

Stolt-Nielsen, S.A. v. AnimalFeeds Int’l Corp.
Doing the *Bazzle* Baffle:
Supreme Court Holds that Class Arbitration Conflicts with FAA Where
the Parties Did Not Agree to Authorize Class Arbitration

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Unfortunately, the opinions in *Bazzle* appear to have baffled the parties in this case at the time of the arbitration proceeding. For one thing, the parties appear to have believed that the judgment in *Bazzle* requires an arbitrator, not a court, to decide whether a contract permits class arbitration. . . . [B]oth the parties and the arbitration panel seem to have misunderstood *Bazzle* in another respect, namely, that it established the standard to be applied by the decision maker in determining whether a contract may permissibly be interpreted to allow class arbitration.

Stolt-Nielsen, S.A. v. AnimalFeeds Int’l Corp., Slip Op., p. 15 (referring to *Green Tree Fin. Corp. v. Bazzle*, 539 U.S. 444 (2003)).

Introduction

Call it the “*Bazzle* Baffle,” this class arbitration dance so many of us have been doing since the Supreme Court issued the *Bazzle* opinion in 2003 and the American Arbitration Association (AAA) adopted its class arbitration rules. Whatever you call it, with the Supreme Court’s April 27, 2010, decision in *Stolt-Nielsen, S.A. v. AnimalFeeds Int’l Corp.*, the old music has stopped, and a new tune is playing, sweet to the ears of all who have been compelled to arbitrate on a class-action basis: 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.***” Slip Op. at 20 (emphasis added). This holding provides welcome clarity and the prospect of predictability regarding class arbitration.

Relying primarily on the “the foundational FAA principle that arbitration is a matter of consent,” Slip Op. at 20, the Supreme Court held that imposing class arbitration on parties who have not agreed to authorize it is inconsistent with the Federal Arbitration Act (FAA). The

Supreme Court thus answered a question that many had expected it to answer in 2003, when it issued its opinion in *Bazzle*. In fact, the question presented in *Stolt-Nielsen* was described as “the same one presented in *Bazzle*: Whether imposing class arbitration on parties whose arbitration clauses are silent on that issue is consistent with the Federal Arbitration Act, 9 U.S.C. § 1.” *Stolt-Nielsen*, Pet. for Writ of Cert. at i.

Procedural History

The arbitration agreement at issue was silent on the question of class arbitration. The parties stipulated that it was silent, and as explained by counsel for the party advocating class arbitration, “[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.” Slip Op. at 4. In what the AAA identifies as the “clause construction” phase of the proceedings, the panel of arbitrators, persuaded by other arbitrators’ rulings, decided that in its silence on the issue, the arbitration clause allowed class arbitration. *Id.* The District Court for the Southern District of New York vacated the clause-construction award, finding that the arbitrators had manifestly disregarded the law when they failed to conduct a choice-of-law analysis, which would have led the arbitrators to apply maritime law, which in turn would have led to interpretation of the arbitration agreement according to custom and usage. *Id.* at 5. The Second Circuit reversed, holding that the arbitrators’ decision did not reflect a manifest disregard of the law, as the petitioners had cited no maritime rule of custom or usage against class arbitration. *Id.*

Grounds for Vacating Arbitral Award

As a threshold matter, the Supreme Court set aside the question whether “manifest disregard of the law” survived its decision in *Hall Street Associates, L.L.C. v. Mattel, Inc.*, 552 U.S. 576 (2008). Instead, the court relied on § 10(a)(4) of the FAA, vacating the arbitrators’

award because the arbitrators had exceeded their powers by grounding their decision on their view of public policy, as opposed to fulfilling their role of interpreting and enforcing a contract.¹ Because the parties had not reached an agreement on the issue of class arbitration, the arbitrators should have looked to controlling law—either the FAA, maritime law, or New York law—for the rule of decision. The court noted that the arbitrators relied on what amounted to a mistaken consensus among arbitrators² that class arbitration was beneficial and had found no convincing reason to depart from that consensus. *Stolt-Nielsen*, Slip Op. at 7-10. Thus, even though the arbitrators’ award never mentioned policy, the majority concluded that “the panel simply imposed its own conception of sound policy.” *Id.* at 11. “In sum, instead of identifying and applying a rule of decision derived from the FAA or either maritime or New York law, the arbitration panel imposed its own policy choice and thus exceeded its powers.” *Id.* at 12.

What *Bazzle* Did Not Decide

The court next turned to what *Bazzle* did not decide. The court noted that *Bazzle* produced not a majority opinion but a plurality with one justice concurring in the judgment vacating and remanding the case. The opinions of the justices who joined in the *Bazzle* judgment addressed three questions: (1) which decision maker, the court or the arbitrator, should decide whether the arbitration agreement was silent on the question of class arbitration; (2) what standard should the decision maker apply in deciding whether an agreement allows class

¹ Though the court found that that arbitrators’ error would satisfy the “manifest disregard” standard, it expressly withheld decision about whether that standard remains viable as grounds for vacating an arbitrator’s decision. Slip Op. at 7.

² A review of AAA “clause construction” awards in AAA arbitrations indicates just how broad a consensus had developed among arbitrators on the issue of class arbitration. Nearly every AAA arbitrator who has considered the issue has decided that a “silent” arbitration clause permits class arbitration. *See* www.adr.org (click on Dispute Resolution Services, then Arbitration and Mediation, then Commercial Rules, then Searchable Class Arbitration Docket) (last visited April 29, 2010). In fact, the AAA web site explains that “[t]he AAA administers Class Arbitrations for cases where (1) the underlying agreement specifies that disputes arising out of the parties’ agreement should be resolved by arbitration and (2) the agreement is silent with respect to class claims, consolidation, or joinder of claims.” *Id.*

arbitration—*e.g.*, the FAA or state law³; (3) whether class arbitration was properly ordered. Slip Op. at 14. The *Bazzle* plurality decided the first issue, concluding that it was for the arbitrator to decide whether the arbitration agreement was “silent” as to class arbitration; on the other hand, Justice Stevens, the concurring justice, “by-passed the first question . . . and rested instead on his resolution of the second and third questions.” *Id.* at 14-15. Thus, *Bazzle* yielded no majority decision on any of the three questions. Even though the parties and the arbitrators in *Stolt-Nielsen* accepted the conventional wisdom that *Bazzle* established a rule for interpreting arbitration agreements that were silent as to class arbitration, and even though the petitioners’ own counsel stated in oral argument that *Bazzle* required the arbitrator to decide the threshold contract-interpretation issue, the Supreme Court has made it clear now that *Bazzle* did no such thing. *Id.* at 14-16. To repeat: *Bazzle* did not require the arbitrator to decide whether the contract permits class arbitration, and it “did not establish the rule to be applied in deciding whether class arbitration is permitted.” *Id.* at 15-16.

The Court’s Holding and Rationale

While *Bazzle* failed to establish a rule for deciding whether class arbitration is permitted, in Section IV of its opinion in *Stolt-Nielsen*, the Supreme Court addressed that critical question.⁴ Arbitration, explained the court, is a matter of consent, and consequently, agreements to arbitrate are enforced according to their terms. As these snippets from the opinion make clear, this core requirement of consent is the foundation of the court’s decision:

³ The court offered the following examples of potentially applicable decisional authority: “For example, does the FAA entirely preclude class arbitration? Does the FAA permit class arbitration only under limited circumstances, such as when the contract expressly so provides? Or is this question left entirely to state law?” Slip Op. at 14. The court also considered the effect of maritime law. Slip Op. at 9. Because the arbitration panel had not consulted any of these sources of authority, the court did not have to address any conflicts among them.

⁴ As for the “decision maker” question decided only by the plurality in *Bazzle*, *i.e.*, whether the class arbitration issue was for the court or the arbitrator to decide, the court made it clear that *Bazzle* did not require the arbitrator to decide the issue. Because the parties entered into a supplemental agreement to submit the class arbitration issue to the arbitrator, however, the Supreme Court did not “revisit that question.” Slip Op. at 16.

“[W]e have said on numerous occasions that the central or ‘primary’ purpose of the FAA is to ensure that ‘private agreements to arbitrate are enforced according to their terms.’”

“[C]ourts and arbitrators must ‘give effect to the contractual rights and expectations of the parties.’ In this endeavor, ‘as with any other contract, the parties’ intentions control.’ This is because an arbitrator derives his or her powers from the parties’ agreement. . . .”

“[W]e have held that parties are ‘generally free to structure their arbitration agreements as they see fit.’”

Slip Op. at 18-20 (citations omitted). Over the years, those same principles, as applied in numerous FAA cases, have shaped the content and scope of parties’ agreements:

- Parties may agree to limit the issues that they choose to arbitrate.
- Parties may agree on the rules by which they will arbitrate.
- Parties may specify *with whom* they will arbitrate.
- Courts and arbitrators must give effect to these agreed-upon limitations.

Id. at 19-20. The court expressly identified these principles of consent as the basis for its rule of decision: “***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.***” *Id.* at 20 (emphasis added).

Applying this rule of decision, the court observed that certain procedural questions arising from the parties’ dispute are presumptively for the arbitrator and not a court to decide, and the arbitrator’s authority in such instances derives from the agreement. Slip Op. at 20-21. A critical passage from the majority’s opinion, however, shows why the arbitrators in this case exceeded their authority:

An implicit agreement to authorize class-action arbitration, however, is not a term that the arbitrator may infer solely from the fact of the parties’ agreement to arbitrate. This is so because 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. In bilateral arbitration, parties forgo the procedural rigor and appellate review of the courts in order to realize the benefits of private dispute resolution: lower costs, greater efficiency

and speed, and the ability to choose expert adjudicators to resolve specialized disputes. . . . But the relative benefits of class-action arbitration are much less assured, giving reason to doubt the parties' mutual consent to resolve disputes through class-wide arbitration.

Slip Op. at 21-22 (emphasis added, citations and parenthetical quotations omitted). Thus, contrary to an oft-repeated argument of class-arbitration proponents, the decision of whether to allow class arbitration is not merely procedural, but instead relates to the underlying agreement of the parties—specifically whether the parties have agreed to authorize class arbitration. *Id.* at 23. The court recognized that class arbitration represents not a single dispute between parties to a single agreement but a dispute involving numerous claimants, with financial stakes comparable to class action litigation; that the presumption of privacy surrounding individual arbitration is lost in class arbitration; and that an arbitrator's award in class arbitration purports to bind absent parties. *Id.* at 22-23. The “differences between bilateral and class-action arbitration” are not mere procedural differences, and they “are too great for arbitrators to presume, consistent with their limited powers under the FAA, that the parties' mere silence on the issue of class-action arbitration constitutes consent” *Id.* at 23. Because the parties had stipulated that there was no agreement on the issue of class arbitration, the parties could not be compelled to submit their dispute to class arbitration, *id.*, and the arbitrators' conclusion that silence on the issue *permitted* class arbitration was “fundamentally at war with the foundational FAA principle that arbitration is a matter of consent.” *Id.* at 20.

Open Questions?

Does the FAA or state law control the class arbitration question?

As noted above, *supra* note 4, the court did not have to grapple with conflicts between “default rules” of state law and the FAA because the arbitration panel did not rely on either. *See* Slip Op. at 9 (noting that the panel had not inquired “whether the FAA, maritime law, or New

York law contains a ‘default rule’ under which an arbitration clause is construed as allowing class arbitration in the absence of express consent”). Matters of state contract law are embedded in the FAA itself. *See* 9 U.S.C. § 2 (arbitration agreements “shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract”). Therefore, we can expect that parties to arbitration agreements will continue to litigate the interplay between state contract law and the FAA and the proper provinces of each, as these issues remain open for resolution.

Given the *Stolt-Nielsen* majority’s insistence on the “foundational” principle of consent, however, it is difficult to imagine how a “default rule” under state law could be used to construe an agreement as permitting arbitration when the agreement itself is silent on the issue and there is evidence that class arbitration was not intended. The majority opinion seems to place primary importance on the FAA: “While the interpretation of an arbitration agreement is generally a matter of state law, . . . the FAA imposes certain rules of fundamental importance, including the basic precept that arbitration ‘is a matter of consent, not coercion’ . . .” Slip Op. at 17 (citations omitted). The primacy of the FAA in the court’s analysis may implicate the issue of preemption in future litigation; while arbitration clauses are subject to the same rules of interpretation as other contracts, *see* 9 U.S.C. § 2, state courts “may not treat arbitration clauses differently than other contract terms, because to do so would be to put arbitration clauses on ‘an unequal footing’ in violation of the FAA.”⁵ Certainly, the majority seems to favor enforcing arbitration agreements *as written*.⁶ Finally, there is a body of pre-*Bazze* authority holding that class

⁵ *Banc One Acceptance Corp. v. Hill*, 367 F.3d 426, 431-432 (5th Cir. Miss. 2004), citing *Allied-Bruce Terminix Cos., Inc. v. Dobson*, 513 U.S. 265 (1995), and *Perry v. Thomas*, 482 U.S. 483 (1987).

⁶ Slip Op. at 17 (“Congress enacted the United States Arbitration Act, as the FAA was formerly known, for the express purpose of making ‘valid and enforceable written provisions or agreements for arbitration of disputes arising out of contracts, maritime transactions, or commerce among the States or Territories or with foreign nations.’”); *see*

arbitration is inconsistent with the FAA unless there is an express agreement for class arbitration.⁷ While there are thickets to be untangled before we can say anything with certainty, it appears that in explaining away *Bazzle* the *Stolt-Nielsen* majority has cleared the path for a return to this pre-*Bazzle* line of cases.⁸

Does the Arbitrator or the Court Decide the Question of Class Arbitration?

The Supreme Court highlighted the parties' and the arbitrators' confusion over what had been decided in *Bazzle*. Only a plurality in *Bazzle* concluded the arbitrator should decide whether the contract permitted class arbitration. Slip Op. at 15-16. Thus, however we might have been baffled in the past, we know now that *Bazzle* does not require the arbitrator to decide whether the contract permits class arbitration. Furthermore, *Stolt-Nielsen* itself does not require

also id. at 16-17 n.8 (“As with any agreement to arbitrate, we are obliged to enforce the parties’ supplemental agreement ‘according to its terms.’”).

⁷ *E.g.*, *Champ v. Siegel Trading Co.*, 55 F.3d 269, 277 (7th Cir. 1995) (“Section four of the FAA requires that district courts enforce the parties’ bargain as they wrote it—and nothing more. Since the parties’ arbitration agreement does not expressly provide for class arbitration, the district court correctly concluded that it was prohibited from reading such a procedure into these arbitration agreements.” (internal citations and quotations omitted)). In so holding the Seventh Circuit joined with the “the Second, Fifth, Sixth, Eighth, Ninth and Eleventh Circuits [which] have held that absent an express provision in the parties’ arbitration agreement” district courts are barred from requiring parties to consolidate arbitration “even where consolidation would promote the expeditious resolution of related claims.” *Id.* at 274-75.

⁸ Before the circuit court, *Stolt-Nielsen* argued that the Second Circuit’s decisions in *Glencore, Ltd. v. Schnitzer Steel Prods.*, 189 F.3d 264 (2d Cir. 1999), and *United Kingdom v. Boeing Co.*, 998 F.2d 68 (2d Cir. 1993), together with the Seventh Circuit’s decision in *Champ v. Siegel Trading Co.*, 55 F.3d 269 (7th Cir. 1995), prohibit class arbitration unless expressly provided for in an arbitration agreement. The Second Circuit rejected the argument, finding that the Supreme Court had abrogated those cases in *Bazzle*:

These decisions are not binding in this case. After they were decided, the Supreme Court ruled in *Green Tree Fin. Corp. v. Bazzle* (“*Bazzle II*”), 539 U.S. 444, 123 S. Ct. 2402, 156 L. Ed. 2d 414 (2003), that when the parties agree to arbitrate, the question whether the agreement permits class arbitration is generally one of contract interpretation to be determined by the arbitrators, not by the court. *Id.* at 452-53. *Boeing*, *Glencore*, and *Champ* had been grounded in federal arbitration law to the effect that the FAA itself did not permit consolidation, joint hearings, or class representation absent express provisions for such proceedings in the relevant arbitration clause. *See Glencore*, 189 F.3d at 267; *Champ*, 55 F.3d at 275; *Boeing*, 998 F.2d at 71. *Bazzle II* abrogated those decisions to the extent that they read the FAA to prohibit such proceedings. *See Bazzle II*, 539 U.S. at 454-55 (Stevens, J., concurring) (“[t]here is nothing in the Federal Arbitration Act that precludes . . . the Supreme Court of South Carolina” from determining “as a matter of state law that class-action arbitrations are permissible if not prohibited by the applicable arbitration agreement”). After *Bazzle II*, arbitrators must approach such questions as issues of contract interpretation to be decided under the relevant substantive contract law. *See id.* at 450 (noting that state law normally governs contract interpretation).

Now the Supreme Court has reversed the judgment of the Second Circuit and in doing so has explained away much of what *Bazzle* appeared to do. That would seem to restore *Champ* and similar cases to their pre-*Bazzle* status.

anything in this regard; the court did not “revisit” the “decision maker” question because the parties had agreed to submit the class arbitration issue to the arbitrator. *Id.* at 16. Nevertheless, there is language in the majority opinion that creates an opportunity for removing the “decision maker” mantle from arbitrators and placing it on the courts.

This shift is presaged by the majority’s conclusion that the issue of whether the contract permits class arbitration is not a procedural question. The majority roundly rejected the dissent’s characterization of the question before the arbitrators “as being merely what ‘procedural mode’ was available to present AnimalFeeds’ claims.” Slip Op. at 23. The question, said the majority, was whether the parties consented to class arbitration: “[W]e see the question as being whether the parties *agreed to authorize* class arbitration.” *Id.* (emphasis in original). Contrast the view of the *Bazzle* plurality: “[T]he question is not whether the parties wanted a judge or an arbitrator to decide whether they agreed to arbitrate a matter. Rather the relevant question here is what kind of arbitration proceeding the parties agreed to.” *Bazzle*, 539 U.S. at 452. The framing of the question by the *Stolt-Nielsen* majority seems freighted with import, because it so starkly contrasts with that of the *Bazzle* plurality and because the distinction between procedural and contractual issues is one of consequence: Procedural questions are presumptively for the arbitrator, not the judge, to decide, Slip Op. at 21, but questions about whether the parties agreed to arbitrate and the scope of any such agreement are generally for a court to decide.⁹ Granted,

⁹ See, e.g., *Allstate Settlement Corp. v. Rapid Settlements, Ltd.*, 559 F.3d 164, 169 (3d Cir. 2009) (noting that in a disagreement over whether parties agreed to arbitrate a particular dispute, the court decides this issue independently unless the parties agreed to submit the issue to arbitration); *Agere Sys. v. Samsung Elecs. Co.*, 560 F.3d 337, 338 (5th Cir. 2009) (applying the general rule that questions of whether parties agreed to arbitrate are decided by the court, not the arbitrator); *JLM Industries, Inc. v. Stolt-Nielsen, S. A.*, 387 F. 3d 163, 169 (2d Cir. 2004); *Fazio v. Lehman Bros., Inc.*, 340 F.3d 386, 395 (6th Cir. 2003) (“District courts have the authority to decide, as a threshold matter, whether an issue is within the scope of an arbitration agreement.”); *Summer Rain v. Donning Company/Publishers, Inc.*, 964 F.2d 1455, 1459 (4th Cir. 1992) (“When there is a dispute as to the scope of the arbitration agreement, the question of whether the parties agreed to arbitrate is to be decided by the court, not the arbitrator, ‘unless the parties clearly and unmistakably provided otherwise.’”) (citing *AT&T Tech. v. Comm’s Workers*, 475 U.S. 643, 649 (1986)).

the majority did not revisit the “decision maker” issue, and *Stolt-Nielsen* no more requires a court to decide the contract interpretation issue than *Bazzle* required an arbitrator to decide, but if the contract interpretation issue is *not procedural*, if it is instead a matter of “whether the parties *agreed to authorize* class arbitration,” then a court and not an arbitrator should make that decision, absent the clear contrary intent of the parties.

Furthermore, practically speaking, by explicitly rejecting the idea that *Bazzle* requires the arbitrator to decide whether the contract permits class arbitration, the majority has eliminated the basis upon which arbitrators have presumed to make such decisions in recent years. At a minimum, after *Stolt-Nielsen* it seems certain that litigants will not labor under the same misunderstandings that led the parties in that case to agree to submit the contract interpretation issue to the arbitrator.

“What If...” and “What About...”

As this is being written, just two days after the court’s decision, discussions about the implications already abound. There are many “what-ifs” for which *Stolt-Nielsen* gives few clues. For example: What if the agreement was not silent on class arbitration, but included a class action waiver? What if a court has found the class action waiver to be unenforceable? What if the arbitration agreement incorporated the rules of the AAA or another entity? What if state courts, applying their own “default rules,” have allowed class arbitration where the agreement is silent—does such a rule conflict with the FAA? What if one of the parties to the arbitration agreement is not a sophisticated business entity? While the basis of the court’s holding—the “foundational” principle of consent—should provide a starting point for the analysis, these and other issues are sure to be litigated in the coming days and years.

On another level, many courts misunderstood *Bazzle* in the same way as the parties and the arbitrators in *Stolt-Nielsen*. In the various circuit and district courts where that misunderstanding obtained, what consequences follow from the unraveling of *Bazzle*?

Beyond these legal questions are practical issues whose resolution will be labored. In the wake of *Bazzle* an entire industry—represented in part by the AAA class arbitration docket—was built largely on the same misunderstandings that the court described in *Stolt-Nielsen*. The docket includes not only cases in which the arbitration agreements were silent on the question on arbitration but also cases in which courts or arbitrators have found class action waivers to be unconscionable and have allowed the cases to proceed as class arbitrations. At a minimum, the future of this industry now seems uncertain.

Conclusion

In *Stolt-Nielsen*, the Supreme Court answered a question that many had expected it to answer back in 2003, when it decided *Bazzle*. For whatever reason, however, the *Bazzle* court did not answer the question, and its decision led to the bafflement described in *Stolt-Nielsen*. Now that the court has answered the question presented in *Bazzle*, at least the rule of decision is clear: Compelling parties to class arbitration absent an agreement to engage in class arbitration is inconsistent with the FAA. Silence alone may not be construed as consent, so parties should not find themselves in class arbitrations unless it could have been predicted, based on the parties' intentions and agreement.

As for whether the FAA or state law will control the resolution of class arbitration issues, the court's reliance on the FAA and its basic principles should strengthen the argument that state law cannot compel parties to a class arbitration on which they did not *expressly* agree, especially in light of the weight of pre-*Bazzle* authority holding that the FAA does not permit class

arbitration absent an express agreement for the same. We can expect that class arbitration proponents will advance arguments to construe agreements as permitting arbitration, but the principle of consent and the parties' intentions should control.

Further, because the court concluded that the issue of class arbitration is not a procedural question but instead is a question of consent—specifically, whether the parties agreed to authorize class arbitration—in the future courts and not arbitrators should decide whether the contract permits class arbitration. This should help to ensure meaningful review of the decision, beyond the limitations of § 10 of the FAA.

Whatever else remains to be litigated—it was, after all, creative, persistent lawyering that gave us both *Bazze* and *Stolt-Nielsen*—the court's 5-3 decision is welcome news to parties who entered into arbitration agreements never expecting to arbitrate a class action and who nevertheless found themselves compelled to do just that.