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Client Alert

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U.S. Supreme Court Strikes Down "Wholly Groundless" Exception Where Parties Have Agreed to Arbitrate Arbitrators' Jurisdiction

On January 8, 2019, the United States Supreme Court issued a unanimous decision in *Henry Schein, Inc. et al. v. Archer & White Sales, Inc.*, No. 17–1272, 2019 WL 122164 (U.S. Jan. 8, 2019), in which the Court yet again considered the question of who decides the scope of arbitrators' jurisdiction, or "arbitrability" as that term is used in the United States. In the first opinion of the Court delivered by Justice Brett Kavanaugh, the Court held that, where the parties have agreed that the arbitrators rather than the court will decide the "threshold question of arbitrability," the courts cannot "short-circuit the process and decide the arbitrability question themselves." *Id.* at *2–*3, This is true even where "the argument that the arbitration agreement applies to the particular dispute is 'wholly groundless.'" *Id.* at *4. The Court found that the "wholly groundless" doctrine finds no justification in either the language of the Federal Arbitration Act ("FAA") or any Supreme Court precedent.

In *Henry Schein*, the Court followed *First Options of Chicago v. Kaplan*, 514 U.S. 938 (1995), which held that there is a rebuttable presumption that parties to an arbitration agreement intend for a court, rather than the arbitrators, to decide issues of arbitrability. That presumption is overcome where there is "clear and unmistakable" evidence that the parties intended to delegate the arbitrability question to the arbitrators. *Id.* at 944. The Court granted *certiorari* to address a split in authority in the lower courts over whether a court faced with a delegation provision could nevertheless decide the arbitrability question itself if the court determined that the argument in favor of arbitration was "wholly groundless." *Henry Schein* at *3. The Court noted that the United States Courts of Appeal for the Fourth, Fifth, Sixth, and Federal Circuits have recognized a "wholly groundless" exception to the rule while the Tenth and Eleventh Circuits have not.

In *Henry Schein*, the parties' contract provided that the dispute would be resolved under the rules of the American Arbitration Association (the "AAA Rules"), and contained a carve-out for certain actions, including those

involving injunctive relief, which would be reserved for the courts. After Archer & White sued Schein in court, Schein moved to compel arbitration. Archer & White objected, on the basis that its case included a request for injunctive relief, at least in part.

The United States District Court then had to determine whether it could decide arbitrability, or whether it must be decided by the arbitrators. Schein argued that the parties' selection of the AAA Rules, which include a rule granting arbitrators the authority to decide the scope of their own jurisdiction, meant that they had agreed to arbitrate arbitrability. Archer & White responded by noting that the Fifth Circuit recognized an exception to that rule where the defendant's argument for arbitration is wholly groundless. In such instances, the court may decide the issue. The District Court agreed with Archer & White's argument that the position in favor of arbitration was wholly groundless and denied the motion to compel arbitration. On appeal, the Fifth Circuit affirmed.

The Supreme Court provided four reasons for overturning the Fifth Circuit's ruling and eliminating the wholly groundless exception. First, while the Court acknowledged that a court confronted with a motion to compel arbitration must first determine whether a valid arbitration agreement exists, the Court rejected Archer & White's argument that Sections 3 and 4 of the FAA require a District Court to resolve arbitrability questions as well before staying litigation and compelling arbitration. "[T]hat ship has sailed" because the Supreme 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.* at *4.

Second, the Court rejected Archer & White's argument based on the provision of Section 10(a)(4) of the FAA that permits "back end" review of an arbitration award by a court if the arbitrators have exceeded their powers. Archer & White reasoned that if a court can review the scope of the arbitrators' powers after the award is issued, it should be permitted to review the scope of the arbitrators' powers at the front end as well. Without explaining the reasons for its conclusion, the Supreme Court simply found this argument to be inconsistent with the way Congress had designed the FAA. Because it was not within the Court's purview to amend a statute, the Court rejected the argument. The Court further noted that courts are not allowed to second-guess arbitrators' decisions on the merits of a claim that parties have agreed to arbitrate "even if the court thinks that a party's claim on the merits is frivolous." The Court concluded: "So, too, with arbitrability." *Id.* at *4.

Third, Archer & White argued that sending wholly groundless arbitrability questions to the arbitrators would be a waste of the parties' time and resources. The Court rejected this argument on the basis that the FAA contained no exception for "wholly groundless" arguments, further noting that while such an exception may save time and resources in individual disputes, it was not at all clear that it would do so on a systemic basis because (1) recognizing a wholly groundless exception "would inevitably spark collateral litigation . . . over whether a seemingly unmeritorious argument for arbitration is *wholly* groundless, as opposed to groundless"; and (2) the outcome of the arbitrability decision might be different if it is decided by an arbitrator rather than by a court because "an arbitrator might hold a different view of the arbitrability issue than a court does." *Id.* at *5.

Fourth, the Court rejected the argument that the exception is necessary to deter frivolous motions to compel arbitration. The Court stated that even if Archer & White's argument were correct, it would still not empower the Court to rewrite the FAA. Further, the Court noted that arbitrators are empowered to resolve frivolous arguments about arbitrability in an efficient way, and that, "under certain circumstances," arbitrators may have the power to impose sanctions in the form of fee- and cost-shifting orders. *Id.*

The obvious holding of *Henry Schein* is that there is no "wholly groundless" exception to a District Court's obligation to stay litigation and compel arbitration in cases where the parties have agreed to arbitrate arbitrability. Even though the opinion is short, it is notable for the following additional issues that it either addresses or fails to address.

Delegation by incorporating institutional rules. Schein argued that the parties had clearly and unmistakably agreed to arbitrate arbitrability by incorporating into their agreement the AAA Rules, which—like the rules of other major arbitral institutions—contain a delegation provision. The Supreme Court has not addressed this issue, but there is widespread consensus among the Circuit Courts of Appeal that incorporation of institutional rules with a delegation provision constitutes "clear and unmistakable" evidence of an agreement to arbitrate arbitrability. *See, e.g.*, *Oracle America v. Myriad Group*, 724 F.3d 1069, 1074 (9th Cir. 2013) ("Virtually every circuit to have considered the issue has determined that incorporation of the American Arbitration Association's (AAA) arbitration rules constitutes clear and unmistakable evidence that the parties agreed to arbitrate arbitrability"). However, as the Reporter for the ALI's forthcoming Restatement of the U.S. Law of International Commercial and Investor-State Arbitration pointed out in an *amicus* brief, the Restatement takes the position that those cases were wrongly decided. Brief of Amicus Curiae Professor George A. Bermann in Support of Respondent at 2, 6 *Henry Schein, Inc. et al. v. Archer & White Sales, Inc.*, No. 17–1272, 2019 WL 122164 (U.S. Jan. 8, 2019). In *Henry Schein*, the Supreme Court merely stated that "we express no view about whether the contract at issue in this case in fact delegated the arbitrability question to an arbitrator." *Henry Schein* at *6. This statement could invite future litigation concerning the effect of the delegation provisions found in institutional arbitration rules.

Judicial Review of Arbitrators' Decisions on Arbitrability. Archer & White argued that because Section 10(a)(4) of the FAA permits a court to vacate an arbitration award where the arbitrator exceeds his or her powers, it would therefore make sense for a court to have the power to prevent an arbitrator from deciding that issue in the first place. The Court disposed of this argument with the cryptic statement that "[t]he dispositive answer to Archer and White's §10 argument is that Congress designed the Act in a specific way, and it is not our proper role to redesign the statute." *Id.* at *4. The Court did not explain how the design of the FAA precludes Archer & White's argument, which may lead to future litigation over what the Court meant by that statement.

Separately, the Court noted—without reference to whether the issue arises prior to arbitration or after the arbitrators have issued an award—that courts have no authority to resolve the merits of a claim that the parties have agreed to arbitrate, citing *AT&T Technologies, Inc. v. Communications Workers*, 475 U.S. 643, 649–50 (1986). Then, without citing any authority, the Court concluded: "So, too, with arbitrability." *Henry Schein* at *4. This is significant because while there is substantial authority in the lower courts addressing delegation provisions at the motion to compel arbitration stage, there are relatively fewer cases addressing delegation provisions at the award-enforcement or vacatur stage. Some courts have found that where there is an effective delegation provision, courts should defer to the arbitrators' ruling on arbitrability. *See, e.g.*, *Schneider v. Kingdom of Thailand*, 688 F.3d 68, 74 (2d Cir. 2012) (holding that "a district court considering whether to confirm the award must review the arbitrators' resolution of [jurisdictional] questions with deference"); *Chevron Corp. v. Republic of Ecuador*, 949 F.Supp.2d 57, 66 (D.C. Cir. 2013) ("To the extent that the parties here have 'clearly and unmistakably' agreed to arbitrate arbitrability, then, this Court must give substantial deference to that decision"). This arguably leaves the door open to future litigation concerning the level of deference courts owe to arbitrators' decisions on arbitrability, and whether *Henry Schein* has resolved that question.

Arbitrators' Authority to Sanction Parties. Finally, the Court held that "under certain circumstances, arbitrators may be able to respond to frivolous arguments for arbitration by imposing fee-shifting and cost-shifting sanctions." *Henry Schein* at *5. The Court did not describe the circumstances under which an arbitrator would have the power to impose sanctions. In many cases, the parties' agreement requires the arbitrator to impose fee shifting. This is not a sanction for frivolous arguments, but simply an agreement to opt out of the so-called "American Rule," which presumes that each party will pay its own attorney's fees and costs. In such a case, a fee-shifting order against a party would arguably not be a sanction.

In other cases, the parties do not empower the arbitrators to order fee-shifting. Moreover, the Court did not say whether the sanctions should be imposed on the party or on the lawyers who advance the frivolous argument. *Henry Schein* could, therefore, lead to future litigation over whether arbitrators have inherent power to impose sanctions on parties or counsel; whether they may only do so pursuant to an agreement of the parties; and whether there are any circumstances under which arbitrators may have authority to do so.