual basis may support a finding that the parties agreed to authorize class-action arbitration."[29]

This was, indeed, an important holding for the Court and one that alarmed any number of proponents of class-action arbitration. One cannot read the majority opinion without being struck by the certainty expressed that the imposition of class arbitration in a situation where there was no evidence that the party had agreed to submit itself to such a proceeding was absolutely unconscionable under the FAA. "[I]t 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."[30] According to the dissent, however, the majority was in such a rush to opine on the merits that it blew past long-standing reviewability principles that stood between it and its goal.

Justice Ginsburg dissented (joined by Justices Stevens and Breyer), forcefully arguing that the majority should have declined to review the class-arbitrability issue on its merits because the matter was not ripe for review (as it was only a partial award), and the traditional rules encouraging limited review of arbitral decision precluded *de novo* review in this case.[31] Justice Ginsburg scolded the majority for disregarding the years of carefully laid precedent outlining how, exactly, arbitration decisions are reviewed under the FAA. "The Court errs in addressing an issue not ripe for judicial review. Compounding that error, the Court substitutes its judgment for that of the decisionmakers chosen by the parties."[32]

The thing is, Justice Ginsburg is clearly right. Under the facts and circumstances laid out by the Court, the arbitration panel's conclusion that the charter party (a standard contract in the maritime trade) permitted for class arbitration was a matter of contract interpretation and, regardless of whether it is considered a question of

fact *or* law, that conclusion was entitled to "great deference" under the applicable law. Instead of "great deference," the majority gave it no deference whatsoever. How did the majority accomplish this, and what does it mean for judicial review of future arbitration awards?

The Hurdle over the Threshold of Reviewability

Arbitration is built for speed. That means that judicial review of questions that have been given over to arbitration is designed to be cursory, dedicated to a narrowly circumscribed punch list, which is contained in 9 U.S.C. § 10(a), laid out above. Thus, it was no surprise when counsel for Stolt-Nielsen was pummeled during oral argument with a flurry of questions raising the threshold issue of reviewability. The questions went something like this: If the parties submit the task of deciding whether a class arbitration is permissible under the parties' agreement to an arbitrator (as was the case in Stolt-Nielsen), and he or she has held that it is (either because of an explicit agreement or an implicit one), then what right does a court have to second guess that decision, given the great deference that arbitral awards deserve?[33] The correct answer is that under the FAA and Court precedent, a court has no right to second guess that decision. To the contrary, the decision must be upheld, even if it is blatantly and obviously wrong. That is simply the "price you pay" for opting for arbitration over litigation.

Of course, that answer would not do in this case because both Stolt-Nielsen and the Court wanted to hurdle the threshold question and get to the merits. There were three ways to accomplish this. One—the manifest disregard doctrine—was not used by the Court, and we will analyze that a little later. The other two paths to review, however, were both cited by the *Stolt-Nielsen* Court.

The first way out of the sticky wicket is to refuse to walk into the sticky wicket in the first place. What that means here is that if the Court could come up with a plausible explanation for why the question concerning class arbitrability is not reserved to the arbitrator, but rather determined by the court, then the restrictions on plenary review suddenly disappear. In other words, changing *who* decides the question (arbitrator or court) changed the Court's ability to review the answer.

The *Stolt-Nielsen* majority made a passing run at this approach, but fell short of making it a true holding, apparently not being quite ready to commit yet. The Court mentions that the parties appeared to rely on the *Bazzle* Court's (very) clear statement that questions of class arbitrability are to be decided by the arbitrator.[34] Appearing surprised that people rely on clear statements contained in U.S. Supreme Court opinions, the Court says (somewhat disingenuously, I think), "but surely, that statement was contained in a *plurality* opinion," implying that it isn't worth the paper it is written on. But we still do not know if it is or not because the Court then said "we need not revisit that question here."[35] I wonder when and if they will, then. Certainly, the question of who decides this important issue—arbitrator or court—is significant, and it should not be left hanging.[36]

It was apparently too much temptation for the Court to allow the panel's clearly incorrect decision to stand in this case.

The second path over the reviewability threshold discussed by the Court is through the use of the specific statutory grounds outlined in 9 U.S.C. § 10(a). As mentioned earlier, Stolt-Nielsen clearly opted to change its approach between the argument to the Second Circuit (which featured a manifest-disregard claim) and the Supreme Court (which featured an exceeded-powers claim). Because section 10 explicitly states that an arbitration award can be vacated when an arbitrator has acted in excess of his or her arbitral powers, the excess-powers claim was a much safer bet than the manifest-disregard claim, which looked like it was going down for the final count.[37] So, the petitioner argued that the panel exceeded its powers by ordering it to class arbitration, and the Supreme Court agreed. But, as Justice Ginsburg cogently points out, the majority applies the test incorrectly:

> The Court of Appeals upheld the award: "Because the parties specifically agreed that the arbitration panel would decide whether the arbitration claus[e] permitted class arbitration," the Second Circuit reasoned, "the arbitration panel did not exceed its authority in deciding that issue—irrespective of whether it decided the issue correctly." 548 F.3d 85, 101 (2008).[38]

Justice Ginsburg is absolutely right: The "exceeds-power" claim focuses on whether an arbitrator has acted outside the scope of the power granted him or her by the parties. Here, there is no question that the parties jointly submitted the question of class arbitrability to the arbitration panel for their resolution; to now hold that the panel exceeded their authority by deciding an issue submitted to them is nonsensical. Yet, the majority does not try to explain why it is tweaking the "exceeded-power" theory to allow for the claim that a wrong decision falls outside of an arbitrator's authority. If that were the case, there would be routine de novo review of arbitration decisions.

More importantly for our purposes, does the Supreme Court's invocation (and likely misapplication) of these two "outs" indicate a new approach to appellate review of arbitration awards? Probably not, and that might explain why the majority made little effort to explain its new twist on the "exceeded power" ground for vacatur. The Court is probably not looking to increase the number of substantive arbitration appeals headed into federal court. On the other hand, it was apparently too much temptation for the Court to allow the arbitration panel's clearly incorrect decision to stand in this case. For all the correctness of Justice Ginsburg's procedural arguments, the fact remains that the arbitration panel's decision was

nearly indefensible and, perhaps, we can forgive the majority for playing fast and loose with the reviewability rules so that it could correct an obvious (and potentially precedent-setting) wrong.

Will the Manifest-Disregard Doctrine Endure?

Finally, some mention should be made of the Court's continuing tease of whether the manifest-disregard doctrine remains good law.[39] Although it is certainly not easy to satisfy,[40] many parties have invoked the manifest-disregard theory in their petitions for vacatur in district court, and it probably remains the number one claim that an arbitrator has erred in his or her award.

The Second Circuit found an attractive, middle-of-the-road alternative following the Supreme Court's decision in *Hall Street*. Perhaps seeing merit in continuing the "manifest-disregard" jurisprudence, the Second Circuit held that the *Hall Street* Court was merely trying to "reconceptualize" the doctrine as a "judicial gloss" on the specific grounds enumerated for vacatur in section 10 of the FAA, perhaps even more specifically sections 10(a)(3) and (4).[41] "It did not, we think, abrogate the 'manifest disregard' doctrine altogether."[42] By "attaching" the manifest-disregard doctrine to subsection 3 or 4 of section 10, the federal courts can continue to employ established arbitration law, yet remain true to Congress's intent for the FAA. It seems like a perfect resolution; let's hope the Supreme Court adopts it when the time comes for it to finally decide what to do with the manifest-disregard doctrine. ■

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Endnotes

1. 130 S. Ct. 1758 (2010).
2. 539 U.S. 444 (2003).
3. Even so, the Supreme Court's remand order was interpreted by most to mean that the Court tacitly approved of the idea of class arbitrations, or it would not have let the action proceed.
4. Justice Sotomayor did not participate in the proceedings. *Stolt-Nielsen*, 130 S. Ct. at 1763.
5. *Id.* at 1775.
6. *Id.*
7. Stolt-Nielsen S.A. v. AnimalFeeds Int'l Corp., 548 F.3d 85, 88 (2d Cir. 2008). These standard form agreements are known as "charter parties" in the maritime trade, a name that is much more colorful than the rather dry agreements themselves.
8. *Id.* at 88 & n.1 (citing JLM Indus., Inc. v. Stolt-Nielsen SA, 387 F.3d 163, 183 (2d Cir. 2004)). The arbitration clause at issue provided:

> Arbitration. Any dispute arising from the making, performance or termination of this Charter Party shall be settled in New York, Owner and Charterer each appointing an arbitrator, who shall be a merchant, broker or individual experienced in the shipping business; the two thus chosen, if they cannot agree, shall nominate a third arbitrator who shall be an Admiralty lawyer. Such arbitration shall be conducted in conformity with the provisions and procedure of the United States Arbitration Act and a judgment of the Court shall be entered upon any award made by said arbitrator.

Stolt-Nielsen, 130 S. Ct. at 1765. The "United States Arbitration Act" is a reference to the FAA.

9. *Stolt-Nielsen*, 130 S. Ct. at 1765 (quoting Supplementary Rules). Supplementary Rule 3 was designed to create a procedure to resolve the question whether a particular arbitration clause permits arbitration to proceed on behalf of or against a class. The amicus curiae brief submitted by the AAA in *Stolt-Nielsen* contains a wonderful explanation of this and the other (now questionable) supplementary class procedures. *See* Brief of the AAA in Support of Neither Party, available at www.scotuswiki.com/index.php?title=Stolt-Nielsen_S.A._v._AnimalFeeds_International_Corp.#Amicus_Briefs.
10. *Bazzle*, 539 U.S. at 453.
11. *Stolt-Nielsen*, 130 S. Ct. at 1766.
12. *Stolt-Nielsen*, 548 F.3d at 90.
13. *Id.* In the absence of explicit language, a party can still attempt to prove implied consent by parol evidence.
14. Duferco Int'l Steel Trading v. T. Klaveness Shipping A/S, 333 F.3d 383, 388 (2d Cir. 2003).
15. 9 U.S.C. § 10(a).
16. *Stolt-Nielsen*, 548 F.3d at 91.
17. *Stolt-Nielsen*, 130 S. Ct. at 1780 (Ginsburg, J., dissenting) ("'If [an arbitration] award is within the submission, and contains the honest decision of the arbitrators, after a full and fair hearing of the parties, a court . . . will not set [the award] aside for error, either in law or fact.'" (quoting *Burchell v. Marsh*, 58 U.S. 344, 349 (1855))).
18. *See* Stolt-Nielsen S.A. v. AnimalFeeds Int'l Corp., 435 F. Supp. 2d 382, 384 (S.D.N.Y. 2006).
19. *See generally* Halligan v. Piper Jaffray, Inc., 148 F.3d 197, 202 (2d Cir. 1998).
20. "[I]f, instead, the Panel had made the choice-of-law analysis that it was mandated to make but chose to ignore, it would have had to recognize that what Stolt presented was tantamount to an established rule of maritime law." *Stolt-Nielsen*, 435 F. Supp. 2d at 385. Stolt-Nielsen had presented uncontested evidence to the panel that the arbitration clauses at issue had *never* been held to permit a class-action arbitration. *Id.* at 386.
21. *Stolt-Nielsen*, 548 F.3d at 97.
22. *Id.* at 101. Before reversing on the merits of AnimalFeeds's claim that the manifest-disregard doctrine had not been satisfied, the Second Circuit first considered whether the doctrine was still good law in light of the Supreme Court's intervening decision in *Hall Street Associates, LLC v. Mattel, Inc.*, 128 S. Ct. 1396 (2008).

As discussed in more detail below, in reaching its holding in *Hall Street* that parties to an arbitration agreement are not free to contractually alter the powers of the reviewing court (for example, by introducing a new ground for vacatur), the Court said, in passing, that it has never indicated that manifest disregard of the law was an independent basis for vacatur outside the grounds provided in section 10 of the FAA. *Id.* at 1404. This statement caused great consternation in arbitration appeals as the manifest-disregard doctrine had a strong and healthy group of adherents. The Second Circuit rejected the notion that the *Hall Street* Court was actually bringing the curtain down on the manifest-disregard doctrine. *See infra.*

23. 128 S. Ct. 1396. *See supra* note 22.
24. *Stolt-Nielsen*, 130 S. Ct. at 1767–68.
25. *Id.* at 1775.
26. *See supra* note 11 and accompanying text.
27. *Stolt-Nielsen*, 130 S. Ct. at 1775.

28. *Id.* at 1770.

29. *Id.* at 1776 n.10.

30. *Id.* at 1775 (emphasis in original).

31. *Id.* at 1777–83 (Ginsburg, J., dissenting).

32. *Id.* at 1777. Although clearly distressed, Justice Ginsburg noted what she saw as two positives to the majority decision: (1) that it "does not insist on express consent to class arbitration" (meaning that something lesser may be sufficient); and (2) that it "apparently spares from its affirmative-authorization requirement contracts of adhesion presented on a take-it-or-leave-it basis." *Id.* at 1783.

While the first of those points is consistent with the majority's footnote, the second point—which might allow a wide range of class arbitrations under consumer contracts—has no direct support in the majority opinion (although the majority mentions that both parties were sophisticated).

33. Justice Breyer was especially perplexed during the oral argument by the idea that the "silence" of the contract was being touted as the basis on which the courts could intervene. To his way of thinking, many times a contract does not explicitly provide for something that the parties later dispute. Someone then needs to decide what the parties intended, in light of the document and any relevant parol evidence; the decision might be that the parties agreed to "X" despite the absence of explicit language or, to the contrary, that the parties did not agree to "X." But the answer has to be one or the other— "silence" is not a third option. A copy of the transcript is available at www .supremecourt.gov/oral_arguments/ argument_transcripts/08-1198.pdf.

34. *Stolt-Nielsen*, 130 S. Ct. at 1772.

35. *Id.*

36. In her dissent, Justice Ginsburg states her support for the plurality statement in *Bazzle*, opining that a question of class arbitrability is more like a question of procedure (how an arbitration is to be conducted), rather than a question of actual consent to arbitrate (consent questions are handled by the court). 130 S. Ct. at 1780-81 (Ginsburg, J., dissenting). While at least she was willing to commit to a position, it is likely the wrong position to take. Given the seriousness of an agreement to participate in a class-action arbitration, it is more akin to a "consent" question than a "procedure" question.

37. *But see infra.*

38. *Stolt-Nielsen*, 130 S. Ct. at 1778.

39. *See supra* note 35 and accompanying text.

40. GMS Group, LLC v. Benderson, 326 F.3d 75, 81 (2d Cir. 2003) (party establishing "manifest disregard" bears a heavy burden).

41. *Stolt-Nielsen*, 548 F.3d at 94–95.

42. *Id.*; *but see* State Employees Bargaining Agent Coal v. Rowland, 494 F.3d 71, 84, 86 (2d Cir. 2007) (adhering to circuit precedent until such time as there is an explicit overruling by the U.S. Supreme Court).