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It means what it says, and not more than it says: the Supreme Court stands firm on interpretation of arbitration clauses under the FAA

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This week, the United States Supreme Court unanimously vacated and remanded the Fifth Circuit's decision in an antitrust case involving the question of whether the Federal Arbitration Act (the "FAA," 9 U.S.C. §§ 1-16) permits a court to decide whether an issue must be arbitrated, even if the parties' contract might indicate that an arbitrator should make that decision, when it appears that the arguments in favor of arbitrability are "wholly groundless," whoever might hear them. The Supreme Court rejected the "wholly groundless" doctrine, holding that "[w]hen the parties' contract delegates the arbitrability question to an arbitrator, the courts must respect the parties' decision as embodied in the contract," even if it seems obvious what the outcome would be. *Henry Schein, Inc. v. Archer and White Sales, Inc.*, No. 17-1272, slip op. at 2 (U.S. Jan. 8, 2019). The decision continues the Court's existing line of jurisprudence emphasizing the importance and limits of the text of the FAA and the importance that text in turn gives to contract language.

Background

The plaintiff in the *Henry Schein* case is a dealer in dental equipment, described by Justice Kavanaugh, in his first opinion on the Court, as "a small business." *Id.* The plaintiff sued various defendant competitors, and the manufacturer whose equipment it had contracted to distribute, in federal court, alleging "violations of federal and state antitrust law, and s[eeking] both money damages and injunctive relief." *Id.*

The arbitration fight concerning these claims began normally enough with a 2013 decision by a Magistrate Judge granting, on the basis of an arbitration clause in the contract between the plaintiff and the manufacturer, a motion to compel arbitration and to stay the underlying litigation. *See Archer & White Sales, Inc. v. Henry Schein, Inc.*, No. 2:12-cv-572-JRG, 2016 U.S. Dist. LEXIS 169245 (E.D. Tex. Dec. 7, 2016), *aff'd,* 878 F.3d 488 (5th Cir. 2017), *rev'd,* No. 17-1272 (U.S. Jan. 8, 2019). The plaintiff objected to that decision, however, and the District Court reversed it on two grounds.

First, the District Court found that, although the parties' contract expressly incorporated the American Arbitration Association ("AAA") Commercial Arbitration Rules, and although those rules expressly "delegate[] the question of arbitrability to the arbitrator," *id.* at *20, the contract also

contained an exclusion from arbitration "for actions seeking injunctive relief and disputes related to trademarks, trade secrets or other intellectual property," *id.* at *8. It then held that "there is no reason to believe that incorporation of the AAA rules, including the AAA rule that delegates the question of arbitrability to the arbitrator, should indicate a clear and unmistakable intention that the parties agreed to arbitrate the question of arbitrability in these circumstances—when an action falls squarely within the clause excluding actions like this from arbitration." *Id.* at *19-20 (citing *James & Jackson, LLC v. Willie Gary, LLC*, 906 A.2d 76, 81 (Del. 2006)).

Second, the District Court held that "[e]ven if this Court were to find that the adoption of the AAA rules constituted clear and unmistakable evidence that the Parties agreed to arbitrate the question of arbitrability . . . a court should nonetheless determine arbitrability where a defendant's argument in favor of arbitrability is 'wholly groundless.'" *Id.* at *20-21 (citing *Douglas v. Regions Bank*, 757 F.3d 460, 463-64 (5th Cir. 2014)). In the District Court's view, "given the clarity of the arbitration provision discussed above", with its exclusion for actions seeking injunctive relief, "it would be senseless to refer the issue of arbitrability to the arbitrator, only to have the arbitrator read the plain language of the clause and then send the Parties back to this Court." *Id.* at *23.

On appeal, the Fifth Circuit noted that "[t]here is a strong argument that the . . . invocation of the AAA Rules" (and thus those Rules' delegation of initial arbitrability questions to an arbitrator) in the relevant contract "does not apply to cases that fall within the carve-out" for actions seeking injunctive relief. *Archer & White Sales, Inc. v. Henry Schein, Inc.*, 878 F.3d 488, 494-95 (5th Cir. 2017), *rev'd,* No. 17-1272 (U.S. Jan. 8, 2019). But it concluded that it did not need to decide that issue. *Id.* Instead, it affirmed the District Court's "wholly groundless" analysis, holding that:

> The arbitration clause creates a carve-out for "actions seeking injunctive relief." It does not limit the exclusion to "actions seeking only injunctive relief," nor "actions for injunction in aid of an arbitrator's award." Nor does it limit itself to only claims for injunctive relief. Such readings find no footing within the four corners of the contract. . . . The mere fact that the arbitration clause allows [Plaintiff] to avoid arbitration by adding a claim for injunctive relief does not change the clause's plain meaning.

Id. at 497. Because the argument that the clause applied to the current dispute was therefore "wholly groundless", there was no reason to send the issue to an arbitrator who would have to reach the same conclusion.

The Supreme Court's decision

The Supreme Court unanimously reversed the Fifth Circuit's decision. In his first opinion on the Court, Justice Kavanaugh usefully provides the key holding in his second paragraph:

> The question presented in this case is whether the "wholly groundless" exception is consistent with the Federal Arbitration Act. We conclude that it is not. The Act does not contain a "wholly groundless" exception, and we are not at liberty to rewrite the statute passed by Congress and signed by the President. When the parties' contract delegates the arbitrability question to an arbitrator, the courts must respect the parties' decision as embodied in the contract.

Henry Schein, Inc. v. Archer and White Sales, Inc., No. 17-1272, slip op. at 2. His opinion's subsequent analysis is entirely consistent with the Court's existing jurisprudence stressing that "courts must enforce arbitration contracts according to their terms." *Id.*, slip op. at 4 (citing *Rent-A-Center, West,*

Inc. v. Jackson, 561 U. S. 63, 67 (2010)). Justice Kavanaugh equates this requirement to the standards for the interpretation of the FAA itself: "We must interpret the Act as written, and the Act in turn requires that we interpret the contract as written." *Id.*, slip op. at 5. And while acknowledging that arbitrability is a "gateway" issue, *see id.*, slip op. at 4 (citations omitted), he rejects any suggestion that that distinction makes a difference here, pointing out 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.*, slip op. at 5. That conclusion is founded on the Court's prior decision in *AT&T Technologies v. Communications Workers*, which Justice Kavanaugh quotes for the proposition "that 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.'" *Henry Schein, Inc.*, slip op. at 5 (quoting 475 U.S. 643, 649-50 (1986)).

Justice Kavanaugh also disposes quickly of each of the plaintiff's four chief arguments against reversal. First, while Sections 3 and 4 of the FAA, 9 U.S.C. §§ 3,4, do specify a role for courts in referring matters to arbitration or staying cases pending arbitration, this role is principally limited to determining whether a valid arbitration agreement exists, *Henry Schein, Inc.*, slip op. at 6 (citing 9 U.S.C. § 2), and whether there is "clear and unmistakable" evidence that the agreement delegates "threshold arbitrability questions to the arbitrator," *id.* (quoting *First Options of Chicago, Inc. v. Kaplan*, 514 U. S. 938, 944 (1995)).

Second, while Section 10 of the FAA permits a court to refuse to confirm an arbitration award if an arbitrator exceeds his or her "powers," *id.* (citing 9 U.S.C. § 10(a)(4)), Congress put this review at the end of the process, not the beginning. The Supreme Court cannot "redesign the statute" to change this order of review. *Id.*

Third, even if it is "a waste of the parties' time and money" to refer a question to an arbitrator that the arbitrator will just refer back to the court, that is how the FAA is structured. The Court "may not engraft our own exceptions onto the statutory text." *Id.* (citing *Exxon Mobil Corp. v. Allapattah Servs., Inc.*, 545 U.S. 546, 556-57 (2005)). Furthermore, in language likely to find its way into many future briefs to the Court seeking affirmance of a decision below, Justice Kavanaugh notes that it is possible that an arbitrator may not agree that an issue is quite so obvious as a party opposing arbitration might think: "It is not unheard-of for one fair-minded adjudicator to think a decision is obvious in one direction but for another fair-minded adjudicator to decide the matter the other way." *Id.*, slip op. at 7.

Finally, a "wholly groundless" exception to the FAA is not necessary to deter frivolous motions to compel arbitration. Not only can arbitrators deal with frivolous arguments appropriately, but "[w]e are not aware that frivolous motions to compel arbitration have caused a substantial problem in those Circuits that have not recognized a 'wholly groundless' exception." *Id.*, slip op. at 8.

Conclusion

The Supreme Court's decision will not end the fight in the *Henry Schein* case itself. Justice Kavanaugh's closing comment is that "courts 'should not assume that the parties agreed to arbitrate arbitrability unless there is clear and unmistakable evidence that they did so.' *First Options*, 514 U.S., at 944 (alterations omitted). On remand, the Court of Appeals may address that issue in the first instance, as well as other arguments that [plaintiff] has properly preserved." *Henry Schein, Inc.*, slip op. at 8. This hints that the Court may be more willing than some have thought to decide that incorporation by reference of arbitration provider rules is not always "clear and unmistakable"

evidence of party intent. The emphasis by Justice Kavanaugh on textual analysis also hints at the significant role that method of decision is likely to continue to play in the next two arbitration cases on the Court's docket, *Lamps Plus, Inc. v. Varela*, No. 17-988 (can a court apply state contract construction principles to conclude that an "ambiguous" arbitration clause should be construed against its drafter and thus to allow class arbitration), and *New Prime, Inc. v. Oliveira*, No. 17-340 (is the statutory exception to application of the FAA to "contracts of employment" something to be decided by an arbitrator, and does the exception include independent contractor agreements).

And, while the Court clarified that it "express[ed] no view about whether the contract at issue . . . in fact delegated the arbitrability question to an arbitrator," and even suggested the Court of Appeals may do so on remand, slip op. at 8, the question of whether incorporation of the AAA rules is, standing alone, sufficient to establish that the parties have "clear[ly] and unmistakabl[y]" agreed that an arbitrator will decide the issue of arbitrability in the class context, is presented in a pending petition for certiorari seeking review of the decision in *Spirit Airlines Inc. v. Maizes*, 899 F.3d 1230 (11th Cir. 2018), *petition for cert. filed*, Case No. 18-617 (Nov. 13, 2018).

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