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US Supreme Court Rejects "Wholly Groundless" Exception to Rule That Arbitrators Must Decide Arbitrability When Contract Delegates That Question to Arbitrators

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On January 8, 2019, the US Supreme Court held in *Henry Schein, Inc. v. Archer & White Sales, Inc.*, 586 U.S. --- (Jan. 8, 2019), that when a contract delegates to arbitrators the question whether a dispute is subject to arbitration, a court must refer the matter to arbitration even if, in the court's opinion, the claim that the dispute is arbitrable is "wholly groundless." The unanimous decision, which was the first opinion of the Court authored by Justice Kavanaugh, is available here.

Background

The *Schein* case involved a dispute between Archer & White, a distributor of dental equipment, and various competitors, including Schein, that distributed and manufactured dental equipment. Archer & White filed suit against Schein and the other defendants in the US District Court for the Eastern District of Texas, alleging violations of federal and state antitrust laws, and seeking both monetary damages and injunctive relief. The relevant contract from which the suit arose included an arbitration agreement which provided, in pertinent part:

> 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.

After Archer & White filed suit, Schein moved to compel arbitration pursuant to the Federal Arbitration Act (FAA). Archer & White opposed the motion, contending that the arbitration agreement in the contract did not apply to the dispute because it excluded arbitration of disputes in which the plaintiff sought injunctive relief.[1]

The parties disagreed as to who (the court or an arbitral tribunal) should decide whether Archer & White's antitrust claims were captured by the arbitration agreement in the parties' contract. Schein argued that the arbitration agreement's express reference to the American Arbitration Association (AAA) rules, which provide that arbitrators are empowered to decide questions of arbitrability,[2] meant that an arbitrator—not the court—must decide, in the first instance, whether the dispute was subject

to arbitration. Archer & White, relying on Fifth Circuit precedent, responded that a court may resolve the threshold arbitrability question—even where the parties' contract delegates this arbitrability question to an arbitrator—in circumstances where the defendant's argument in favor of arbitrability is "wholly groundless."

Agreeing with Archer & White, the district court determined that Schein's argument for arbitration was "wholly groundless" because the plain language of the arbitration agreement excluded actions seeking injunctive relief. The district court therefore denied Schein's motion to compel arbitration. *Archer & White Sales, Inc. v. Henry Schein, Inc.*, No. 2:12-cv-572-JRG, 2016 WL 7157421, at *8-9 (E.D. Tex. Dec. 7, 2016). The Fifth Circuit Court of Appeals affirmed the district court's decision, *Archer & White Sales, Inc. v. Henry Schein, Inc.*, 878 F.3d 488, 495-98 (5th Cir. 2017), and Schein sought review in the Supreme Court.

The Supreme Court granted certiorari in Schein to resolve a circuit split as to whether the "wholly groundless" exception is consistent with the FAA. (Slip op. 3.) In addition to the Fifth Circuit, the Fourth, Sixth, and Federal Circuits had adopted the "wholly groundless" exception or a similar analysis. *See, e.g., Simply Wireless, Inc. v. T-Mobile US, Inc.*, 877 F.3d 522, 528-29 (4th Cir. 2017); *Douglas v. Regions Bank*, 757 F.3d 460, 464 (5th Cir. 2014); *Turi v. Main Street Adoption Servs., LLP*, 633 F.3d 496, 511 (6th Cir. 2011); *Qualcomm, Inc. v. Nokia Corp.*, 466 F.3d 1366, 1373-75 (Fed. Cir 2006). The Tenth and Eleventh Circuits had come to a contrary conclusion, holding that where the parties have delegated the question of arbitrability to an arbitrator, the court could not consider the merits of that question at all before sending the case to arbitration. *See Belnap v. Iasis Healthcare*, 844 F.3d 1272, 1286-87 (10th Cir. 2017); *Jones v. Waffle House, Inc.*, 866 F.3d 1257, 1268-71 (11th Cir. 2017); *see also Douglas*, 757 F.3d at 464-68 (Dennis, J., dissenting).

The Supreme Court's Decision

In a unanimous decision, the Court vacated the Fifth Circuit's ruling and held that the "wholly groundless" exception is inconsistent with the FAA and the Court's precedent. The Court's decision was firmly rooted in the FAA's mandate that courts respect and enforce the agreement of parties to arbitrate controversies between themselves. The Court reiterated its explanation in *Rent-A-Center, West, Inc. v. Jackson*, 561 U.S. 63, 68-69 (2010), that "parties may agree to have an arbitrator decide not only the merits of a particular dispute but also 'gateway' questions of 'arbitrability,' such as whether the parties have agreed to arbitrate or whether their agreement covers a particular controversy." (Slip op. 4.) And the Court made clear that agreements to delegate to arbitrators the question of arbitrability must be enforced to the same extent as any other agreement to arbitrate:

> 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. That is true even if the court thinks that the argument that the arbitration agreement applies to a particular dispute is wholly groundless. (Slip op. 5.)

The Court based its analysis both on the text of the FAA, which contains no "wholly groundless" exception, and on the Court's prior jurisprudence. In particular, the Court analogized the threshold issue of arbitrability to its decision in *AT&T Technologies, Inc. v. Communications Workers*, 475 U.S.

643, 649-50 (1986), in which the Court held that a court may not rule on the merits of a party's claim that is delegated by contract to an arbitrator, even if the court considers the claim to be frivolous. (Slip op. 5.) Relying on *AT&T Technologies*, the Court in *Schein* concluded that "[j]ust as a court may not decide a merits question that the parties have delegated to an arbitrator, a court may not decide an arbitrability question that the parties have delegated to an arbitrator." *Id*.

The Court was not persuaded by Archer & White's arguments that the "wholly groundless" exception is consistent with the FAA. ***First***, the Court summarily rejected Archer & White's contention that Sections 3 and 4 of the FAA should be interpreted to mean that "a court must always resolve questions of arbitrability and that an arbitrator never may do so." (Slip op. 6.) As the Court observed, "that ship has sailed," because the Court "has consistently held that parties may delegate threshold arbitrability questions to the arbitrator, so long as the parties' agreement does so by 'clear and unmistakable' evidence." *Id*. (citing *First Options of Chicago, Inc. v. Kaplan*, 514 U.S. 938, 944 (1995); *Rent-A-Center*, 561 U.S. at 69 n.1). The Court confirmed that, pursuant to Section 2 of the FAA, a court may first determine whether a valid arbitration agreement exists before referring a dispute to an arbitrator. Id. "But," the Court explained, "if a valid agreement exists, and if the agreement delegates the arbitrability issue to an arbitrator, a court may not decide the arbitrability issue." *Id*.

Second, the Court disagreed with Archer & White's argument that a court should be able to determine that an issue is not arbitrable "at the front end" of a dispute because Section 10(a)(4) of the FAA allows a court "at the back end" of an arbitration to vacate the award if the arbitrators exceeded their powers. *Id*. The Court explained that, as a matter of principle, "Congress designed the [FAA] in a specific way, and it is not our proper role to redesign the statute." *Id*. The Court also noted that Archer & White's interpretation of Section 10 of the FAA, if accepted, would also allow a court, using the concept of "frivolousness," to decide some merits questions that the parties had delegated to an arbitrator, which is incompatible with the Court's holding in *AT&T Technologies*. (Slip op. 6-7.)

Third, the Court rejected Archer & White's argument that, "as a practical and policy matter, it would be a waste of the parties' time and money to send the arbitrability question to an arbitrator if the argument for arbitration is wholly groundless." (Slip op. 7.) The Court first concluded, again as a matter of principle, that such considerations are beside the point because the Court is not empowered to rewrite the FAA to accommodate such concerns. *Id*. In addition, the Court doubted that the exception would systematically save parties time and money by preventing frivolous attempts to transfer disputes from a court to arbitration. As the Court observed, the "wholly groundless" exception "would inevitably spark collateral litigation … over whether a seemingly unmeritorious argument for arbitration is wholly groundless, as opposed to groundless." *Id*. The Court also recognized the possibility that a fair-minded arbitrator "might hold a different view of the arbitrability issue than a court does, even if the court finds the answer obvious." *Id*.

Finally, the Court rejected Archer & White's argument that the "wholly groundless" exception is necessary to deter frivolous motions to compel arbitration. (Slip op. 8.) Once again, the Court emphasized that it lacked the power to rewrite the terms of the FAA in the service of a policy concern.

The Court also indicated that, in any event, this argument overstated the potential problem given that arbitrators may dispose of frivolous cases efficiently by quickly ruling that a claim is not arbitrable, and may also deter and remedy frivolous arguments for arbitration by imposing fee-shifting and cost-shifting where appropriate. *Id*.

Implications and Open Questions

By eliminating the "wholly groundless" exception to the rule that arbitrators must decide the question of arbitrability if that question has been delegated to them by the parties, the *Schein* decision strongly reaffirms the US federal policy respecting and enforcing the terms of parties' agreements to arbitrate. The Schein decision should reassure contracting parties who want arbitrators to decide the gateway issue of arbitrability (applying the principle of "competence-competence") that US courts will not override the parties' delegation of that issue to arbitration, even in circumstances where the court believes the arguments in favor of arbitrability to be "wholly groundless."

Importantly, the Supreme Court, like the Fifth Circuit in the proceeding below, did not address the question whether there was "clear and unmistakable" evidence that the parties had, in fact, delegated the question of arbitrability to the arbitrator. (Slip op. 8, citing *First Options*, 514 U.S. at 944.) It held only that the Fifth Circuit was wrong to find that, even if the parties had done so, the case should not be referred to arbitration because the claim of arbitrability was "wholly groundless." *Id*. Having vacated the decision on appeal, the Court remanded the case to the Fifth Circuit to decide whether the parties' incorporation of the AAA's arbitration rules, which include a provision empowering arbitrators to rule on their own jurisdiction, was sufficient to constitute "clear and unmistakable" evidence that the parties agreed to delegate the question of arbitrability to the arbitrator.

The Court thus left open an interesting question for future resolution. A majority of lower courts addressing this issue have concluded that an arbitration agreement's incorporation of arbitration rules that allow arbitrators to determine their own jurisdiction is a "clear and unmistakable" expression of the parties' intent to delegate the question of arbitrability to the arbitrators. *See, e.g., Oracle Am., Inc. v. Myriad Group, A.G.*, 724 F.3d 1069, 1074-75 (9th Cir. 2013); *Petrofac, Inc. v. DynMcDermott Petroleum Operations Co.*, 687 F.3d 671, 675 (5th Cir. 2012); *Awuah v. Coverall N. Am., Inc.*, 554 F.3d 7, 11 (1st Cir. 2009); *Fallo v. High-Tech Inst.*, 559 F.3d 874, 878 (8th Cir. 2009); *Conte Corp. v. Remote Solution, Co., Ltd.*, 398 F.3d 205, 208 (2d Cir. 2005); but *see, e.g., Riley Mfg. Co., Inc. v. Anchor Glass Container Corp.*, 157 F.3d 755, 777 n.1, 780 (10th Cir. 1988) (concluding that an arbitration agreement incorporating the AAA rules did not reflect "a specific intent to submit to an arbitrator" the question of arbitrability).

On the other hand, the American Law Institute's *Restatement of the US Law of International Commercial and Investor-State Arbitration* has adopted a contrary position, concluding that the incorporation of such arbitral rules generally does not itself constitute "clear and unmistakable" evidence of the parties' intention to arbitrate questions of arbitrability. Restatement (Third) US Law of Int'l Comm. & Investor-State Arb. § 2-8 Reporter's Note b(iii) (Tentative Draft No. 4, 2015). Given that this is an important and unsettled issue in US arbitration law, the Supreme Court may ultimately be asked to address it. In the meantime, if parties wish for courts, rather than arbitral tribunals, to

decide gateway issues of arbitrability at the beginning of a dispute, they would be wise to make that preference clear in their arbitration agreement—particularly where the institutional rules selected by the parties would otherwise delegate that decision to an arbitral tribunal in the first instance.

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[1] Although not the focus of this alert, it bears noting that arbitration agreements such as the one at issue in *Schein*, which seek to carve out certain types of claims or disputes from the general agreement to arbitrate, must be drafted with great care. Often, as in this case, such carve-outs lead to disputes about the scope of the carve-out and end up substantially increasing the time and costs necessary to resolve the dispute.

[2] As is typical in US court decisions, the Supreme Court used the term "arbitrability" to refer to the broad question whether the dispute was subject to arbitration as opposed to resolution in court. In international practice, the term "arbitrability" generally refers to the narrower question whether a particular cause of action was determined by a national law to be capable of resolution by arbitration or was instead exclusively reserved to courts of law.

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