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Securing Judicial Review of Arbitral Class Awards

Tuesday, Nov 20, 2007 --- Companies often include arbitration provisions in their contracts in the interest of having disputes arising from or related to those contracts resolved simply, informally, and expeditiously, at least relative to litigation.

Another advantage of arbitration is finality: the Federal Arbitration Act's ("FAA") extremely deferential judicial review standard ensures that most awards are final.

But with courts (and arbitrators) increasingly open to the concept of class-based arbitrations, the arbitral finality that can be a benefit in the context of individual claims can be quite daunting in the context of class proceedings.

A 2003 Supreme Court decision has given considerable leeway to arbitrators and courts to permit class arbitration. Green Tree Financial Corp. v. Bazzle, 539 U.S. 444, 452 (2003).

In response to Bazzle, the American Arbitration Association ("AAA") enacted Supplementary Rules for Class Arbitrations ("Supplementary Rules") in October 2003.

The rules require arbitrators considering claims brought on a putative class basis to issue an award as to whether the arbitration clause permits class arbitration ("Clause Construction Award") and, if so, to issue another award as to whether the matter should proceed as a class arbitration ("Class Determination Award").

Arbitral proceedings are automatically stayed after the issuance of each award to permit judicial review. But because the FAA's judicial review standard remains as deferential as ever, these opportunities for judicial review may be more illusory than real.

This article explains what courts have been doing in those few instances where they are actually reviewing these awards. This article also reviews options for reformulating arbitration agreements to ensure more meaningful scrutiny of class-based awards.

Class Arbitrations and the Federal Arbitration Act

Under Supreme Court interpretations of the FAA, some decisions about arbitrability are generally to be made by courts and others are generally to be made by arbitrators. When the issue is not whether the parties agreed to

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arbitrate a dispute but what kind of arbitration they agreed to, arbitrators rather than courts usually decide the issue in the first instance.

In Bazzle, a plurality of the Court found that the issue of whether the arbitration contracts forbade class arbitration was not the kind of “gateway” matter that parties would ordinarily expect courts, rather than arbitrators, to decide absent clear and unmistakable evidence to the contrary.

Under the AAA’s Supplementary Rules, if the arbitrator’s Clause Construction Award finds that the applicable arbitration clause permits class claims, the arbitrator must decide whether a class should be certified.

To make this determination, the arbitrator is required to apply a number of criteria, many of them identical to those a federal court applies under Fed. R. Civ. P. 23 in deciding whether to certify a class action.

These include criteria that mirror Rule 23(a) (numerosity, commonality, typicality, and adequacy) and Rule 23(b)(3) (predominance and superiority), as well as some criteria particular to arbitration (such as whether the class members’ arbitration clauses are substantially similar to one another).

The arbitrator’s determination as to whether an arbitration should proceed on a class basis is required to be set forth in a Class Determination Award that addresses each these criteria.

Proceedings are then automatically stayed for at least 30 days to permit judicial review. If the Class Determination Award is not appealed or is unsuccessfully appealed, the arbitration proceeds on the (class or non-class) basis stated in the award.

Judicial Review of Clause Construction and Class Determination Awards

The Supplementary Rules have been effective for four years, but there are fewer than 10 published cases (available using standard research resources) reviewing Clause Construction Awards, and fewer still (using the same resources) reviewing Class Determination Awards.

Despite the Supplementary Rules’ express contemplation of judicial review, some federal courts have declined to review these awards, either for lack of subject matter jurisdiction or because they find that such “interim or partial” rulings are not appealable under Section 9 of the FAA.

And, as might be expected given the FAA’s deferential review standard, the few courts that ultimately reviewed the interim awards on the merits have generally refused to disturb them.

Indeed, there appear to be only two published decisions disturbing Clause Construction Awards (Stolt-Nielsen SA v. Animal Feeds Int’l Corp., 435 F. Supp. 2d 382 (S.D.N.Y. 2006) and Veliz v. Cintas Corp., No. C-03-1180-SBA, 2007 U.S. Dist. LEXIS 71555 (N.D. Cal. Sept. 5, 2007)),

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and no published decisions disturbing Class Determination Awards.

Thus, in accordance with the traditional deference afforded arbitrators, there are limited opportunities for meaningful review either of awards construing arbitration clauses to permit class proceedings, or of ensuing class-based merits awards.

Outside the class context, some companies may be comfortable with the status quo—by agreeing to arbitration, they bargained for and received minimal judicial involvement in their disputes.

But the specter of an effectively unreviewable class award may give some parties to arbitration agreements a case of buyer's remorse.

In the next section, we discuss some options for using the contractual nature of arbitration to make a better procedural bargain on the treatment of class claims.

Options for Addressing the Risks Posed by Class-Based Arbitrations

Organizations that remain enthusiastic about the value of arbitration in individual disputes, but have concerns about surrendering meaningful judicial scrutiny of arbitrators' actions in big-ticket class action disputes, have a number of options available to them.

Each relies on the contractual nature of the arbitration mechanism to define special procedures for addressing purported class proceedings.

Contractually Bar Class Proceedings. The most obvious response to the threat of class-based arbitrations is to draft the arbitration agreement to preclude them altogether.

After all, arbitration is a matter of contract, and parties to arbitration agreements have freedom, subject to statutes that express a contrary intention, to contract away some of their rights: "Having made the bargain to arbitrate, the party should be held to it unless Congress itself has evinced an intention to preclude a waiver of judicial remedies for the statutory rights at issue." Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc., 473 U.S. 614, 628 (1985).

Since Bazzle, companies have pursued this option with increasing frequency. The viability of this approach is subject to some question, however. The FAA instructs state and federal courts to enforce arbitration agreements "save upon such grounds as exist at law or in equity for the revocation of any contract." 9 U.S.C. § 2.

Contractual waivers of the class mechanism or remedies may be held unconscionable or otherwise unenforceable under state or federal law, and many state and federal courts have done just that.

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One option for addressing the growing hostility of state courts to class arbitration waivers is to expressly assign to the arbitrator, and not the court, the issue of whether a class arbitration waiver can be enforced in the context of the claims at issue.

Under such a scenario, whatever result the arbitrator reached on the state-law unconscionability question would be subject to the extremely deferential arbitral standard of review, and hence would not likely be disturbed.

Companies that already have concluded, as a general matter, that they prefer an arbitrator's judgment to that of a court in run-of-the-mill consumer or business disputes are apt to find this option preferable to letting courts decide the unconscionability issue.

Contract for Broader Judicial Review of Clause Construction or Class Determination Awards. Another option — whose permissibility may depend on the outcome in a matter presently before the Supreme Court, as detailed below — is to contract for broader judicial review of class-related rulings by arbitrators than would otherwise be available under the FAA.

For instance, the parties to an arbitration agreement could contract to adopt the abuse of discretion standard used by courts of appeals in reviewing class certification decisions under Fed. R. Civ. P. 23(f).

In those instances, reviewing courts would arguably stand in the same position relative to arbitral panels as federal courts of appeals presently stand to district courts when reviewing district courts' class certification orders.

If a reviewing court found that the arbitrator(s) did not apply the correct standard for class certification under Supplementary Rule 4 (which mirrors Rule 23), there would, by definition, be a reversible abuse of discretion.

This approach presents some difficulties, however. Some courts have found that they lack jurisdiction under applicable statutes to review interlocutory decisions of arbitrators.

Perhaps more importantly, there is a circuit split, presently under review by the Supreme Court, on the fundamental question whether parties to arbitration agreements may contract for a broader scope of judicial review of arbitral awards than the FAA's standard. Hall St. Assocs., L.L.C. v. Mattel, Inc., 196 Fed. Appx. 476 (9th Cir. 2006), cert. granted, 127 S. Ct. 2875 (2007).

If the Supreme Court sides with those circuits permitting expanded review, this option will be especially attractive for companies that want to keep their disputes largely in arbitration, but not get hit with devastating — and all but bulletproof — class determination awards.

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Contract for Special Arbitral Procedures Where Purported Class Claims Are at Stake. Another option is to specify special procedures where purported class claims are presented in an arbitration demand.

Parties that prefer class arbitration to class litigation can contract for more extensive arbitral procedures tailored to the greater amount in controversy typically presented by class petitions.

For instance, such parties could elect to submit purported class arbitration demands—including the accompanying clause construction awards, class determination awards, and/or class-based merits resolutions—to a panel of three arbitrators rather than a single arbitrator.

Because such decisions will be effectively unreviewable under the FAA (absent expanding the scope of judicial review), it may be desirable to have the decision result from the collective judgment of several arbitrators rather than just one.

Parties who prefer to litigate class proceedings in court rather than before an arbitrator can contract for back-end limitations on arbitral jurisdiction in the event that the arbitrator finds class proceedings to be appropriate.

For instance, parties who clearly invest the arbitrator with the responsibility to decide whether a class waiver is enforceable can provide for an end to arbitral jurisdiction (and recommencement of the dispute in court) in the event that class proceedings are found permissible notwithstanding that waiver.

Contractually Require Class Proceedings to Be Maintained in Court, At Least Through Class Certification. Some companies may not want arbitrators to have any role in class issues, preferring the greater experience that judicial tribunals bring to bear on such issues.

Companies that want to secure a judicial resolution of the class certification question may be able to adopt arbitration agreements that require purported class claims to be maintained in court, at least through the certification phase of the proceeding, and perhaps beyond.

One option might be for the parties to specify that purported class claims must be commenced in a court with subject matter jurisdiction, as an exception to arbitration, and that the action must be maintained in that court through judgment unless and until the court decides that class treatment is inappropriate, in which event the merits of the plaintiff's individual claims would be presented to an arbitrator.

Companies wishing to have merits issues arbitrated regardless of how the class issues are decided by the court could specify that, whatever the result of the court's class determination, the merits of the dispute would be resolved by an arbitrator.

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Conclusion

The FAA's deferential standard of judicial review, coupled with recent developments that facilitate class-based arbitrations, creates a potentially unpredictable situation for companies that rely on arbitration to govern disputes that arise out of their contractual relationships.

Because of the big-ticket nature of most purported class claims, companies should review strategies, including those outlined in this article, for preserving the efficiency benefits of arbitration while establishing mechanisms for meaningful arbitral or judicial review of all-important class certification determinations.

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