High Court May Clarify Key Arbitration Issue

By **Kevin O'Brien**

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Since the enactment of the Federal Arbitration Act in 1925, volumes of case law have been generated regarding the scope, validity and enforceability of agreements to arbitrate, as parties argued over whether an arbitration agreement applied to a particular dispute.

But sometimes the controversy is not simply whether the arbitration clause applies, but over who has the power to make that determination — the arbitrator or a court.

This so-called gateway issue has added a level of complexity to arbitration practice for many years, and the courts have yet to establish definitive guidance on the question, as demonstrated by long-running litigation where a second hearing is **currently pending** before the U.S. Supreme Court.

On Dec. 8, the Supreme Court is scheduled to hear oral arguments for the second time in Henry Schein Inc. v. Archer & White Sales Inc., or Schein II.

The dispute over whether the parties agreed that the arbitrator would have the power to decide the gateway arbitrability question has generated eight years of litigation, two decisions by the U.S. Court of Appeals for the Fifth Circuit, and two proceedings before the Supreme Court with the parties no closer to resolving the merits of their dispute than they were at the time the plaintiff initially filed its lawsuit in 2012.

Moreover, despite the fact that the Supreme Court's first decision in the case was unanimous, the complexity of the questions presented allows the high court to go in any number of directions on its second bite at the apple.

As in many cases where arbitrability is in dispute, the procedural history of the case is tangled.

The parties were distributors of dental equipment. Archer & White sued Henry Schein in the U.S. District Court for the Eastern District of Texas, alleging that Schein and other distributors had violated state and federal antitrust laws by conspiring to terminate or restrict Archer & White's distributorship rights.

The complaint sought both money damages and injunctive relief. Schein moved to stay the litigation citing the arbitration clause in the relevant distribution agreements requiring that the parties arbitrate disputes "arising under or related to" the agreements. The arbitration clause reads as follows:

Any dispute arising under or related to this Agreement (except for actions seeking injunctive relief and disputes related to trademarks, trade secrets, or other intellectual property of [Schein]), shall be resolved by binding arbitration in accordance with the arbitration rules of the American Arbitration Association.[1]

One key feature of the arbitration clause was its incorporation of the AAA rules, which provide that gateway questions of arbitrability are to be resolved by the arbitrator. AAA Commercial Rule 7:

The arbitrator shall have the power to rule on his or her own jurisdiction, including any objections with respect to the existence, scope, or validity of the arbitration agreement or to the arbitrability of any claim or counterclaim.

The other significant aspect of the clause was a carveout provision for "actions seeking injunctive relief."

Such a carveout provision is understandable, given that parties seeking a time-sensitive injunction may wish to proceed immediately into court rather than convene an arbitration panel, obtain a ruling and then face the prospect of enforcing that ruling through the courts.

As defendant, Schein invoked the arbitration clause in moving the stay the litigation and compel arbitration in accordance with the provisions of Section 3 of the FAA.[2]

Archer & White objected, arguing that the dispute was not arbitrable because its complaint included a request for injunctive relief.

However, before the district court could address the merits of whether the carveout provision applied, it had to deal with the threshold question of whether the court or the arbitrator had the power under the contract to make that decision.

Schein contended that the parties' contractual agreement to AAA rules meant that the arbitrator had the power to rule on the "existence, scope, or validity" of the arbitration agreement and therefore should decide the threshold question of whether the carveout for injunctive relief made the arbitration clause inapplicable.[3]

However, citing the Fifth Circuit's precedent, the district court ruled that where arguments in favor of arbitration were "wholly groundless," the court — not the arbitrator — would decide the gateway arbitrability question.

The district court reasoned that Schein's attempt to invoke arbitration was wholly groundless because the injunctive component of Archer & White's complaint fell within the carveout in the arbitration clause, and denied Schein's motion to compel arbitration on that basis.

The Fifth Circuit affirmed and the Supreme Court granted Schein's petition for certiorari.

In its unanimous opinion written by Justice Brett Kavanaugh — the first full opinion of his tenure — the Supreme Court summarily rejected the wholly groundless exception as inconsistent with the Federal Arbitration Act and prior court precedent:

When the parties' contract delegates the arbitrability question to an arbitrator, a court may not override the contract. In those circumstances, a court possesses no power to decide the arbitrability issue.

In light of the holding, one would think that the high court would have remanded with an order to compel arbitration on the threshold arbitrability question.

But, unfortunately, the courts below had not expressly determined whether the contract "clearly and unmistakably" delegated the threshold question to the arbitrator — only that a wholly groundless arbitration claim could be disposed of by the courts in the first instance.

The Supreme Court directed the Fifth Circuit to consider whether the contract did actually

provide for delegation, as well as any other arguments that had been preserved.[4]

As a result, the parties on remand argued whether the contract had in fact delegated the threshold arbitrability question to the arbitrator.

Two competing factors were at play: the contract's incorporation of AAA rules delegating such threshold questions to the arbitrator — the incorporation question — and the arbitration clause's carveout of requests for injunctive relief — the carveout question.

On remand, the Fifth Circuit once again refused to compel arbitration.

It concluded that the parties had delegated at least some questions of arbitrability to the arbitrator, stating that "an arbitration agreement that incorporates the AAA rules 'presents clear and unmistakable evidence that the parties agreed to arbitrate arbitrability.'"[5]

But it held that because the arbitration agreement included a provision exempting certain claims from arbitration (as relevant here, actions seeking injunctive relief), the agreement did not "'clearly and unmistakably' delegate[] the question of arbitrability to an arbitrator."[6]

The Fifth Circuit's ruling prompted Schein's second certiorari petition to the Supreme Court, focusing on the carveout issue in its question presented: "Whether a provision in an arbitration provision that exempts certain claims from an arbitration negates an otherwise clear and unmistakable delegation of questions of arbitrability to an arbitrator."[7]

In a conditional cross-petition, Archer & White argued that this question did not warrant review, but that if the Supreme Court accepted the case it should also decide whether the incorporation of the AAA rules "clearly and unmistakably" delegated the gateway issue to the arbitrator.[8] The high court granted Schein's petition but denied Archer & White's.[9]

Despite the denial of the cross-petition, Archer & White and amici appearing on its behalf pressed the incorporation question in their briefs to the Supreme Court. Archer & White argued that the mere incorporation of AAA rules did not constitute "clear and unmistakable" evidence that the parties had agreed to delegate the gateway question to the arbitrator; citing the Supreme Court's 1995 First Options of Chicago Inc. v. Kaplan decision[10] it contended that the lack of an explicit statement of delegation demonstrates that the parties had not manifested an intent to give the arbitrator power to decide the gateway question.[11]

Three separate amicus briefs also urged the high court to find that the reference to the AAA rules did not satisfy the "clear and unmistakable" standard for delegation.[12]

In reply, Schein has argued that the Supreme Court should not reach the incorporation question, as contending that Archer & White had lost that battle at when the high court denied its cross-petition for certiorari.[13]

Instead, Schein contended, the high court should address only the carveout question because the Fifth Circuit had correctly resolved the incorporation question in accordance with the weight of federal authority.[14]

Schein contends that the specific exemption of certain types of claims from the scope of the arbitration agreement does not negate the general delegation of the gateway question of arbitrability to the arbitrator; as a result, the arbitrator, not the court, determines whether

the carveout for injunctive relief applies.[15]

Predicting the Supreme Court's disposition of Schein II is as treacherous as navigating the nine-year procedural morass that has led to the case's current posture.

Although the Supreme Court's prior decision rejecting the wholly groundless exception was unanimous, the issues before the high court today are significantly different.

Those who have argued against the broad application of arbitration clauses in "take-it-or-leave it" employment and consumer agreements would no doubt wish to see the court address the incorporation question by ruling that reference to the AAA rules does not effect a "clear and unmistakable" delegation of the gateway arbitrability question.

During the first oral argument in October 2018, several of the justices raised the issue of whether the arbitration agreement did so delegate in the first instance.[16] Delivering a "bright line" ruling on the incorporation question would certainly give clear guidance to alternative dispute resolution practitioners.

However, a sweeping ruling that incorporation of AAA rules does not constitute a clear and unmistakable delegation of the gateway question would have the potential to send many gateway disputes to courts rather than arbitrators in the first instance.

The high court's decision not to reach that issue in its first decision, combined with its denial of Archer & White's cross-petition for certiorari in Schein II, suggests that the Supreme Court may issue a more limited ruling focusing on the effect of the carveout provision.

By taking that approach, the high court could indicate that it was supporting its long-held presumption favoring arbitration as a mechanism for dispute resolution[17] while addressing the effect of the specific carveout language at issue in the instant case.

It would also potentially offer a mechanism to resolve the case without addressing the incorporation question; the court could rule that the express carveout of actions for injunctive relief would trump any argument that there was a general delegation of gateway questions to the arbitrator.

Whichever route the court may choose, its holding will have important consequences for attorneys in interpreting and drafting arbitration clauses.

A broad ruling on the incorporation question could have significant ramifications with regard to "boilerplate" arbitration agreements that reference only AAA rules.

If the high court rules that such a reference does not constitute a "clear and unmistakable" delegation, all gateway questions in such contracts would be directed to the court.

A more narrow ruling on whether the general delegation of arbitrability questions could be carved out to exempt specific actions would likely lead to more detailed arbitration agreements spelling out the types of actions for which the arbitrator would have sole authority to decide the gateway question of arbitrability.

Kevin O'Brien is a partner at Porter Wright Morris & Arthur LLP.

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[1] Henry Schein, Inc. v. Archer & White Sales, Inc. ("Schein I"), 139 S. Ct. 524, 528 (2019).

[2] 9 U.S. Code, Section 3.

[3] Schein, 139 S. Ct. at 528.

[4] Id. at 531.

[5] Archer & White Sales, Inc. v. Henry Schein, Inc., 935 F.3d 274, 279-80 (5th Cir. 2019).

[6] Id. at 281-82.

[7] Petition for a Writ of Certiorari, Henry Schein, Inc. v. Archer & White Sales, Inc. No. 19-863, U.S. S. CT. BRIEFS LEXIS 365 (January 31, 2020), at I.

[8] Brief for the Respondent in Opposition, Henry Schein, Inc. v. Archer & White Sales, Inc. No. 19-863, U.S. S. CT. BRIEFS LEXIS 822 (March 2, 2020), at I.

[9] Henry Schein, Inc. v. Archer & White Sales, Inc. No. 19-863, 2020 U.S. LEXIS 3181 (June 15, 2020).

[10] First Options of Chicago, Inc. v. Kaplan, 514 U.S. 938 (1995).

[11] Brief for the Respondent, Henry Schein, Inc. v. Archer & White Sales, Inc. No. 19-863, U.S. S. CT. BRIEFS LEXIS 5506 (October 13, 2020), at 13-17.

[12] See Brief of American Association for Justice and Public Justice as Amici Curiae Supporting Respondent, U.S. S. CT. BRIEFS LEXIS 3670 (Oct. 20, 2020), at 6 ("clear and unmistakable" is a "heightened standard" requiring explicit, not inferred, delegation); Brief of Constitutional Accountability Center as Amicus Curiae Supporting Respondent, U.S. S. CT. BRIEFS LEXIS 3518 (Oct. 20, 2020), at 5 (the FAA's text creates a "strong presumption" that gateway aribitrability questions are not delegated to the arbitrator); Brief of Amicus Curiae Professor George A. Bermann in Support of Respondent, U.S. S. CT. BRIEFS LEXIS 6054 (Oct. 19, 2020), at 27 (a "clear and unmistakable" delegation belongs in the text of the arbitration agreement itself, not in incorporated rules).

[13] Reply Brief for the Petitioner, Henry Schein, Inc. v. Archer & White Sales, Inc. No. 19-863, U.S. S. CT. BRIEFS LEXIS ___ (November 12, 2020), _____, at 12.

[14] Id. at 13-14.

[15] Id. at 3.

[16] Brief of Amicus Curiae Professor George A. Bermann in Support of Respondent, U.S. S. CT. BRIEFS LEXIS 6054 (Oct. 19, 2020), at 5-6 (citing questions from Justices Ginsburg, Kagan, Breyer, and Gorsuch).

[17] See, e.g., Moses H. Cone Mem'l Hosp. v. Mercury Constr. Corp., 460 U.S. 1, 24-25 ([A]s a matter of federal law, any doubts concerning the scope of arbitrable issues should be resolved in favor of arbitration . . . .")