Henry Schein Case Illuminates Maze Of Arbitrability Questions

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In Archer and White Sales Inc. v. Henry Schein Inc., the U.S. Court of Appeals for the Fifth Circuit recently held that it had the authority to determine threshold questions of arbitrability because the underlying contractual arbitration clause had not clearly and unmistakably vested such authority in an arbitral tribunal.

The decision follows a January ruling in the case by the U.S. Supreme Court that invalidated the so-called wholly groundless exception, which the Fifth Circuit and others had previously used to justify keeping threshold arbitrability questions within the purview of the courts instead of arbitrators.

The Henry Schein case involves many issues relating to arbitrability, and, while it has resolved a circuit split on one such issue, it has left others open.

Much like subject matter jurisdiction prescribes the power of federal courts, arbitral tribunals have only as much power to adjudicate disputes as is vested in them. Parties seeking to avoid arbitration and instead avail themselves of national courts will typically argue that the dispute at issue is beyond the scope of the arbitration clause. These arguments — referred to as questions of threshold arbitrability — have created novel and oftentimes intricate jurisprudence in the arbitration arena.

One issue related to arbitrability is who has authority to adjudicate these threshold questions: the courts or the arbitral tribunal. In the case of Henry Schein v. Archer and White Sales, the U.S. Supreme Court was tasked with resolving a circuit split on this issue.

On Jan. 8, the Supreme Court ruled in favor of keeping threshold questions of arbitrability in the hands of arbitrators rather than in the courts in situations where the parties so agreed.[1] Justice Brett Kavanaugh found that the wholly groundless exception to the enforcement of contract provisions requiring arbitrability questions be resolved by an arbitrator was inconsistent with the Federal Arbitration Act and Supreme Court precedent. Where the relevant agreement clearly and unmistakably delegates questions of arbitrability to the arbitrators, courts are required to enforce that agreement without exception.

The contract at issue in Schein contained an arbitration provision that read, in relevant 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 Pelton & Crane), shall be resolved by binding arbitration in accordance with the arbitration rules of the American Arbitration Association (AAA).

Although the contract made no express reference to the issue of arbitrability, the applicable AAA rules provide that arbitrators shall have the power to resolve arbitrability questions, much like most other institutions' arbitration rules.[2]

Despite the parties' choice of the AAA rules, the district court declined to compel arbitration based on the wholly groundless exception — an approach used by some U.S. courts of appeals that favors keeping questions of arbitrability in the courts if the argument for arbitration is wholly groundless.[3] These courts of appeals "have reasoned that the 'wholly groundless' exception enables them to block frivolous attempts to transfer disputes from the court system to arbitration."[4] The Fifth Circuit affirmed the district court's decision.[5]

The Supreme Court disagreed with this approach. Justice Kavanaugh observed that the text of the Federal Arbitration Act "does not contain a 'wholly groundless' exception, and [the court is] not at liberty to rewrite the statute."[6] He then explained that Supreme Court precedent has held that the FAA also applies to "'gateway' questions of 'arbitrability,' such as whether the parties have agreed to arbitrate or whether their agreement covers a particular controversy."[7]

Justice Kavanaugh wrote: "This 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."[8]

Justice Kavanaugh cited Supreme Court precedent relating to the enforcement of arbitration provisions generally as a principle that could be applied to questions of arbitrability: "[A] court may not 'rule on the potential merits of the underlying' claim that is assigned by contract to an arbitrator, 'even if it appears to the court to be frivolous.'"[9] Justice Kavanaugh and the court held that this "principle applies with equal force to the threshold issue of arbitrability ... [just] 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."[10]

The Supreme Court's opinion recognized the practical reality presented by the wholly groundless exception — that it necessarily required some level of inquiry into the merits of the arbitrability claim — and held that such an inquiry into arbitrability is prohibited by the Federal Arbitration Act much like any inquiry into the merits of the claims asserted in the dispute.[11]

The Supreme Court's decision reconciled a split among the courts of appeals and appeared to provide greater predictability for litigants when they clearly and unmistakably choose to have questions of arbitrability determined by arbitrators and not by the courts, particularly where the underlying arbitration clause references arbitration rules giving the arbitrators the authority to determine their own jurisdiction.

However, the Supreme Court's decision left open the specific question of whether references to arbitration rules are sufficient to vest arbitrators with authority to determine threshold arbitrability. Although most of the arguments presented in the case related to the wholly groundless exception, the amicus brief of professor George Bermann of Columbia Law School argued that jurisdictional provisions in arbitral rules (referred to as competence-competence rules) are too commonplace and generic to constitute clear and unmistakable intent by the parties to submit questions of arbitrability to the arbitrator.[12]

The Supreme Court remanded the case and tasked the Fifth Circuit with determining whether the arbitration clause at issue represents clear and unmistakable intent by the parties to submit questions of arbitrability to the arbitrator, including whether reference to AAA rules is sufficient to demonstrate such intent.[13]

On Aug. 14, the Fifth Circuit issued its decision in Henry Schein on remand from the Supreme Court.[14] No longer able to apply the wholly groundless exception, the Fifth Circuit held that the arbitration clause in question did not clearly and unmistakably choose to have questions of arbitrability determined by arbitrators and not by the courts.

While Fifth Circuit precedent (as well as decisions from other circuit courts) has found references to AAA rules as sufficient to demonstrate an intent to arbitrate questions of arbitrability,[15] the Fifth Circuit's holding in Schein did not address that specific question but instead turned on a parenthetical phrase in the underlying contract's arbitration clause.

The arbitration clause at issue contained a parenthetical exception for "actions seeking injunctive relief and disputes related to trademarks, trade secrets, or other intellectual property of Pelton & Crane." This carveout for actions seeking injunctive relief would become the linchpin of the Fifth Circuit's ruling.

In its lawsuit, the plaintiff sought both monetary damages as well as injunctive relief. The Fifth Circuit held that the suit therefore fell within the carveout to the arbitration clause and, as a result, the AAA rule requiring that questions of arbitrability be determined by an arbitrator did not apply.

The defendants argued that this carveout should not supersede the parties' delegation of authority to an arbitrator. But the Fifth Circuit was unswayed, ruling that the "the placement of the carve-out here is dispositive": The plain language of the carveout does not clearly and unmistakably evince an intent to delegate questions of arbitrability to an arbitrator.

After making this determination, the Fifth Circuit then turned to whether the carveout applied to the entirety of the plaintiff's lawsuit or only to the injunctive relief portion. The Fifth Circuit held that, because the carveout provision did not expressly refer to "actions seeking only injunctive relief," it applied to the entirety of the plaintiff's lawsuit.

The defendants pointed out that this interpretation would allow the plaintiff to willfully evade arbitration by simply tacking on a request for injunctive relief along with any damages claims. Again, the Fifth Circuit was unmoved: The court reasoned that holding otherwise would "rewrite the unambiguous arbitration clause," which the court could not do.

While the Supreme Court's decision strengthens the overall enforceability of arbitration provisions and arguably puts greater power in the hands of arbitrators rather than courts, the Fifth Circuit's holding exemplifies the need for careful drafting of arbitration clauses. Furthermore, Henry Schein demonstrates the veritable maze of arguments and precedent that one must navigate when seeking to enforce an arbitration provision in the United States.

By comparison, jurisdictions outside the United States generally offer clearer guidance as to how courts determine who has the power to answer threshold questions of arbitrability. For example, French courts apply the principle of competence-competence even in situations in which the jurisdiction of the arbitral tribunal is challenged.

The result in France is that the arbitral tribunal has priority to rule on issues of arbitrability before a court will interfere. French law empowers arbitral tribunals with exclusive jurisdiction to determine their jurisdiction and with chronological priority.[16] While American courts exercise chronological precedence and act as a gatekeeper to arbitration, French courts act as a backstop, exercising a limited review of the arbitration panel's decision once it has been rendered, including decisions related to arbitrability.[17]

In the United Kingdom, the English Arbitration Act vests an arbitral tribunal to "rule on its own substantive jurisdiction [including] what matters have been submitted to arbitration in accordance with the arbitration agreement."[18] Unlike French civil procedure, English courts are not entirely divested of jurisdiction and may be called to make preliminary determinations as to the jurisdiction of the arbitral tribunal.[19]

However, an English court must receive permission to determine threshold questions of arbitrability either from all parties to the arbitral proceedings or from the tribunal itself.[20] If such permission is not obtained, a party must wait for an award to be rendered before challenging the tribunal's arbitrability determination in English court.[21] Overall, English law seems to fall somewhere in the middle between the American and French approaches, offering parties with more predictable, balanced and clear requirements.

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Disclosure: The authors and Baker Botts have represented clients in cases involving gateway arbitrability questions.

[1] Henry Schein, Inc. v. Archer & White Sales, Inc., 586 U.S. ___ (2019) (slip op.).

[2] Rule 7(a) of the AAA's Commercial Arbitration Rules states: "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." Other arbitral rules also include similar provisions. See Arbitration Rules, International Chamber of Commerce, Art. 6(5) ("any decision as to the jurisdiction of the arbitral tribunal ... shall [] be taken by the arbitral tribunal itself"); Arbitration Rules, London Court of International Arbitration, Art. 23.1 ("The Arbitral Tribunal shall have the power to rule upon its own jurisdiction and authority, including any objections to the initial or continuing existence, validity, effectiveness, or scope of the Arbitration Agreement."); UNCITRAL Arbitration Rules, United Nations Commission on International Trade Law, Article 23(1) ("The arbitral tribunal shall have the power to rule on its own jurisdiction, including any objections with respect to the existence or validity of the arbitration agreement.").

[3] See, e.g., Simply Wireless, Inc. v. T-Mobile US, Inc., 877 F. 3d 522 (4th Cir. 2017).

[4] Henry Schein, Inc., 586 U.S. at *4-5.

[5] Archer & White Sales, Inc. v. Henry Schein, Inc., 878 F. 3d 488 (5th Cir. 2017).

[6] Id. at *2.

[7] Henry Schein, Inc., 586 U.S. at *4 (citing Rent-A-Center, West, Inc. v. Jackson, 561 U.S. 63, 68-69 (2010); First Options of Chicago, Inc. v. Kaplan, 514 U.S. 938, 943 (1995)).

[8] Id. at *6 (quoting First Options, 514 U.S. at 944).

[9] Id. at *5 (quoting AT&T Tech., Inc. v. Communications Workers, 475 U.S. 643, 649-50 (1986)).

[10] Id.

[11] See id. at *8 ("[The 'wholly groundless' exception] confuses the question of who decides arbitrability with the separate question of who prevails on arbitrability.").

[12] See Brief of Professor George Bermann as Amicus Curiae Supporting Respondent, Henry Schein, Inc. v. Archer & White Sales, Inc., 586 U.S. ___ (2019) (No. 17-1272) ("If ordinary competence-competence language found in all modern arbitral rules and all modern arbitration laws were sufficient to rebut the First Options presumption (that courts should decide questions of arbitrability), that presumption would cease to exist.").

[13] Henry Schein, Inc., 586 U.S. at *8.

[14] Archer & White Sales, Inc. v. Henry Schein, Inc., No. 16-41674, Doc. 515076566 (5th Cir. Aug. 14, 2019).

[15] See Petrofac, Inc. v. DynMcDermott Petroleum Operations Co., 687 F.3d 671, 675 (5th Cir. 2012).

[16] Code of Civil Procedure, Art. 1465.

[17] Code of Civil Procedure, Art. 1520(1).

[18] Arbitration Act,1996, Art. 30(1).

[19] Arbitration Act,1996, Art. 9.

[20] Arbitration Act,1996, Art. 32.

[21] Arbitration Act,1996, Art. 67(1).