JANUARY 22, 2019

Arbitration: Justice Kavanaugh eliminates "wholly groundless" exception to delegation clauses – Did you know you had a delegation clause?

by James F. Bogan III

Takeaway: Justice Kavanaugh's first Supreme Court opinion is yet another High Court reminder that, when it comes to arbitration, the contract controls. If parties agree that an arbitrator should resolve the "gateway" issue of arbitrability, that agreement must be respected and enforced, even if, in the trial court's view, the arbitration demand is "wholly groundless." On another level, the decision is reminder about the implications of incorporating arbitration rules, such as the rules of American Arbitration Association. Because the AAA rules authorize arbitrators to resolve questions of arbitrability, the incorporation of such rules can equate to delegating the gateway issue to an arbitrator and taking that issue away from a court.

In *Henry Schein, Inc. v. Archer & White Sales, Inc.*, No. 17-1272, 2019 WL 122164 (U.S. Jan. 8, 2019), Archer & White Sales, Inc. ("Archer"), a distributor, seller, and servicer for makers of dental equipment, brought suit in the Eastern District of Texas against Henry Schein, Inc. and Danaher Corporation, the biggest distributor and dental equipment manufacturer, respectively, in the United States. The suit alleged antitrust claims under federal and Texas law, seeking compensatory damages as well as injunctive relief.

The Defendants moved to compel arbitration, seeking to enforce the following arbitration clause: "Disputes. This Agreement shall be governed by the laws of the State of North Carolina. 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)]. The place of arbitration shall be in Charlotte, North Carolina."

The motion was referred to a magistrate judge, who granted it based on the clause's incorporation of the AAA rules and also on a "reasonable construction" of the clause. The district court, however, interpreted the clause differently and vacated the magistrate's order, ruling that the plain language of the clause excluded from arbitration suits seeking injunctive relief.

On appeal, the Fifth Circuit found that "the interaction between the AAA Rules and the carve-out is at

best ambiguous." *Archer & White Sales, Inc. v. Henry Schein, Inc.*, 878 F.3d 488, 494-495 (5th Cir. 2017). Accordingly, the appellate court elected not to resolve the delegation issue. Instead, it relied on the "wholly groundless" exception, which posits that if there is no plausible argument that the dispute must be arbitrated, then the district court may resolve the issue "despite a valid delegation clause." *Id*. at 492 (citation omitted). Based on this exception, the Fifth Circuit ruled "[w]e see no plausible argument that the arbitration clause applies here to an 'action seeking injunctive relief.'" *Id.* at 497.

In a unanimous decision, the Supreme Court reversed. As Justice Kavanaugh explained, "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." 2019 WL 122164, at *4. The Supreme Court vacated the Fifth Circuit's decision and remanded for a determination of whether there is "clear and unmistakable evidence" the parties agreed to "arbitrate arbitrability." *Id*. at *6 (quoting *First Options of Chicago, Inc. v. Kaplan,* 514 U.S. 938, 944 (1995)).

The parties did not explicitly agree to arbitrate arbitrability. Instead, they incorporated the AAA Rules into their arbitration clause. Under AAA Commercial Arbitration Rule R-7(a), "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." *Archer & While Sales, Inc.*, 878 F.3d at 493. And the Fifth Circuit determined in a prior case that the incorporation of such rules amounts to the required "clear and unmistakable evidence." *Id*. (citing *Petrofac, Inc. v. DynMcDermott Petroleum Operations Co*., 687 F.3d 671, 675 (5th Cir. 2012)).

Whether the courts will find "clear and unmistakable evidence" on remand is doubtful, given the Fifth Circuit's prior ruling that the applicability of the AAA Rules to cases excepted from arbitration in the arbitration clause ("actions seeking injunctive relief") is ambiguous. And this might be the biggest lesson of this case. The parties apparently believed that incorporating the AAA Rules into their arbitration clause would create a clear and easy path to enforce the arbitration agreement. But the parties in *Henry Schein* have heard from the magistrate judge, the district court judge, the Fifth Circuit, and the U.S. Supreme Court, and they still do not know whether the case will be resolved in court or in arbitration.

If parties truly intend to delegate the gateway issue of arbitrability to an arbitrator, perhaps the best course is to provide for that directly in the arbitration agreement itself. And that may be the Supreme Court's explicit edict in one of its forthcoming arbitration decisions. In the penultimate paragraph of the opinion, the Court explicitly refused to address whether incorporating the AAA Rules constituted "clear and unmistakable evidence" that the parties intended to delegate the arbitrability issue to the arbitrator, noting the Fifth Circuit "did not decide that issue." *See* 2019 WL 122164, at *6. Another case before the Court, however, squarely presents the issue, albeit in the context of class arbitrability.

In *Spirit Airlines, Inc. v. Maizes*, 899 F.3d 1230, 1233-36 (11th Cir. 2018), the Eleventh Circuit held that the incorporation of the AAA Rules delegated the class arbitrability issue to the arbitrator. Spirit Airlines petitioned for certiorari. Although the class plaintiffs waived the right to respond, the Supreme Court ordered a response to the petition on December 10, 2018. *See* No. 18-617 (U.S. Dec. 10, 2018).

As we noted in an earlier post regarding the Lamps Plus oral argument [*The Lamps Plus oral argument suggests the U.S. Supreme Court may address the threshold issue of an arbitrator's power to adjudicate the claims of absent class members*], Justice Kavanaugh recently raised the question of whether *Stolt-Nielsen S.A. v. AnimalFeeds Int'l Corp.* , 559 U.S. 662 (2010), required "something on the order of express language" to authorize class arbitration. *See Lamps Plus*, No. 17-988, Tr., at 20 (U.S. argued Oct. 29, 2018). This may indicate that the forthcoming *Lamps Plus* decision will reiterate that an arbitration agreement will not be interpreted to authorize class arbitration unless it explicitly so provides (and not merely by reference to the AAA Rules).

If *Lamps Plus* holds that an arbitration agreement must explicitly authorize class arbitration to avoid *Stolt-Nielsen*, the Supreme Court may extend that ruling in *Spirit Airlines* and hold that an arbitration agreement likewise must explicitly delegate the class arbitrability issue to the arbitrator (rather than effectuating such delegation though the incorporation of the AAA Rules). Alternatively, the Court may "GVR" (grant certiorari, vacate the lower court's decision, and remand for further consideration) *Spirit Airlines* for further consideration in light of *Lamps Plus*. Either way, *Lamps Plus* likely will provide critical guidance for class action practitioners on the arbitrability of putative class claims.