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Is 'Class Arbitration' An Oxymoron?

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Law360, New York (April 23, 2017, 11:48 AM EDT) -- We recently began a series of articles in which we ask: Is "class arbitration" viable given the essential nature of arbitration, or is it an oxymoron? (The premise here is that "class arbitration" signifies the utilization of a Federal Rule of Civil Procedure 23 class action protocol in an arbitration proceeding.) In this article, we examine possible bases for the viability of class arbitration. Spoiler alert: they do not hold up to scrutiny.

In brief, here is why. The U.S. Supreme Court has repeatedly stated that it is an overarching principle that commercial arbitration is a creature of contract, and so the roots of a viable class arbitration presumably must be found in an arbitration agreement. The threshold problem in trying to import a class action protocol into a private arbitration proceeding is that the consent of the parties to an arbitration agreement is necessary but not sufficient. An arbitration agreement has the force of contract, not of law, and so it binds only its consenting parties. Nonparty putative "class members" are not bound by an arbitration agreement unless they each agree with the contracting parties to be mutually bound. And absent such additional ad hoc agreements, the arbitrator has no jurisdiction over the putative class members. Consequently, it seems unlikely that a true "class arbitration" award would survive a vacatur motion under Section 10(a)(4) of the Federal Arbitration Act ("FAA").

On a related note, if the foregoing is correct, then most of the litigation and judicial resources devoted to the question of the enforceability of a "class arbitration waiver" have been misspent. The premise of the controversy is that an arbitrating party has a unilateral right to employ a class arbitration mechanism. But there is no unilateral right in arbitration to any particular procedure; all must be agreed. The pertinent question regarding "class arbitration" concerns agreement; there is no unilateral right in that regard to be waived.

(Finally, we point out that a viable alternative mechanism for adding parties to an arbitral proceeding is conventional joinder according to the rules of the arbitration administering organizations. And that could be facilitated by the inclusion in an arbitration agreement of certain third-party beneficiary rights in favor of other identifiable persons.)

In General

First, it seems uncontroversial that in the absence of bilateral consent in an arbitration agreement, no class arbitration procedure should be permitted or imposed. The potential postures of the parties to an arbitration agreement with respect to the permissibility of "class arbitration" are binary: agreement or not. Currently, if there is no agreement to permit class arbitration — whether that "no agreement" posture is expressed as a prohibition or mere silence concerning it — neither party should be permitted to prosecute a class arbitration.

Thus, a prerequisite to the employment of a class arbitration mechanism is that the parties to an arbitration agreement (a) must have agreed to permit it, or (b) must be deemed to have agreed to that. Agreement might be "deemed" by reason of (i) incorporation by reference in the arbitration agreement of rules — typically the arbitration rules of an administering organization

(e.g., the American Arbitration Association ["AAA"]) — that provide for a class action mechanism, without expressly excluding such "class arbitration" rules; or possibly (ii) the contracting parties' creation of pertinent third-party beneficiary rights. This is in keeping with the principle that the procedural rules of an arbitration are fashioned by agreement of the parties.

Other theoretical bases upon which a stranger to an arbitration agreement might compel a contracting party to arbitrate — e.g., estoppel by a nonparty — ultimately would not afford the means to establish a true class action. Rather, if successful, they would enable a particular stranger to engage in an arbitration proceeding, but would not enable a party to create a class of nonconsenting nonparticipant litigants in such a proceeding. So too, considering a converse dynamic in which a party to an arbitration agreement seeks to compel a nonsignatory to arbitrate, the potential legal bases — various common law contract and agency theories — do not afford the means to create a class of nonparticipant litigant parties either. (And the typical use of such theories in a motion under FAA § 4 to compel an adverse person to arbitrate is not consistent with the typical dynamic of class litigation, where a party seeks to become a representative by fiat of putative friendly co-parties.)

In any case, there is a fundamental problem too where there is a bilateral agreement to permit "class arbitration" in a particular proceeding. Such a bilateral agreement binds only the parties to it, and no current law clearly extends its effect further. If that is so, then a true "class action" protocol would seem not to be viable. A Rule 23 protocol makes a defined group of nonconsenting persons into de jure members of a litigating class, who will be bound by the result of a litigation unless they take steps to opt out of that class. That is inconsistent with the nature of arbitration, which is contract-based and inherently consensual. Furthermore, an arbitral tribunal would not have jurisdiction over additional persons who are not parties (or deemed parties) to the controlling bilateral arbitration agreement. Therefore, a true class arbitration award should be vacated under FAA § 10(a)(4) because the arbitral panel will have exceeded its powers by purporting to bind persons beyond its jurisdiction.

On the other hand, a bilateral agreement, relying on an opt-in protocol, to permit joinder of additional identifiable persons — e.g., those with virtually identical claims against the same respondent — might be effective. That is, it might be agreed by the parties to an arbitration agreement that certain identifiable others may, in defined circumstances, opt into that agreement. The result would be consensual joinders, not a class action protocol. And a resultant award would be sustainable.

Is this approach (and the analysis above) plausible? At least two justices of the Supreme Court have indicated that purported "class members" who have not opted into a "class arbitration" proceeding would not be bound by a purported class arbitration award. See, Oxford Health Plans LLC v. Sutter, 133 S.Ct. 2064, 2072 (2013) (Justices Samuel Alito and Clarence Thomas, concurring).

Agreement (and its Limits)

1. The Arbitration Agreement Requirement

"Class arbitration" is not permitted under the FAA unless it is authorized by the parties in their arbitration agreement (or by some controlling law). Stolt-Nielsen v. AnimalFeeds Int'l Corp., 559 U.S. 662, 684, 130 S.Ct. 1758 (2010).

The jurisdiction of an arbitrator to adjudicate and issue an award derives only from an arbitration agreement, and applies only to the parties to it. Therefore, an arbitrator presumably cannot compel nonparties to arbitrate. So too, a court is not authorized by the FAA to compel arbitration by persons who are not bound by an arbitration agreement. EEOC v. Waffle House Inc., 534 U.S. 279, 289 (2002); see 9 U.S.C. § 4; cf., United Steel Workers of America v. Warrior & Gulf Navigation Co., 363 U.S. 574, 581 (1960).

2. Interpretation of an Arbitration Agreement

Where class arbitration is not clearly prohibited in an arbitration clause, whether it is permitted is a matter of contract interpretation typically applying state law. E.g., 2 Domke, Commercial

Arbitration § 32:32 (June 2016); Stolt-Nielsen, 559 U.S. at 681 ("interpretation of an arbitration agreement is generally a matter of state law"); 9 U.S.C. § 2 (FAA § 2).

There must be a textual basis for concluding that the parties agreed to class arbitration in particular. Stolt-Nielsen, 559 U.S. at 684-85. Mere silence in that regard in an arbitration clause may not be construed to constitute or indicate an agreement to class arbitration. Stolt-Nielsen, 130 S.Ct. at 1776; 1 Oehmke, Commercial Arbitration § 16:1.

3. Inherent Limits of a Bilateral Agreement

Contracting counterparties may agree among themselves to permit the utilization of a particular procedural mechanism — e.g., class arbitration — in their private dispute resolution proceeding. Their bilateral agreement in that regard would bind no other persons, however. Therefore, while such an agreement might effectively neutralize an objection by either contracting party to the employment of a class arbitration mechanism, it would not bind any other person, or be a basis for a party or arbitrator to compel any other person, to join in the arbitral proceeding as a class member. (You and I can agree that we are the new Kings of Spain, and that our subjects will contribute funds to raise an armada to conquer England. Forty-seven million Spaniards might question our authority, however, even if we gave them the option of filing papers to opt out of our "deal.")

And a bilateral arbitration agreement, whatever its terms, does not confer upon an arbitrator jurisdiction over a person who has not agreed with the parties to be mutually bound by it. Arbitration "is a matter of consent, not coercion." Stolt-Nielsen, 103 S.Ct. at 1773, citing Volt Information Sciences Inc. v. Board of Trustees of Leland Stanford Junior University, 489 U.S. 468, 479, 109 S.Ct. 1248 (1989).

4. Express Agreement to Class Arbitration — the Optimal Case

Illustrating the point that bilateral agreements do not bind third parties, we can imagine an example involving multiple identical consumer contracts — e.g., credit card agreements — in which the card issuer and each cardholder agree to permit class arbitration; indeed, they agree to import the Rule 23 class action protocol, with its opt-out option, into an arbitration. In that case, could a representative cardholder create a class of all cardholders and conduct an effective class arbitration without the affirmative consent of any other cardholder to be bound by the arbitration agreement?

The representative cardholder can rely on the card issuer's agreement to block an objection by the issuer to permitting a class arbitration procedure. But each party only agreed that a class arbitration mechanism would be permitted in the arbitration of a claim by that cardholder against the issuer (or vice versa). No cardholder will have pre-agreed with the issuer to become a class member in an arbitration commenced by another cardholder, or to be bound by an agreement, however similar, made by another cardholder with the issuer. And an arbitrator has no inherent power, any more than a court, to compel (or to permit) a noncontracting party to join an arbitration.

Consequently, even in the case of a broadly common bilateral agreement expressly to permit a class arbitration mechanism, a further affirmative agreement by each of the other cardholders who intend to assert a claim and to be bound by an award in a particular arbitral proceeding would seem to be required. And that would not be "class arbitration."

5. Third-Party Beneficiaries

However, a bilateral agreement arguably could be the basis to invite additional parties — presumably, similarly situated parties — to join in a particular arbitration proceeding. That is, an arbitration agreement might make a defined group of persons third-party beneficiaries. If an arbitration agreement permitted identifiable persons to opt in by agreeing to become additional parties to an arbitration agreement, and if such persons did so, their claims arguably could be joined in a single proceeding. The result would be the joinder of additional persons, with consents by all parties, and subject to conventional administrative rules in that regard (see, e.g., ICC Arb. Rules Art. 7-10; LCIA Arb. Rules Arts. 22.1(vii)). And in that scenario, a resulting award would be

confirmable.

Incorporation of Pertinent Rules by Reference

There are a variety of procedural rules that parties to an arbitration agreement may incorporate by reference and that relate to the addition to an arbitral proceeding of noncontracting persons.

1. AAA Rules

The AAA's Supplementary Rules for Class Arbitrations ("SRCA") (eff. Oct. 8, 2003) in effect imports the elements of Rule 23 into the AAA's arbitration rubric. The AAA's policy is that it will administer a class arbitration applying those rules if the arbitration agreement (i) indicates that the arbitration will be conducted in accordance with the rules of the AAA without excluding the SRCA; and (ii) is silent concerning consolidation, joinder of claims, and "class claims."

The arbitrator must consider two screening criteria before applying the SRCA, however. He/she must first determine "whether the applicable arbitration clause permits the arbitration to proceed on behalf of or against a class." (SRCA-3.) However, in construing the applicable arbitration agreement, "the arbitrator shall not consider the existence of [the SRCA] … to be a factor either in favor of or against permitting the arbitration to proceed on a class basis." (Id.) If the arbitrator is satisfied that a class arbitration may proceed under the arbitration clause in question, he/she "shall determine whether the arbitration should proceed as a class arbitration." (SRCA-4(a).) One of the requirements in that regard is that "each class member has entered into an agreement containing an arbitration clause which is substantially similar to that signed by the class representative(s) and each of the other class members." (SRCA-4(a)(6).)

Eventually, if the arbitrator makes a Class Determination Award (and it is not vacated), a Notice of Class Determination to each of the class members would be required, and that notice would describe an opt-out right of the class members. (See, SRCA-6(b)(5).)

Finally, parties to a class arbitration under the SRCA are "deemed to have consented that judgment upon each of the awards rendered in the arbitration may be entered in any federal or state court having jurisdiction thereof." (SRCA-12.) (The definition of "parties" for that purpose is not specified.)

The question remains, however, whether the jurisdiction of an arbitrator, which is inherently limited to the parties to the arbitration agreement that empowers him (for purposes of issuing an award) is, as a matter of law, expanded to include other persons by reason of the contracting parties' agreement to the applicability of the SRCA in an AAA arbitration. We suggest not.

The AAA Commercial Arbitration Rules (eff. July 1, 2016) contain no provisions specifically regarding joinder (or consolidation of proceedings), but do provide that the arbitrator shall have the power to rule on the existence, scope and validity of any arbitration agreement (R-7(a)), and on objections to the jurisdiction of the arbitrator (R-7(c)). On the other hand, the current (June 1, 2014) arbitration rules of the International Centre for Dispute Resolution ("ICDR") — the international arm of the AAA — include provisions concerning joinder (and consolidation of proceedings). (See Arts. 7, 19(1), 8.)

2. ICC Rules

The current ICC Rules of Arbitration (effective March 1, 2017) include joinder (and case consolidation) provisions (see, ICC Arts. 7-10, 6), but do not appear to provide a basis for class arbitration.

3. LCIA Rules

The LCIA Arbitration Rules (effective Oct. 1, 2014) too do not consider class arbitration, but do provide for consensual joinder of additional persons (and consolidation of arbitral proceedings) (see Arts. 22.1(viii)-(x)).

Estoppel

Estoppel is a legal theory by which a nonsignatory may compel a signatory of an arbitration agreement to arbitrate. E.g., Thomson-CSF SA v. American Arb. Ass'n, 64 F.3d 773, 776, 778 (2d Cir. 1995). A signatory may be estopped from avoiding arbitration with a nonsignatory when the issues that the nonsignatory is seeking to resolve in arbitration are "intertwined" with the particular commercial agreement (containing an arbitration clause) that the party to be estopped signed. Estoppel thus may enable certain strangers to a bilateral arbitration agreement individually to compel arbitration by a party to such an agreement. Any such stranger would have to be an active participant in the proceedings, at least in its application to compel arbitration, rather than a passive "class member." There would seem to be no road to class arbitration using this theory.

Furthermore, a different variation of an estoppel theory may enable a signatory of an arbitration agreement to compel a nonsignatory to arbitrate (i) if the nonsignatory knowingly accepted benefits "flowing directly from [an] agreement" that contains an arbitration clause, MAG Portfolio Consult, GmbH v. Merlin Biomed Group LLC, 268 F.3d 58, 61 (2d Cir. 2001), (ii) if the nonsignatory reaped a direct benefit made possible by the agreement containing an arbitration clause, Hartford Fire Insurance Co. v. Evergreen Org Inc., 410 Supp.2d 180, 182, 186-87 (SDNY 2006); (iii) if the non-signatory exploits an agreement to acquire or use an asset created by such an agreement, e.g., Deloitte Noraudit A/S v. Deloitte Haskins & Sells, U.S., 9 F.3d 1060, 1063-64 (2d Cir. 1993); or (iv) if a benefit to the non-signatory is (a) provided or contemplated in the agreement containing an arbitration clause or (b) otherwise clearly contemplated by the signatories of the agreement, Deloitte Noraudit, 9 F.3d at 1063-64. Applying this version of the theory would not seem to be a basis for creating a class arbitration either.

A "Class Arbitration Waiver" Is Pointless

Finally, we note that if the foregoing analysis is correct, then the notion of a "class arbitration waiver" is unnecessary. (Much paper and many electrons may have been wasted on this superfluous subject.) An arbitrating party has no inherent unilateral right to "class arbitration." Neither that nor any other procedure may be invoked unilaterally in an arbitration; all must be adopted by agreement. If there is no actual or deemed agreement to permit "class arbitration," then there should be no possibility that that mechanism could be employed. "Class arbitration" is either permitted by agreement of the parties or not. A "waiver" of a non-existent unilateral right to employ it would be superfluous.

(In the case of the incorporation by reference in an arbitration agreement of a set of rules that include provisions for class arbitration (e.g., the AAA's SRCA), a simple exclusion of those provisions in the terms of the arbitration agreement is what is called for, not a "waiver.")

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