Desirability of International Class Arbitration

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It is now well established and well documented that class arbitrations are possible, at least in the United States.[1] But are they desirable? The answer to this, as to so many questions, is it depends. It depends on the particulars of the case and the claim, and whether you are a claimant or respondent, a bank or consumer, an issuer or shareholder, an employer or employee, and your country of origin.

But make no mistake, the issue has been joined and positions staked out. In the United States, where the courts have ruled that the permissibility of a class action in arbitration is essentially a question of clause construction that is left up to the arbitrators (at least in the first instance), the American Arbitration Association (AAA) and the Judicial Arbitration and Mediation Services (JAMS), two leading arbitral institutions, have promulgated rules for class arbitrations and are actively administering them. In stark contrast, the International Chamber of Commerce (ICC) has promulgated a policy statement that "implementing class action systems has adverse consequences for business and consumers that outweigh the perceived benefit to society," including "exposure to 'legal blackmail.'"[2] The ICC's International Court of Arbitration has not taken any action to date to create rules to accommodate class arbitration.

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[1] *See, e.g.*, Green Tree Fin. Corp. v. Bazzle, 539 U.S. 444 (2003); Stolt Nielsen SA v. Animalfeeds Int'l Corp., 548 F.3d 85 (2d Cir. 2008); JSC Surgutneftegaz v. President and Fellow of Harvard Coll., 2007 U.S. Dist. LEXIS 79161 (S.D.N.Y. Oct. 11, 2007).

[2] ICC Commission on Commercial Law and Practice, Class Action Litigation, Policy Statement, Document No. 460/585 (2005), *available at* http://www.iccwbo.org/uploadedFiles/ICC/policy/clp/Statements/Class_action_litigation.pdf.

On both the international and domestic fronts, public policy and due process concerns are among the greatest obstacles to the acceptability of class arbitration. Many of the same procedural concerns that implicate due process also inform the debate over whether class arbitration is consistent with the conventional notion of arbitration as a prompt, inexpensive proceeding. As Professor Stacie Strong has pointed out, overcoming these concerns may require "a radical reconceptualization of both (1) acceptable procedure in international arbitration and (2) the nature of individual rights in arbitration."[3] The path toward rethinking time and costs in arbitration has already been paved, to some extent, by the large, complex individual arbitrations that have become commonplace. Coming to terms with broader concerns over policy and justice may not be as easy.

While the debate rages, international class securities arbitrations may make their debut in a case brought by Harvard College against JSC Surgutneftegaz ("Surgut"), currently pending before an AAA tribunal, which serves as a useful paradigm for considering some of the issues relevant to the desirability of class arbitrations.[4] Harvard commenced an arbitration pursuant to a 1998 deposit agreement governing American depository receipts. The parties to the deposit agreement were Surgut, a Russian oil and gas company, Bank of New York as depository, and the owners and beneficial owners of the Surgut American depository receipts. Harvard brought claims on behalf of all owners of the American depository receiptss, alleging that Surgut had violated U.S. securities laws and the deposit agreement.

After Surgut's court challenges to arbitrability were denied,[5] the distinguished AAA panel issued two interim awards, one of which addressed the issue relevant here: Did the arbitration clause in the deposit agreement permit the arbitration to proceed on behalf of a class?[6]

The deposit agreement provided that disputes arising out of or relating to the American depository receipts or the deposit agreement would be settled "in accordance with the rules of the American Arbitration Association."[7] It did not specify what rules. The arbitrators applied the AAA Supplementary Rules for Class Arbitrations, which had become effective before the arbitration was commenced but some five years after the deposit

[3] S.L. Strong, "Enforcing Class Arbitrations in the International Sphere: Due Process and Public Policy Concerns," 30(1) *U. Pa. J. Int'l L.* 1, 5 (2008).

[4] President and Fellows of Harvard Coll. v. JSC Surgutneftegaz, AAA Case No. 11 168 T 01654 04.

[5] *See* JSC Surgutneftegaz v. President and Fellows of Harvard Coll., 167 F. App'x 266 (2d Cir. 2006).

[6] President and Fellows of Harvard Coll. v. JSC Surgutneftegaz, AAA Case No. 11 168 T 01654 04, Partial Final Award on Clause Construction, Aug. 1, 2007.

[7] *See id.* at 2.

agreement was entered into, and which require in Rule 3 that the arbitrators "determine as a threshold matter . . . whether the applicable arbitration clause permits the arbitration to proceed on behalf of or against a class."

Over the dissent of one arbitrator, the panel found that the arbitration clause was very broad and covered any claim brought by any party and did not preclude the arbitration from proceeding on a class basis. Writing in the shadow of a U.S. federal court decision rendered in New York the prior year—*Stolt-Nielsen SA v. Animalfeeds International Corp.*,[8]—which ruled that another AAA panel's decision to allow an arbitration to proceed on a class basis was a manifest disregard of the law,[9] the *Harvard v. Surgut* majority discussed in detail why the deposit agreement and its arbitration clause were particularly hospitable to class arbitration. Among other things, they noted the following:

- All members of the proposed class (i.e., all holders of the American depository receipts, were parties to a single deposit agreement. Unlike many potential class arbitrations, the panel did not have to consider consolidating claims under separate agreements that were similar or identical. Here, by the terms of the deposit agreement, all of the holders became parties to the same agreement when they purchased the American depository receipts, even though they purchased them at different times.
- The arbitration clause permitted the parties to submit any claims arising under the federal securities laws of the United States either to arbitration or to U.S. courts, in effect implicitly agreeing to class action litigation, since a class action clearly would have been permissible had the action been brought in the U.S. courts.

Both of these factors could potentially help set the critics of international class arbitration at ease, or at least at relative ease. Where the defendant and all members of the plaintiff class are signatories to a single agreement that evidences a willingness to participate in class actions, it is much harder to complain that they have been unfairly required to participate in a class arbitration. Notably, however, the U.S. Court of Appeals for the Second Circuit has recently reversed the district court's decision in *Stolt-Nielson,* ruling that the AAA panel's decision to construe the contract language at issue in that case to permit class arbitration was not in manifest disregard of

[8] Stolt-Nielsen SA v. Animalfeeds Int'l Corp., 435 F. Supp. 2d 382 (S.D.N.Y. 2006).

[9] *See* President and Fellows of Harvard Coll. v. JSC Surgutneftegaz, AAA Case No. 11 168 T 01654 04, Partial Final Award on Clause Construction, at 16-20 (discussing *Stolt-Nielsen*).

the law.[10] Accordingly, it is possible that future arbitral tribunals seated in New York may not require the sort of extraordinary factors present in the *Harvard v. Surgut* case to find that an arbitration clause permits class arbitrations.

The *Harvard v. Surgut* panel also addressed the respondent's argument that class arbitrations were so inherently "incompatible with the 'nature' or 'principles' or 'norms' of international arbitration" that the panel should not allow it to go forward.[11] Noting that the respondent did not "identify any 'norm' that explicitly bars the class action in the context of international arbitration,"[12] the majority rejected this challenge without determining its merits:

> That reasonable people will inevitably have different views about the merits of the use of the class action device in international arbitration is distinct from the conclusion that the class action device is so incompatible or at odds with the process that an arbitration clause, properly construed in accordance with its governing law and the procedure of the situs of the arbitration, is invalid to the extent it permits a case to proceed on a class basis.[13]

Under the AAA rules, if the case goes forward, the next stage is class certification, at which the panel will still have to decide whether a class action is appropriate in the particular circumstances of the case. However, it has clearly decided that the misgivings of foreign parties and some in the international arbitration community about U.S.-style class actions cannot bear on whether a class action is permissible as a general matter, thus paving the way for what may be the first-ever securities class action in international arbitration.[14]

[10] Stolt Nielsen SA v. Animalfeeds Int'l Corp., 548 F.3d 85, 99-110 (2d Cir. 2008).

[11] *Id.* at 28.

[12] *Id.*

[13] *Id.* at 30.

[14] U.S. courts following *Green Tree Financial Corp. v. Bazzle,* 539 U.S. 444 (2003), have similarly avoided imposing their public policy view. For instance, in *Johnson v. Long John Silver's Restaurants, Inc.*, 320 F. Supp. 2d 656, 668 & n.7 (M.D. Tenn. 2004), *aff'd,* 414 F.3d 583 (6th Cir. 2005), the court observed that "foreclosing the possibility of a class action would force an individual plaintiff to bear the entire cost of proving a [violation of the Fair Labor Standards Act] because the benefit to any individual plaintiff is small," but found that under *Bazzle,* the question was left up to the arbitral tribunal.

POLICY AND PERSPECTIVE

At its essence, the policy dispute that the *Harvard v. Surgut*[15] panel declined to resolve seemingly had little to do with arbitration *per se*; rather, it stemmed from the respondent's more general contention that "the class action is a 'pernicious' and 'uniquely American form of collective action,'" which should therefore not be imposed in an international forum.[16] Likewise, much of the broader policy debate about the desirability of class arbitrations appears to have little to do with the unique combination of class actions and arbitration. Rather, many of the disputes focus either on the general desirability of arbitration or the general desirability of class actions.

For instance, if an attorney for a U.S. plaintiffs' class complains about having to bring her class action in arbitration because she prefers to be in front of a jury, she would likely have the same complaint if she were bringing a claim on behalf of a sole aggrieved plaintiff. And like the complaint from the *Harvard v. Surgut* respondent that class actions are pernicious from a non-U.S. litigant's perspective, the ICC's strident policy statement—in which it expresses strong opposition to class actions on behalf of its business constituents—is a statement about class actions generally, not class actions in arbitration in particular.

It would be a mistake, however, for the international arbitration community to simply shrug its collective shoulders and avoid discussion of these issues. The participants in the international class arbitration debate will surely be informed by their long-formed, general perspectives on both arbitration and class actions, but the convergence of class actions and international arbitration does shine some new light on old questions and require a further look.

One interesting feature of this debate is that opposing parties—for example, issuers and investors in securities disputes—may not necessarily be at odds concerning the desirability of resolving a class action in arbitration rather than litigation. Indeed, issuers may feel themselves pulled in both directions. They may hesitate to leave the U.S. courts where heightened pleading standards are often strictly enforced by pre-discovery motions to dismiss, but if international arbitration lives up to its promise of much more limited discovery, it might be worth the trade. They may be concerned by the lack of effective appellate review when such large amounts are at stake, but delighted to leave behind the uncertainty of a trial by jury.

And the starkly different view of class actions taken from the perspective of different national legal cultures and regimes must be considered, not

[15] President and Fellows of Harvard Coll. v. JSC Surgutneftegaz, AAA Case No. 11 168 T 01654 04.

[16] *Id.*, Partial Final Award on Clause Construction, at 22.

because it will be possible to fairly choose between them or to attempt to discern an international public policy—it will not—but to recognize the impact such a choice may have on the public policy balance that has been struck within any one country. Where class actions are permitted, they are often thought to play a quasi-regulatory function, encouraging companies to deal honestly and fairly with their customers, or their shareholders, by giving plaintiffs a mechanism for redress even where no single plaintiff would have a sufficient incentive to sue.[17] Denying arbitration claimants the opportunity to act on behalf of a class in an action that would otherwise have been brought in a court in such a country may degrade an important public function. Likewise, many countries that forbid class actions undoubtedly do so in the belief that their regulatory structure appropriately enforces, through other means, the rights of shareholders and consumers without this particular litigation mechanism. To permit class actions in cases that would otherwise be brought in such a country may result in a double-enforcement regime that is unreasonably onerous for defendants.

But how should this be resolved? Are class actions in international arbitration appropriate only in cases that, absent an arbitration clause, could have been brought in the courts of a country that permits class actions? The *Harvard v. Surgut* majority clearly was encouraged by the fact that the claimant could have chosen to bring the case as a class action in a U.S. court. It would be difficult to impose such a standard, however, even by national arbitration legislation. The *situs* of an arbitration is not necessarily the only place where litigation over the claim would have been brought; in fact, it might not have even been an available forum. One very rough approximation might be to treat class actions as a substantive right rather than a procedural one;[18] thus, tribunals would take the approach to class actions taken by the country whose substantive law applies to the dispute. Whatever the resolution, consideration of the impact on a country's regulatory policy likely will have a place in this discussion.

PROCEDURE AND DUE PROCESS

Even the most ardent proponents of class actions in arbitration are faced with the enormous reality of developing and administering the complex set

[17] *See, e.g.*, Dell Computer Corp. v. Union des consommateurs, [2007] S.C.C. 34, ¶ 106 (Canada) ("It is accepted that the class action has a social dimension: Its purpose is to facilitate access to justice for citizens who share common problems and would otherwise have little incentive to apply to the courts on an individual basis to assert their rights."—internal quotation marks omitted).

[18] *But see id.* ("[A]s important as it may be, the class action is only a legal procedure.").

of procedural mechanisms necessary to conduct the proceedings fairly and efficiently. In the United States, class action procedures have been adjusted and refined for decades through legislation and judicial innovation, often openly attempting to remedy perceived unfairness to class action plaintiffs or defendants, or both, and to strike a balance that is consistent with prevailing U.S. public policy.[19] Even if we set aside the due process concerns of those who believe the class action mechanism is inherently unfair (perhaps to defendants or to absent class members who are included unless they opt-out), due process can surely be implicated by a failure to appropriately craft a set of procedures to adapt the class action to arbitration. The AAA has adopted probably the most sophisticated set of procedures for class action arbitrations, and they are modeled after the class action procedures in Rule 23 of the U.S. Federal Rules of Civil Procedure, but they do not incorporate wholesale the extensive body of statutes and case law that guide U.S. courts adjudicating class actions.

It is far beyond the scope of this article to propose a set of procedures to be followed in international class arbitrations, or even to mention all of the procedural challenges they will face, but it is worthwhile to raise some of the challenges of process and administration, the resolution of which may greatly impact the desirability of international class arbitrations.

Pleading Standards

In the United States, Congress passed the Private Securities Litigation Reform Act of 1995 (PSLRA),[20] which, among other things, sets heightened pleading requirements for federal securities class actions, and the Securities Litigation Uniform Standards Act of 1998 (SLUSA),[21] which ensures that certain types of securities actions be brought in federal court where the PSLRA's standards apply, rather than in state court where they might be avoided. Should those relatively strict pleading requirements be grafted onto class arbitrations as a necessary protection for defendants?

Also, considering that these two laws expressed significant policy statements by Congress, query whether these statutes might (or should) be

[19] *See, e.g.*, Class Action Fairness Act of 2005, Pub. L. No. 109-2, 119 Stat. 4, codified as amended in various sections of 28 U.S.C. (2005) (purporting to address "abuses of the class action device that have," among other things, "harmed class members with legitimate claims and defendants that have acted responsibly").

[20] Pub. L. No. 104-67, 109 Stat. 737, codified as amended in various sections of 15 U.S.C. (1995).

[21] Pub. L. No. 105-353, 112 Stat. 3227, codified as amended in various sections of 15 U.S.C. (1998).

invoked to preclude class arbitrations, or worse, their enforcement, if the pleading requirements and other standards set out in these laws are not available in arbitration.

Participation of Absent Class Members

In class actions in U.S. courts and in the AAA class action rules, notice to prospective class members is required both at the time the class is certified and at the time of any settlement. Prospective class members are given the right to opt out of the class or object to settlement. Would it make more sense to operate an opt-in policy, where potential class members are only included in the class if they affirmatively request inclusion (even by merely returning a form)?

An opt-in policy could make class actions less lucrative and thus less attractive to plaintiffs' lawyers working for a contingent fee, who often are the key drivers behind class action litigation. It might also make it harder for defendants to achieve peace, since they could face serial opt-in class actions. But perhaps it would resolve some due process and policy concerns if members of the class were given notice and had to affirmatively choose to have their claims adjudicated by opting in rather than being bound by a proceeding and result merely because they had failed to opt out. Would an opt-in approach thus help to facilitate enforcement in countries that are reluctant to recognize class actions?

If notice is to be required, who pays for the notice? What form of notice is required? Should actual notice be required, or should the tribunal deem a certain notice procedure constructive notice, and would it make a difference for enforcement? Are there other steps that should be taken to protect the rights of absent class members?

Settlement Fairness and Administration

In U.S. class action practice, cases are far more likely to settle than to be tried to a final judgment, and class action settlements raise complicated questions of administration and fairness.

U.S. courts have a duty to scrutinize settlements for fairness, reasonableness, and adequacy.[22] This is a core element of due process in court-based class actions. Under the AAA rules, the arbitrators will have a similar duty. But how will this be played out in practice, among arbitrators who may lack

[22] Fed. R. Civ. P. 23(e)(2).

both experience in such matters and the public trust invested in national courts? Judges must anticipate poorly equipped class representatives and attorneys, inadequate class settlement provisions, and overly generous fee stipulations. Are arbitrators prepared to assume this role in international class arbitrations? Will this create a bias in class action arbitrator selection in favor of U.S. litigators and former judges?

Administration of the settlement also requires compiling and maintaining mailing lists of class members and providing adequate notice, collecting and evaluating individual proofs of claim from each class member who wishes to benefit from the settlement, and managing the investment and distribution of settlement funds. In the United States, there is a well-developed for-profit industry experienced in notice and settlement administration. But what if class arbitrations are conducted in countries without this infrastructure? And will the arbitrators be available to provide sufficient oversight of class award distribution? Arbitrators ordinarily become *functus officio* after they render an award, whereas courts are available to resolve disputes about class award distribution long after a judgment is rendered.

Discovery

How will international class arbitrations address the discovery process? In U.S. securities class actions, for example, discovery is often largely one sided; the issuer has most of the relevant knowledge and information, and the class plaintiffs who purchased the securities have little or no relevant knowledge other than what is publicly available. This imbalance makes discovery extremely important to the plaintiff class attempting to prove its claims; it also puts undue pressure on the defendant, which will be bearing most of the discovery burden, to settle. If discovery is sharply limited, as it often is in international arbitration, this could substantially alter the balance of power in class actions.

Costs and Fees

No discussion of the arbitration process would be complete without a discussion of costs and fees. Arbitrators' fees will likely be much higher in class arbitration than in ordinary international arbitration, commensurate with a greatly expanded commitment of time and attention from the arbitrators. Under the AAA rules, for instance, the arbitrators are required to address the dispute in several phases—clause construction, class certification, merits—and issue awards at each phase. The process can also involve

disputes among various plaintiffs and various plaintiffs' counsel, objections to settlement, and a variety of issues not present in traditional arbitration.[23]

With respect to attorneys' fees, the routine American system of contingency payments for plaintiffs' lawyers, which is likely a critical structure in many cases if the action is to be brought at all, is anathema to other countries' legal systems. Furthermore, in arbitration, often the loser is required to pay the winner's costs. If the defendant prevails, from whom will the fees be collected—the named plaintiffs, their counsel? Are defendants going to ask for a bond to be posted?

Enforcement

If a comprehensive procedure for the conduct of class arbitrations can be established, there remains the question of enforcement of arbitral awards, which is discussed above to some extent. As Professor Strong explains, "As class arbitration becomes more international"—if it will, if it does—"state courts, particularly those in civil-law countries, will have to consider whether and to what extent they should permit foreign conceptions of rights to be enforced in arbitration."[24] She suggests that, in doing so, they consider the purposes and requirements of the New York Convention[25] and other enforcement treaties, because, even if a state domestically prohibits the use of representative actions in its own courts, that may not be an adequate reason rising to the level of international public policy for the state's courts to refuse enforcement on a wholesale basis (i.e., without looking at the way a given class arbitration award evolved).[26]

WHAT LIES AHEAD

The majority of class arbitrations that have been brought to date appear to be domestic consumer and employment arbitrations, but these issues should be of interest to anyone concerned with the future of international

[23] Clancy and Stein have also noted several reasons why a class arbitration may actually be more burdensome on the parties than a class litigation. The clause construction phase is unique to arbitration, as is the need to pay arbitrators, which can be a substantial or even prohibitive burden on the parties. *See* David S. Clancy & Matthew M.K. Stein, "An Uninvited Guest: Class Arbitration and the Federal Arbitration Act's Legislative History," 63(1) *Bus. Law.* 55, at 63-64, 73 (2007).

[24] Strong, *supra* note 3, at 3.

[25] U.N. Convention on the Recognition and Enforcement of Foreign Arbitral Awards, June 10, 1958, 21 U.S.T. 2517, 330 U.N.T.S. 3.

[26] Strong, *supra* note 3, at 3.

arbitration, because the considerations that arise and approaches developed in consumer class arbitrations under the U.S. Federal Arbitration Act may ultimately inform the broader international commercial arbitration context. The *Harvard v. Surgut*[27] example may be the first of many.

Are we heading into an era where class arbitration is permitted, but only when allowed by the forum, or by the institutional rules, or both? If an international arbitration is brought in the United States, where class arbitrations are permissible, under the auspices of the ICC, which may not be willing to administer them, what is the result? Are parties going to avoid the United States as a forum, and AAA or JAMS rules, for contracts that could give rise to class actions? Perhaps certain class actions will be redirected, by statute or by institutional rules, into the courts, as currently required by the New York Stock Exchange rules.[28]

The enforceability of class action arbitration waivers—arbitration clauses that expressly disallow class action—is also an evolving issue. Should the United States and other countries consider statutory amendments to address the permissibility of class arbitrations and, if they are going to be permitted, create consistent standards for class action waivers and other disputed issues? And should courts expand judicial review of class arbitration awards to address the critical due process issues discussed above?

The debate is just beginning, and its implications for the arbitration world could be enormous.

[27] President and Fellows of Harvard Coll. v. JSC Surgutneftegaz, AAA Case No. 11 168 T 01654 04.

[28] NYSE Regulation Rule 600(d).