



Employer Update

July-August 2010

‘Stolt-Nielsen’: So What Is the Standard of Review of Arbitration Awards?

Reprinted from *New York Law Journal* July 26, 2010.

By Allan Dinkoff

Commentary on the Supreme Court’s recent decision in *Stolt-Nielsen S.A. v. Animalfeeds International Corp.*, 130 S.Ct. 1758 (April 27, 2010), has focused on the Court’s holding that if an arbitration agreement is silent on the subject of class arbitrations, then generally such arbitrations are not permitted. This holding is certainly important, but it could well pale in comparison to the implications of the reasoning the Court used to arrive at that holding. The Court showed little deference to the arbitrators’ award, which arguably portends a shift to more rigorous judicial review. However, lower courts are unlikely to abandon their traditional deference to arbitration awards because of the Court’s opinion in *Stolt-Nielsen*, and the Court may not have intended that they do so, but those seeking to vacate arbitration awards can find good fodder in the Court’s decision.

The Facts of ‘Stolt-Nielsen’

Stolt-Nielsen involved a “standard contract” routinely entered into between shipping companies, such as Stolt-Nielsen, and shippers who need their goods transported, such as Animalfeeds. Shippers generally choose from among a number of standard contracts, called a “charter party.” Animalfeeds chose a charter party that contained a broad arbitration clause.

According to the U.S. Department of Justice, Stolt-Nielsen and other shippers engaged in a conspiracy to fix prices. Animalfeeds served Stolt-Nielsen and others with a demand for class arbitration on behalf of itself and other shippers alleging that Stolt-Nielsen and other shipping companies violated the antitrust laws. The parties stipulated that the arbitration clause in the charter party was silent on the question of class arbitration. There was no dispute that the arbitration agreement otherwise covered the underlying antitrust claims, and the sole threshold issue was whether the charter party’s silence on the question of class arbitrations allowed or precluded class arbitrations. Or, as the parties framed the question, what is the import of the silence?

After the arbitration claim was filed, the parties entered into a supplemental agreement submitting to a panel of three arbitrators the question of whether class arbitrations were authorized by the charter party arbitration clause. The parties selected three very prominent, experienced arbitrators – Kenneth Feinberg, William Jentes, and Gerald Aksen. The arbitration panel heard testimony from experts on the general absence of class arbitrations in maritime law, and the history of the

charter party used by the parties here as well as other forms of charter parties in general use. Animalfeeds presented evidence about the almost uniform conclusion reached by other arbitration panels outside the maritime context holding that class arbitrations were appropriate where the contract contains a broad arbitration clause and is otherwise silent on the question of class arbitrations.

The panel wrote a lengthy reasoned opinion in which it (1) noted that the issue was the parties' intent to permit or preclude class arbitrations, (2) started its analysis with the contractual language, (3) noted that it was bound by maritime law and New York law of contract interpretation, (4) reviewed the decisions of other arbitration panels outside the maritime context on whether class arbitrations could proceed when the contract contained a broad arbitration clause but was otherwise silent on the issue of class arbitrations, and (5) assessed the impact of Supreme Court precedent on the issue.

After considering all these factors, the panel held that the charter party's broad arbitration clause requiring arbitration of "[a]ny dispute arising from the making, performance or termination of this Charter Party" required the parties to arbitrate class as well as individual claims.

Stolt-Nielsen brought proceedings to vacate the award, which the district court granted on the ground that the arbitrators had acted in "manifest disregard" of the law.¹ The U.S. Court of Appeals for the Second Circuit reversed, holding that whatever errors the arbitrators may have committed did not rise to the level of manifest disregard.² The Supreme Court granted the writ of certiorari "to decide whether imposing class arbitration on parties whose arbitration clause is 'silent'

on that issue is consistent with the Federal Arbitration Act." Slip op. at 1. It held that where the parties had not reached express agreement on the issue of class arbitrations, then the parties had not agreed to arbitrate. It was not sufficient that the parties had agreed to arbitrate "any dispute" and had not expressed an intent to preclude class arbitrations.

The Court showed little deference to the arbitrators' award, which arguably portends a shift to more rigorous judicial review.

The Court's Reasoning

The threshold question is what standard of review should the court apply on Stolt-Nielsen's motion to vacate the arbitration award. The Supreme Court held in *Green Tree Financial Corp. v. Bazel*³ that whether the parties had agreed to arbitrate class claims was a question for the arbitrators, and here the parties expressly submitted this question to the arbitration panel. So, the question of the meaning of the arbitration clause would not appear to be subject to de novo judicial review. Yet, that is exactly how the majority opinion reads.

The Supreme Court held in *Hall Street Associates, L.L.C. v. Mattel Inc.*⁴ that when, as here, a motion to vacate is brought under the Federal Arbitration Act (FAA), the award may be vacated only if the movant demonstrates that one of the four grounds expressly articulated by Congress for vacating an arbitration award has been satisfied. There is no dispute that in *Stolt-Nielsen* the only relevant ground was whether the arbitrators "exceeded their powers."⁵

Historically, the Supreme Court has held that an award should

not be vacated on this ground if the arbitrator was "even arguably construing or applying the contract and acting within the scope of his authority"; even if the court is "convinced [the arbitrator] committed serious error," the award must be confirmed.⁶ Vacatur has been appropriate, according to the Court, "only in very unusual circumstances."⁷

Lower courts also have uniformly taken a very narrow view of this provision of the FAA. For example, the U.S. Court of Appeals for the Fifth Circuit has interpreted Supreme Court case law as requiring only that the arbitrators' decision "draws its essence" from the contract. It thus has held that it will "not review the language used by, or the reasoning of, the arbitrators in determining whether their award draws its essence from the contract. [The] Court looks only to the results reached. The single question is whether the award, however arrived at, is rationally inferable from the contract."⁸

Here, (1) *Bazel* committed to the arbitrators the question of whether the arbitration agreement encompasses class arbitrations, (2) the parties expressly stipulated post-dispute that the arbitrators would decide that very question, and (3) the award is rationally inferable from the contract. Thus, it is hard to see how the arbitrators could have "exceeded their powers" as that term has been understood historically. In the dissent's view, the first two points alone were the end of the inquiry, and the award should have been confirmed. Slip op. at 7 (Ginsburg, J., dissenting).

The *Stolt-Nielsen* majority disagreed. While it gave lip service to the historical approach to these questions, saying "it is not enough for petitioners to show that the panel committed an error – or even a serious error," Slip op. at 7

(citations omitted), it went further. An arbitrator, the Court continued, may not “stray from interpretation and application of the agreement and effectively ‘dispense his own brand of industrial justice.’”⁹ True enough, but that phrase also has been given a very narrow interpretation.

Thus, the U.S. Court of Appeals for the Sixth Circuit, for example, refused to find that arbitrators had “exceeded their powers” or dispensed “their own brand of industrial justice” when the arbitrators ignored a contractual limitation on damages, awarding much larger amounts than permitted by the plain language of the agreement.¹⁰ In *Stolt-Nielsen*, the Court took a much broader approach to whether the arbitrators were applying “their own brand of industrial justice.”

For example, the majority rejected the panel’s reliance on the breadth of the arbitration language itself, saying that since the agreement was silent on the question of class arbitrations, “the particular wording of the charter party was quite beside the point.” Slip op. at 12. Whether that would be correct or not if the Court were reviewing a district court decision, it is quite an extraordinary statement when the Court is reviewing an arbitration award. It is even more remarkable in light of the Court’s long-standing insistence that “ambiguities as to the scope of the arbitration clause itself [should be] resolved in favor of arbitration.”¹¹

Similarly, the Court rejected the arbitration panel’s interpretation of the Court’s decision in *Bazel*. According to the Court, the arbitration panel believed *Bazel* “‘controlled’ the ‘resolution’ of the question of whether the . . . charter party ‘permit[s] th[e] arbitration to proceed on behalf of

the class, but that understanding was incorrect.” Slip op. at 12 (emphasis added). Yet another extraordinary statement to make in the context of the review of an arbitration award, particularly since what follows is a very detailed parsing of the plurality and concurring opinions in *Bazel*, which the Court criticizes the arbitrators and the parties for getting wrong. Unfortunate perhaps, and grounds for reversal when reviewing a lower court decision, but precisely the kind of mess courts historically would not disturb when reviewing an arbitration award.

One other point worth noting is the potential applicability of the judicially created “manifest disregard” test for vacating arbitration awards. The Court acknowledged that there is uncertainty as to whether this test survived the Court’s *Hall Street* decision, but said without any analysis that the standard was satisfied here. Slip op. at 7 n.3. However, that standard requires, as the Court accepts, “a showing that the arbitrators ‘knew of the relevant [legal] principle, appreciated that this principle controlled the outcome of the disputed issue, and nonetheless willfully flouted the governing law by refusing to apply it.’” *Id.* (quoting respondent’s brief).

The Court never analyzes the case under that standard and clearly that standard is not satisfied in *Stolt-Nielsen*. The Court concluded in *Stolt-Nielsen* that the arbitrators were wrong in concluding that *Bazel* controlled the outcome and that “the opinions in *Bazel* appear to have baffled the parties in this case.” *Id.* at 15. It later concluded that “both the parties and the arbitration panel seem to have misunderstood *Bazel* in another respect, namely that it established the standard to be applied by a decision maker in determining whether a contract may be interpreted

to allow class arbitration.” *Id.* at 16. This would appear to be precisely the opposite of “knowing the relevant legal principle and nonetheless willfully flouting the governing law by refusing to apply it,” and thus there would be no basis for vacating the award on manifest-disregard grounds.

Conclusion

So, what is one to make of all this? Parties seeking to vacate arbitration awards are sure to argue that *Stolt-Nielsen* heralds in a new era of expansive and probing analysis of arbitration awards and that the historical judicial deference to arbitration awards is dead. The Court’s opinion in *Stolt-Nielsen* certainly provides support for that argument. However, it is unlikely to prove correct.

The Court viewed class arbitrations as an extraordinary process, and was reluctant to allow class arbitrations to go forward absent evidence of express consent to such a process, either in the language of the arbitration agreement itself or in the normal course of dealings between the parties. It is thus likely that the Court will retreat to its historical deference to arbitration awards when faced with more routine issues.

1 435 F. Supp. 2d 382 (S.D.N.Y. 2006).

2 548 F.3d 85 (2d Cir. 2008).

3 539 U.S. 444 (2003).

4 552 U.S. 576 (2008).

5 9 U.S.C. § 10(a)(4).

6 *United Paperworkers Int’l Union v. Misco Inc.*, 484 U.S. 29, 38 (1987).

7 *First Options of Chicago Inc. v. Kaplan*, 514 U.S. 938, 942 (1995).

8 *Anderman/Smith Operating Co. v. Tennessee Gas Pipeline Co.*, 918 F.2d 1215, 1218-19 & n.3 (5th Cir. 1990).

9 Quoting *Major League Baseball Players Assn. v. Garvey*, 532 U.S. 504, 509 (2001) (per curiam).

10 *Jacada (Europe), Ltd. v. Int’l Marketing Strategies Inc.*, 401 F.3d 701, 712-13 (6th Cir. 2005).

11 *Volt Info. Scis. Inc. v. Bd. of Trs. of Leland Stanford Junior Univ.*, 489 U.S. 468, 476 (1989).