

Second Circuit Rules That Arbitrators Must Decide Whether to Consolidate Multiple Proceedings

By Jeffrey Gross

Arbitration is frequently described as a “creature of contract.”¹ But the creators of this “creature,” the parties who sign contracts with arbitration provisions, may not realize that they may have to participate in multiple arbitration proceedings arising from the same events or transactions, perhaps before different arbitrators, governed by different rules, and scheduled for hearings in multiple locations. Recently, the Second Circuit held that arbitrators, not courts, must decide whether to consolidate multiple proceedings. However, there is little guidance about how arbitrators should make this decision or on addressing the practical and logistical consequences of multiple proceedings. Absent coordinated case management or guidance from the courts, multiple arbitration proceedings may turn into Dr. Frankenstein’s Monster, a “creature” run amok, which may threaten to destroy the simplicity and cost-savings that may have motivated the parties to arbitrate, rather than litigate, their disputes in the first place.

Consolidation Under the Federal Arbitration Act

The Federal Arbitration Act (FAA) does not explicitly address consolidation of multiple proceedings. Historically, courts consolidated multiple arbitration proceedings based on the then-prevailing view of the FAA’s goal of facilitating the swift and efficient resolution of disputes. Indeed, more than 30 years ago, the Second Circuit found that district courts had the inherent power to consolidate arbitrations based on the FAA’s underlying purpose and Rules 42(a) and 81(a)(3) of the Federal Rules of Civil Procedure.² In the years that followed, district courts within the Second Circuit frequently consolidated arbitration proceedings when the arbitration agreements were silent about consolidation.³

In 1993, the Second Circuit reversed its course and ruled that courts could not consolidate arbitration proceedings absent the parties’ consent. In *United Kingdom v. The Boeing Company*, the Second Circuit reversed a district court ruling consolidating two arbitration proceedings even though they involved the same legal and factual issues.⁴ Neither of the underlying contracts addressed consolidation of multiple proceedings. The court held that it was powerless to consolidate the arbitrations, noting that the FAA required enforcement of agreements as they were written. Thus, the court refused to add provisions to private agreements merely to promote efficiency.⁵ The *Boeing* court did not address whether arbitrators had the inherent power to consolidate arbitration proceedings.

Six years later, the Second Circuit hewed to the view expressed in *Boeing* when it addressed a similar issue in

*Glencore Ltd. v. Schmitzer Steel Products Co.*⁶ In that case, the plaintiff had asked the district court to consolidate related arbitration proceedings or, in the alternative, require a joint hearing before both arbitration panels. The district court had found that it did not have the authority to consolidate the proceedings but nonetheless ordered a joint hearing. In spite of plaintiff’s arguments that it was subject to a risk of duplicative, more expensive, and potentially inconsistent proceedings, the Second Circuit again held that neither the FAA nor the Federal Rules of Civil Procedure authorized courts to consolidate proceedings or order a joint hearing. Once again, *Glencore* did not address whether arbitrators could decide whether to consolidate multiple proceedings.

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The U.S. Supreme Court Broadens the Scope of Arbitrators’ Powers

In recent years, the U.S. Supreme Court has ruled that arbitrators, not courts, should address matters of arbitration procedure. In *Howsam v. Dean Witter Reynolds Inc.*, the Court identified a distinction between “gateway” issues of arbitrability, which should be adjudicated by the courts, and issues of arbitration procedure, which should be resolved by an arbitrator.⁷ Applying this rubric, the Court found that an arbitrator, not the trial court, had to decide whether an NASD rule on the statute of limitations barred the petitioner’s claim.

One year later, in *Green Tree Financial Corp. v. Bazzle*, a plurality of the U.S. Supreme Court held that an arbitrator should decide whether a dispute could proceed as a class arbitration.⁸ After finding that the parties’ agreement was silent about whether class-wide arbitration was permissible, Justice Breyer’s plurality decision stated that the relevant question was to “what kind of arbitration proceeding” the parties had agreed.⁹ Justice Breyer concluded that answering this question was the province

of arbitrators because it required knowledge of "contract interpretation and arbitration procedures."¹⁰ Thus, the Court vacated the South Carolina Supreme Court's ruling that class arbitrations were permitted under the contract so that the arbitrator could reach his own conclusion. However, because Justice Breyer spoke on behalf of only a plurality of the Court, there was some doubt as to *Bazzle's* precedential value.

After these Supreme Court decisions, several trial courts within the Second Circuit concluded that arbitrators, not courts, had to decide whether to consolidate multiple proceedings. For example, in *Blimpie Int'l Inc. v. Blimpie of the Keys*, Judge Leisure rejected the effort by a franchisor to compel several subfranchisors to participate in multiple proceedings.¹¹ Citing *Howsam* and *Bazzle*, Judge Leisure granted the defendant's motion to dismiss and found that the decision whether to consolidate was a procedural issue to be determined by an arbitrator. Until recently, however, the Second Circuit had not had the opportunity to revisit this issue.

The Second Circuit's Decision in *Stolt-Nielsen*

Finally, in late 2008, the Second Circuit reviewed its prior decisions in *Boeing* and *Glencore* in light of the Supreme Court's rulings in *Howsam* and *Bazzle*. In *Stolt-Nielsen SA v. Animal Feeds International Corp.*, a party had filed a putative class action lawsuit, alleging that *Stolt-Nielsen* and others engaged in a conspiracy to restrain competition in the market for shipping liquid chemicals.¹² The district court dismissed the action because the two contracts between the plaintiff and *Stolt-Nielsen* contained arbitration clauses which encompassed the antitrust claim. During the arbitration, the parties submitted evidence and briefing whether class arbitration was permissible given the contracts' silence on that issue. The arbitration panel concluded that the agreements permitted class arbitration and ultimately issued an award in favor of claimants.

Stolt-Nielsen persuaded the district court to vacate the arbitration award because the panel had not decided whether the dispute was governed by federal maritime law or state law. The Second Circuit found that the panel's treatment of the choice-of-law issue did not require *vacatur*, and then rejected *Stolt-Nielsen's* argument that class arbitration was improper under the Second Circuit's rulings in *Boeing* and *Glencore*. The court concluded that arbitrators should decide questions involving consolidation, joint hearings, and class arbitration "as issues of contract interpretation to be decided under the relevant substantive contract law."¹³ Because there was no governing rule of contract construction which would prohibit class arbitration when the agreement was silent, the Second Circuit held that the arbitrator's decision was not in manifest disregard of the law.

Practical and Strategic Issues When Arbitrators Decide Whether to Consolidate Proceedings

While consolidation of arbitrations governed by the FAA is now solely an issue for arbitrators, many questions remain unsettled. First of all, it is difficult to predict whether arbitrators will consolidate proceedings when the operative agreements are silent on that point. Parties can make plausible arguments interpreting the silence of an agreement to support or oppose consolidation. For example, if an agreement contains detailed provisions about the procedures governing the arbitration, such as how arbitrators are selected and how an award should be rendered, the failure to include a provision about consolidation could arguably reflect a considered decision to avoid consolidation. On the other hand, because any party could reasonably contemplate the possibility of facing consolidated proceedings (at least with the benefit of hindsight), an arbitrator could well view the lack of a provision excluding consolidation as evidence that the parties contemplated consolidation. Arbitrators may also try to glean the parties' intent by analyzing the language of the contract, such as whether it refers to other transactions or the involvement of non-signatories, or based upon the use of defined terms, such as "party" or "dispute." At best, this evidence is often ambiguous.¹⁴ Thus, the rules of interpreting contracts will not give consistent and satisfactory answers to whether multiple proceedings should be consolidated.

Arbitrators may also decide consolidation motions based upon equitable, non-contractual arguments. But there can be strong equitable arguments either for or against consolidation. Parties seeking consolidation may argue that consolidation reduces the risk of conflicting judgments or may reduce the expense caused by duplicative proceedings. However, parties opposing consolidation may argue that consolidation could increase their costs if they are involved in only some of the transactions at issue or involved in only a limited fashion. Furthermore, if any party to potentially consolidated proceedings did not participate in selecting the arbitrator(s) who is deciding whether to consolidate and/or the arbitrator who will preside over consolidated proceedings, it may have a persuasive argument that it has suffered prejudice.¹⁵ Moreover, prejudice may exist if the two (or more) contracts at issue have substantially different provisions on arbitration procedures, such as how arbitrators are selected, location of the hearing, standards for admission of evidence, or the rendition of awards.¹⁶ In such a case, the most important question may not be whether the proceedings are consolidated, but which arbitration proceeding should be the consolidated forum.

These equitable factors have been used by courts to decide whether to consolidate arbitrations that are not governed by the FAA. For example, the model state statute intended to be a counterpart to the FAA, the Revised

Uniform Arbitration Act (RUAA), states that a court may consolidate proceedings if the operative agreements do not expressly bar consolidation, after weighing: (i) whether the claims arise from the same transaction or related transactions; (ii) if there are common factual or legal issues, which creates a risk of conflicting decisions; and (iii) the risk of prejudice or undue delay versus potential prejudice from declining to consolidate the proceedings.¹⁷ Likewise, New York state courts have applied similar factors when considering whether to consolidate arbitration proceedings that are not governed by the FAA.¹⁸ Of course, both the RUAA and New York state rules are different in that a court, not an arbitrator, decides whether to consolidate. Nevertheless, they reflect the well-considered view that the existence of common issues and equitable concerns, not rules on how to interpret a contract's silence about consolidation, should drive the decision whether to consolidate multiple proceedings.

In any event, there are substantial strategic and practical consequences to having arbitrators decide whether to consolidate proceedings. Once multiple arbitration demands have been filed, it is unclear which arbitration panel should be empowered to decide whether to consolidate the multiple proceedings—the first panel assembled, the first to render a decision on consolidation, the panel reviewing the claim with the most at stake, or a panel selected upon other criteria. Furthermore, there can be incentives for gamesmanship if a party can selectively commence one arbitration before another proceeding in order to gain an advantage concerning consolidation in a hearing in a favorable location or under favorable rules, or a party may seek to delay the selection of an arbitrator in one panel so that another panel can first address consolidation. Procedurally, even if a panel decides to consolidate proceedings, there may be no easy way to coordinate among arbitration panels. If the parties cannot agree about which arbitrator will decide whether to consolidate the proceedings or how to resolve different decisions on consolidation by multiple arbitrators, the parties could end up litigating such disputes in court.

Conclusion

Many potential disputes over consolidation of multiple arbitration proceedings can be avoided through careful drafting. Parties whose contract may reflect only part of an overall transaction or event—such as a reinsurer who participates in one of many related insurance contracts, or contracts among owners, prime contractors, and subcontractors—may wish to explicitly address the potential for multiple proceedings, whether they are permitted, and under what circumstances. At a minimum, parties may wish to set forth procedures to be used to govern how consolidation decisions should be made and ensure that all parties can participate equally in the selection of arbitrators in a consolidated proceeding. This

might contemplate having an arbitrator appointed solely to address consolidation issues. Or parties could agree that a court should decide any issue concerning consolidation. While boilerplate arbitration provisions do not address these issues, given the likelihood that an arbitrator would have nearly unfettered discretion whether to consolidate multiple proceedings, a well-drafted arbitration clause can substantially limit the potential expense and delay resulting from poorly coordinated multiple proceedings.

Endnotes

1. *Hall Street Assocs. v. Mattel, Inc.*, 128 S. Ct. 1396, 1404 (2008).
2. *Compania Espanola de Petroleos, S.A. v. Nereus Shipping, S.A.*, 527 F.2d 966, 975 (2d Cir. 1975).
3. *E.g., P/R Clipper Gas v. PPG Indus.*, 804 F. Supp. 570, 575 (S.D.N.Y. 1992); *Rio Energy Int'l Inc. v. Hilton Oil Transport*, 776 F. Supp. 120 (S.D.N.Y. 1991).
4. 998 F.2d 68 (2d Cir. 1993).
5. *Id.* at 73.
6. 189 F.3d 264 (2d Cir. 1999).
7. 537 U.S. 79, 84 (2002).
8. 539 U.S. 444 (2003).
9. *Id.* at 452.
10. *Id.* at 453.
11. 371 F. Supp. 2d 469 (S.D.N.Y. 2005).
12. 548 F.3d 85 (2d Cir. 2008).
13. *Id.* at 100.
14. For example, in *Bazzle*, the operative loan agreement contained a provision that an arbitrator would be "selected by us with the consent of you." 539 U.S. at 448. Justice Breyer's plurality decision found this provision ambiguous as to whether it permitted class arbitration. *Id.* at 453. By contrast, Justice Rehnquist's dissent concluded that this provision, along with provisions in the contract which referred to a specific loan, did not contemplate class-wide dispute resolution. *Id.* at 459.
15. *Id.* at 456–57 ("I have no hesitation in saying that the choice of arbitrator is as important a component of the agreement to arbitrate as is the choice of what is to be submitted to him.") (Rehnquist, C. J., dissenting).
16. *Continental Energy Assoc. v. Asea Brown Boveri, Inc.*, 192 A.D.2d 467, 596 N.Y.S.2d 416 (1st Dep't 1993).
17. Revised Uniform Arbitration Act, 7 U.L.A. 6 (Supp. 2002).
18. *See, e.g., Cullman Ventures v. Conk*, 252 A.D.2d 222, 682 N.Y.S.2d 391 (1st Dep't 1998) (consolidation of arbitrations in New York improper when agreements provided for hearings in Indiana and New York); *Gershen v. Hess*, 163 A.D.2d 17, 558 N.Y.S.2d 14 (1st Dep't 1990) (trial court improperly denied motion to consolidate when there were common issues, the possibility of inconsistent judgments, and no showing of prejudice arising from consolidation).

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