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Third Circuit Rules that Courts – Not Arbitrators – Decide the Threshold Question of the Existence of an Agreement to Arbitrate where the Validity of the Underlying Agreement is in Doubt

On September 14, 2020, the United States Court of Appeals for the Third Circuit unanimously ruled in *MZM Construction Co. Inc. v. New Jersey Building Laborers' Statewide Benefit Funds*, Nos. 18-3791 & 19-3102, (3d Cir. Sept. 8, 2020) that judges – not arbitrators – decide the gateway question of arbitrability if one party disputes having ever entered into the agreement containing the relevant arbitration clause, even where that clause contains language purporting to delegate questions of arbitrability to the arbitrator. It found that “unless the parties clearly and unmistakably agreed to arbitrate questions of contract formation in a contract whose formation is not at issue,” courts retain jurisdiction to decide that gateway question.¹

Background

In 2001, MZM Construction Company (MZM) hired workers from a local labor union to work on a construction project at Newark Liberty International Airport. The following year, MZM's president and sole shareholder signed a one-page short form agreement with the local labor union. That agreement referenced related two “collective bargaining agreements or CBAs,” but did not include “any other substantive terms.”² One of those two CBAs – the 2002 CBA – was not signed. Under the 2002 CBA, employers are required to make contributions to the New Jersey Building Laborers' Statewide Benefits Funds (the Funds) in accordance with “the applicable trust agreement” and grants the Funds the right to audit the books of contracting employers to ensure that all required contributions have been made.³



From 2001 until 2018, MZM remitted more than US\$ 500,000 in contributions to the Funds for work related to Newark Liberty International Airport. In 2018, the Funds requested to audit MZM's contributions, and MZM consented to the audit. At the conclusion of the audit, the Funds alleged that MZM was contractually obligated to pay US\$ 230,000 in contributions for the relevant time period.

When MZM questioned the basis for the alleged liability, the Funds produced the contract signed by MZM's president, along with an unsigned copy of the 2002 CBA, which stated both that "questions or grievances involving the interpretation and application of this Agreement" shall be submitted to arbitration and that "[t]he Arbitrator shall have the authority to decide whether an Agreement exists, where that is in dispute."⁴ On that basis, the Funds unilaterally scheduled an arbitration to begin in November 2018.⁵ In response, MZM filed a complaint against the Funds in the District of New Jersey (the New Jersey District Court) seeking to enjoin the arbitration on the basis that MZM was not a signatory to the 2002 CBA, had no obligation to arbitrate under the 2002 CBA, and was not liable to the Funds under the 2002 CBA.⁶ MZM further alleged that there was no agreement to arbitrate because MZM did not intend to sign onto a state-wide bargaining agreement (which the 2002 CBA was), had never seen the 2002 CBA, and alleged that the Funds committed a fraud in the execution of the short form agreement between the parties by incorporating such an agreement.⁷

The New Jersey District Court was therefore asked to determine "whether this [dispute] stays here or goes to the arbitrator."⁸ The New Jersey District Court emphasized the "presumption that issues of 'arbitrability' are for the court to decide," and that to "overcome this presumption, an arbitration clause must contain clear and unmistakable evidence that the parties agreed to arbitrate arbitrability."⁹ It granted MZM's request to enjoin the arbitration, holding that although the 2002 CBA included an arbitration provision which "empower[ed] the arbitrator to decide whether an agreement exists," this was not "sufficient to send the matter to an arbitrator where a party legitimately disputes whether it ever saw, heard about, or agreed to [the contract (here the 2002 CBA)] at all, and where it even disputes the scope of the [umbrella contract (here the short form agreement)] that supposedly incorporated the [contract with the arbitration clause (here the 2002 CBA)]."¹⁰ The Funds appealed.

The Decision

On September 14, 2020, the Third Circuit affirmed the New Jersey District Court's ruling that determining whether an arbitration agreement exists between the parties is a question for the court, and not one for the arbitrator. It explained, "[t]he critical question in this appeal [was] who decides MZM's contract defense, *i.e.*, its claim that it never intended to execute a [contract] incorporating statewide CBAs with an arbitration provision but rather intended to execute a single-project agreement with no mention of arbitration."¹¹

The Third Circuit's analysis focused on the relationship between two lines of precedent. First, the Court recognized the precedent set in *Prima Paint Corp. v. Flood & Conklin Mfg. Co.*, 388 U.S. 395, 406 (1967) where the Supreme Court held that absent a specific challenge to the validity of an arbitration clause, a court must treat the arbitration clause as a valid and an enforceable agreement and refer any challenges to arbitration.¹² This established what is known as the "severability doctrine," which provides that an arbitration clause is generally 'severable' and independently enforceable from the rest of the contract in which it is contained. Second, it analyzed the Third Circuit's prior holding in *Sandvik AB v. Advent International*, 220 F.3d 99 (3d Cir. 2000) that the Federal Arbitration Act (FAA) "affirmatively requires" a court to decide questions about the formation or existence of an arbitration agreement, namely the element of mutual assent."¹³

Here, the Court considered that these two issues came to a head where there were true questions as to whether the 2002 CBA – the agreement containing the arbitration clause – was a valid contract between MZM and the Funds. The Court found the issues arising in *MZM* to be more complex than those in *Sandvik* (which concerned a scenario where



one party alleged that the agent who signed the agreement lacked the authority to do so).¹⁴ Here, MZM did not dispute that it signed a contract with the Funds (*i.e.*, the short form agreement), but argued that, because it did not sign the 2002 CBA (the agreement containing the arbitration provision), it was not obliged to arbitrate the dispute between the parties pursuant to that agreement.

In these circumstances, the Court, while acknowledging the principle of severability, determined that it must first satisfy itself that the 2002 CBA was in fact an agreement between the two parties to arbitrate. It found that, notwithstanding the general federal policy favoring arbitration, disputes as to whether the parties agreed to arbitrate at all were for the courts – not arbitrators – to decide. The Court therefore considered that it must resolve those questions “even when the answer requires passing judgment on the formation or existence of the container contract” because “[o]therwise, arbitrators would be allowed ‘to determine their own jurisdiction, something that is not permitted in the federal jurisprudence of arbitration.’”¹⁵ The Court observed further that “the doctrine of severability presumes an underlying, existent, agreement.”¹⁶

The Court noted there was “some appeal” to the Funds’ argument that “absent any allegation that the delegation provision itself is invalid ... the District Court was obligated to enforce it – no questions asked,” it still considered it necessary for the court to “satisfy itself that an arbitration agreement exists” first.¹⁷ Thus, the Third Circuit held that the courts’ authority to decide questions about the parties’ mutual assent “is no less true when the container contract includes or incorporates a delegation provision.”¹⁸

Finally, the Court affirmed the District Court’s finding that there may have been fraud in the execution of the short form agreement to the extent that MZM was misled as to the terms of the incorporated agreements which, if proven would negate the parties’ mutual assent.¹⁹

Effect of the Decision

As the Third Circuit itself acknowledged, the *MZM Construction* case brings the Third Circuit in line with several of its sister courts which, when confronted with parallel concerns of contract formation and arbitrability have declined to apply the severability doctrine to enforce delegation provisions to arbitration where the validity of contract containing the arbitration clause itself was at issue.²⁰ Specifically, the Fourth,²¹ Fifth,²² Sixth²³ and Eighth²⁴ Circuits have all previously ruled that “under section 4 of the FAA courts retain the primary power to decide questions of whether the parties mutually assented to a contract containing or incorporating a delegation provision.”²⁵ Notably, this line of cases – with which the Third Circuit’s decision in *MZM* is consistent – involve critical facts distinct from, and should not implicate, the separate line of cases holding that where a party agrees to arbitrate under a set of arbitration rules that allows the arbitrator to determine the scope of his/her own authority (pursuant to a *competence-competence* provision),²⁶ provided that the parties’ consent to the underlying contract containing the *competence-competence* provision is not in question.

In light of the Third Circuit’s holding – which followed a growing consensus among the federal circuits – parties should be cautious when attempting to incorporate arbitration clauses by referencing separate agreements. Indeed, the *MZM* case suggests that in the context of “container agreements,” the parties must express their “clear[] and unmistakabl[e]” intent to arbitrate arbitrability in the container agreement itself rather than in any agreement referenced therein. Parties wishing to avoid pre-arbitration litigation concerning the existence of an agreement to arbitrate should exercise caution and consider a “belt-and-suspenders” approach by ensuring that the agreement to arbitrate is set forth or specifically referenced in the container contract itself.



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¹ *MZM Construction Co. Inc. v. New Jersey Building Laborers' Statewide Benefit Funds*, Nos. 18-3791 & 19-3102, 3, 24, (3d Cir. Sept. 8, 2020) (emphasis supplied).

² *Id.* at 4.

³ *Id.*

⁴ *Id.* at 5.

⁵ *Id.*

⁶ *Id.* at 6.

⁷ *Id.*

⁸ *Id.* at 7.

⁹ *Id.* at 8-9.

¹⁰ *Id.* at 9.

¹¹ *Id.* at 10-11.

¹² *Prima Paint*, 388 U.S. at 406; see also *MZM Construction*, Nos. 18-3791 & 19-3102, at 13-14 (discussing *Prima Paint*).

¹³ *Id.* at 14-15 (quoting *Sandvik*, 220 F.3d at 108-09). Notably, in *Sandvik* the dispute concerned whether or not the agent who signed the agreement containing the arbitration clause had the authority to do so. See *Sandvik AB v. Advent Int'l Corp.*, 220 F.3d 99, 100 (3d Cir. 2000). Indeed, in *Sandvik*, the Court held that "[e]ven under the severability doctrine, there may be no arbitration in the agreement to arbitrate is nonexistent" and so where a party contends that the underlying contract never existed, the severability doctrine cannot apply. *Id.* at 105.

¹⁴ See *Sandvik*, 220 F.3d at 1000.

¹⁵ *Id.* at 15-16 (quoting *Sandvik*, 220 F.3d at 111).

¹⁶ *Id.*

¹⁷ *Id.* at 19-20.

¹⁸ *Id.* at 20.

¹⁹ *Id.* at 29-30, 35.

²⁰ *Id.* at 23.

²¹ *Berkeley Cty. Sch. Dist. v. Hub Int'l Ltd.*, 944 F.3d 225, 234 (4th Cir. 2019).



²² *Lloyd's Syndicate 457 v. FloaTEC*, L.L.C., 921 F.3d 508, 515 (5th Cir. 2019).

²³ *In re: Auto. Parts Antitrust Litig.*, 951 F.3d 377, 385-86 (6th Cir. 2020).

²⁴ *Nebraska Mach. Co. v. Cargotec Sols., LLC*, 762 F.3d 737, 741 & n.2 (8th Cir. 2014).

²⁵ *MZM Construction*, Nos. 18-3791 & 19-3102, *Id.* at 23

²⁶ See *First Options of Chicago, Inc. v. Kaplan*, 514 U.S. 938, 944 (1995) (holding that parties to an arbitration agreement could delegate to the arbitrators the primary authority to decide matters that would ordinarily have been left to a court to decide if there was "clear and unmistakable" evidence of the parties' intent to do so.); see also *Henry Schein, Inc. v. Archer & White Sales, Inc.*, 139 S. Ct. 524, 526, (2019) ("[W]hen the parties' contract delegates the arbitrability question to an arbitrator, a court may not override the contract..."); *Contec Corp. v. Remote Sol., Co., Ltd.*, 398 F.3d 205, 208 (2d Cir. 2005) ("[W]hen ... parties explicitly incorporate rules that empower an arbitrator to decide issues of arbitrability, the incorporation serves as clear and unmistakable evidence of the parties' intent to delegate such issues to an arbitrator.") (citations omitted).