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REPORT

ARBITRATION

The U.S. Supreme Court's April 27 ruling in *Stolt-Nielsen v. AnimalFeeds Int'l.* (No. 08-1198), leaves numerous questions unanswered, says attorney Robert E. Crotty in this BNA Insight. The five-justice majority ruled on when class action procedures can be used in arbitration, but the author says Justice Ruth Bader Ginsburg's dissenting opinion could ''eviscerate'' the majority opinion because class action arbitration arises most often in consumer transactions and employment contexts, areas Ginsburg presumably referred to as ''contracts of adhesion.''

Crotty says that as long as Ginsburg's ''carve out'' remains viable, attorneys should continue to include clauses in arbitration agreements that preclude class arbitration, and to include fee-splitting provisions, so that arbitration is not economically or procedurally onerous for consumers or employers.

Unresolved Questions in the Wake of the U.S. Supreme Court's Class Arbitration Ruling in *Stolt-Nielsen v. AnimalFeeds International*

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In *Stolt-Nielsen SA v. AnimalFeeds Int'l Corp.* (11 CLASS 432, 5/14/10), the U.S. Supreme Court apparently answered the important question of when class action procedures can be used in arbitration. Justice Samuel A. Alito Jr. wrote the five-to-three (Justice Sonia Sotomayor did not participate in the decision) majority opinion. We will see why the court only ''apparently'' answered the question when we discuss Justice Ruth Bader Ginsburg's dissent.

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The supreme court's answer in *Stolt-Nielsen* is that under the Federal Arbitration Act, class action procedures cannot be imposed in an arbitration ''unless there is a contractual basis for concluding that the party *agreed* to do so.'' No. 08-1198, slip op., at 20.

The court, however, did not define what form that ''contractual basis'' needed to take:

> We have no occasion to decide what contractual basis may support a finding that the parties agreed to authorize class-action arbitration.

Stolt-Nielsen, No. 08-1198, slip op., at 23, n.10

Alito based the court's decision on the ''basic precept that arbitration 'is a matter of consent, not coercion.' '' *Stolt-Nielsen*, No. 08-1198, slip op., at 17 (quoting *Volt Information Sciences, Inc.* v. *Board of Trustees of Leland Stamford Junior Univ.*, 489 U.S. 468, 479 (1989)). Moreover, the court stated ''[w]e think it is also clear from our precedents and the contractual nature of arbitration that parties may specify *with whom* they choose to arbitrate their disputes.'' *Stolt-Nielsen*, No. 08-1198, slip op., at 19.

Finally, the agreement to arbitrate by itself does not allow any inference that the parties agreed to class action arbitration:

> 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 the 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.

No. 08-1198, slip op., at 21.

The court summed up this way:

> And the commercial stakes of class-action arbitration are comparable to class-action litigation . . . even though the scope of judicial review is much more limited, see *Hall Street*, 552 U.S. at 588. We think that the differences between bilateral and class arbitration 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 to resolve their disputes in class proceedings.

No. 08-1198, slip op., at 23.

The court also acknowledged that the parties were ''sophisticated business entities'' and ''there is no tradition of class arbitration under maritime law.'' No. 08-1198, slip op., at 20.

The court did not ''decide whether 'manifest disregard' survives'' as a basis for review of an arbitration award. No. 08-1198, slip op., at 7, n.3 (quoting *Hall St. Assoc. LLC v. Mattel Inc.*, 552 U.S. 576, 585 (2008)). The court stated in a footnote that the Respondent had characterized the manifest disregard doctrine as requiring that the arbitrator (1) knew the legal principle; (2) understood that the legal principle controlled the disputed issue, and (3) willfully refused to apply that legal principle. No. 08-1198, slip op., at 7, n.3. The court concluded that ''assuming, *arguendo*, that such a standard applies, we find it satisfied'' here. No. 08-1198, slip op., at 7, n.3. Thus, manifest disregard of the law, as discussed in the Second Circuit's Opinion in *Stolt-Nielsen*, seems to be still alive. 548 F.3d 85 (2d Cir., 2008).

Ginsburg's Dissent

In her dissenting opinion, Ginsburg wrote that she ''would dismiss the petition as improvidently granted,'' *Stolt-Nielsen*, No. 08-1198, slip op., dissent at 1, (Ginsburg, J., dissenting), because the parties had agreed to submit to the arbitrators the issue of whether there should be class arbitration and because the arbitrators decided that issue. Therefore, under ordinary arbitration principles, the arbitrators' determination should be reviewed only on the statutory bases for review and, more important, should be reviewed only after the arbitrators' final award.

Ginsburg then went on to discuss a potential carve out from the majority opinion for ''contracts of adhesion presented on a take it or leave it basis.'' No. 08-1198, slip op., dissent at 13, (Ginsburg, J., dissenting). If such a carve out is there, it would go a long way to eviscerating the majority opinion because class action arbitration arises most often in the consumer transaction and employment contexts, which Ginsburg presumably is referring to as ''contracts of adhesion.'' Ginsburg asks:

> Why should the class action prospect vanish when the 'any dispute' clause is contained in an arbitration agreement? *Cf. Connecticut General Life Ins. Co. v. Sun Life Assurance Co. of Canada*, 210 F. 3d 771, 774-776 (CA 7 2000) (reading contract's authorization to arbitrate '[a]ny dispute' to permit consolidation of arbitrations).
>
> And, if the court is right that arbitrators ordinarily are not equipped to manage class proceedings . . ., then the claimant should retain its right to proceed in that format in court.

No. 08-1198, slip op., dissent at 12, (Ginsburg, J., dissenting).

Ginsburg then states her apparent carve out, saying, because the majority ''does not insist on express consent to class arbitration,'' No. 08-1198, slip op., dissent at 12-13, (Ginsburg, J., dissenting), and because the majority notes that the parties are ''sophisticated'':

> The court apparently spares from its affirmative authorization requirement contracts of adhesion presented on a take-it-or-leave-it basis . . . [T]hese qualifications limit the scope of the Court's decision . . . .

No. 08-1198, slip op., dissent at 13, (Ginsburg, J., dissenting).

One of the cases Ginsburg cited might give some context to whether class arbitration is beneficial to consumers, and whether the majority in *Stolt Nielsen* is correct that arbitrators are not equipped to manage class proceedings.

Ginsburg quoted the following from *Carnegie v. Household International, Inc.*, 376 F.3d 656, 661 (7th Cir. 2004): ''The realistic alternative to a class action is not 17 million individual suits, but zero individual suits, as only a lunatic or a fanatic sues for $30.'' *Carnegie* was one of a number of class action suits which were brought around the country, beginning in the early 1990s, on behalf of 17 million borrowers of tax refund anticipation loans made by H&R Block and Beneficial National Bank. Some of these cases withstood dispositive motions and one action in Texas state court had been scheduled for trial as of 2002. Carnegie was the

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Seventh Circuit's second go round with that litigation. Its first was Reynolds v. *Beneficial National Bank*, 288 F3d. 277 (7th Cir. 2002).

Reynolds/Carnegie Examined

Here are the facts in *Reynolds*/*Carnegie* taken from the Seventh Circuit's opinions at 288 F.3d 277 and 376 F.3d 656. Plaintiff, ''on behalf of herself and all others similarly situated,'' brought an action charging violations of various state and federal laws, including RICO, against defendant tax preparer, which arranged for its plaintiff-customers' refund anticipation loans from defendant bank. The bank paid a fee to the tax preparer for arranging the loan, although neither the tax preparer nor the bank disclosed the fee to the plaintiff-customer. The bank made the refund anticipation loan to the plaintiff-customer. The refund anticipation loan gave the plaintiff-customer immediate access to the amount of its tax refund, minus the interest charged by the bank for the loan. The annual interest rate for these loans ''will often exceed 100 percent.'' *Carnegie*, 376 F3d. at 659. The court noted, however, that the ''customer can expect to receive the refund within a few weeks unless the IRS decides to investigate the return.'' *Id*. Presumably, therefore, the loan ordinarily would be outstanding for ''a few weeks.''

The *Reynolds*/*Carnegie* litigation itself started in 1997. In 1999, the original named plaintiff, and his lawyers, made a global settlement with the bank and the tax preparer for $25 million and the release of all 17 million claims relating to the refund anticipation loans. The settlement ''capped damages at [$15 to $30] for single and multiple claims, respectively . . .'' *Carnegie*, 376 F.3d at 661. These amounts were at least ''indicative of the modest stakes of the individual class members.'' *Id*.

Notice of the settlement was sent to the 17 million plaintiffs. Most of the plaintiffs ignored the notice, and ''several million'' notices ''were undeliverable.'' *Reynolds*, 288 F.3d at 282. One million recipients filed claims and six thousand opted out of the settlement. *Id*. The amount of the filed claims, of course, exhausted the settlement amount. The settlement amount provided for attorneys' fees of $4.25 million to be paid by the defendants in addition to the settlement fund. *Id*. at 283. Other lawyers sought fees for successfully objecting to a part of the proposed settlement. *Id*. at 286. Those fees were not awarded. *Id*. at 287. The District court approved the settlement on July 8, 2000.

In 2002, 11 years after the series of litigations had begun, five years after the *Reynolds* suit had been commenced, and two years after the District court approved the *Reynolds* settlement, the Seventh Circuit reversed the approval of the settlement. The court noted that the class action settlement approval process ''requires district judges to exercise the highest degree of vigilance in scrutinizing proposed settlements of class actions.'' 288 F.3d at 279. A district court judge ''is subject therefore to the high duty of care that the law requires of fiduciaries.'' 288 F.3d at 280.

As long as Justice Ginsburg's carve out remains possible, attorneys will be wise to continue to include clauses in their arbitration agreements.

In *Carnegie*, the Seventh Circuit stated that it had reversed the settlement in *Reynolds* because the court was concerned that the settlement might be a product of collusion between the defendants and the plaintiffs' class action lawyers:

> We reversed, *Reynolds* v. *Beneficial National Bank*, 288 F.3d 277 (7th Cir. 2002), on the ground that the district judge had failed to scrutinize the fairness of the settlement adequately. We were concerned that the settlement might have been the product of collusion between the defendants, eager to minimize their liability, and the class lawyers, eager to maximize their fees.

Carnegie, 376 F.3d at 659.

One year after the Seventh Circuit reversed *Reynolds*, a new district court judge, with a new class plaintiff and new class counsel, disapproved the original settlement but ''certified the same class that had been contemplated by the rejected settlement. . . .'' *Carnegie*, 376 F.3d at 659. This time, however, even though defendants had agreed to the same class before, the defendants objected to the class certification. After the new district judge certified the class, the case went back up to the Seventh Circuit under the name *Carnegie v. Beneficial National Bank*. The Seventh Circuit heard argument and issued its decision in 2004, holding that even though the court had rejected the previous settlement, defendants were judicially estopped from contesting the class certification and, accordingly, affirmed the class certification. *Id*. at 659, 664.

Settlement Class v. Litigation Class

In discussing the difference between a settlement class and a litigation class, the Seventh Circuit seemed to assume that any problems between the two could be dealt with as the case progressed and noted – without discussing the fairness or benefits of the proposition – that the ''pressures for settlement of class actions are enormous and will not be lessened significantly by our upholding the class certification.'' *Carnegie*, 376 F.3d. at 663. Seven years after the *Reynolds*/*Carnegie* litigation had started, the Seventh Circuit noted that no substantive issues had begun to be resolved:

> Whether particular members of the class were defrauded and if so what their damages were are another matter, and it may be that if and when the defendants are determined to have violated the law separate proceedings of some character will be required to determine the entitlements of the individual class members to relief.

376 F.3d at 661.

The court went on to point out:

> . . . the question [is] whether the defendants violated RICO. Once that question is answered if it is

> answered in favor of the class, a global settlement along the lines originally negotiated (though presumably with different dollar figures) will be a natural and appropriate sequel.

376 F.3d at 661.

Then, the Seventh Circuit went on to say that even if there were no settlement, district courts could use their imaginations to come up with procedures to determine individual damages:

> And if there is no settlement, that won't be the end of the world. Rule 23 allows district courts to devise imaginative solutions to problems created by the presence in a class action litigation of individual damages issues.

376 F.3d at 661.

Defendants' petition for certiorari to the U.S. Supreme Court was denied in January 2005, 543 U.S. 1051 (2005). So, fourteen years after the refund anticipation loan litigation started, some eight years after the *Reynolds*/*Carnegie* litigation had started, after two district court judges had opined on the class action procedures, after two appeals to the Seventh Circuit on the class action procedures, after a petition for certiorari to the supreme court was denied, after settlement notices to 17 million class members had been sent, which notice would have to be sent again if there were another settlement, now – after all of that - maybe, the district court could begin to address the merits of the substantive legal issues and the 17 million individual damages issues.

Conclusion

Justice delayed is justice denied. Taken individually, none of the claims in the refund anticipation loan cases are very difficult and individual damages are easily determined. Moreover, many companies have gone a long way to making arbitration in the consumer and employment area efficient and inexpensive for the individual.

Individual arbitration can be made to work well – as small claims courts do – so that arbitration provides a remedy in a time frame reasonably related to the acts giving rise to the claim.

If there are class arbitrations, what arbitrators will want to be involved for years and years with the litigation, and, who will pay them? If there are multiple class arbitrations, which arbitrators will decide which arbitrations should go forward? Can more than one class arbitration proceed? And, if so, which one will take precedence if a settlement is reached? What standards will apply to settlement approvals and who will review those approvals? Who will review the amount of the attorneys' fees and on what basis? And, when will all of this be presented to the courts if there is an objection to any part of the class procedure? Who will oversee class counsel's administration of multi-million dollar settlement funds?

Given the Seventh Circuit's skepticism about the arms length nature of the settlement agreement in *Reynolds*, would the very narrow review standards of the Federal Arbitration Act be sufficient to ensure just settlements? Finally, how is the individual claimant benefited from class action procedures?

All good questions. But, for now, as long as Ginsburg's carve out remains possible, attorneys will be wise to continue to include clauses in their arbitration agreements that expressly preclude class arbitration and to include provisions such as fee splitting provisions, so that arbitration is not economically or procedurally onerous on consumers or employees.

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