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The Supreme Court Continues Trend of Favoring Arbitration

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Client Advisory
January 16, 2019 by Jeffrey S. Boxer and Alexander G. Malyshev

The Supreme Court recently issued a unanimous decision highlighting the federal courts' liberal policy of favoring arbitration. This policy is grounded in Section 2 of the Federal Arbitration Act (the "Act"), which provides, with limited exceptions, that an agreement to arbitrate "shall be valid, irrevocable, and enforceable."[1] The reach of this policy has been tested over time, most notably in recent years with respect to its conflicts with state laws disfavoring arbitration and class-action waivers in consumer contracts, and its interplay with the National Labor Relations Act's collective action rationale. The first question was resolved in favor of upholding the liberal goal of the Act over more restrictive state law policies in a 5-4 decision in *AT&T Mobility v. Concepcion*, 563 U.S. 333 (2011). The second question was resolved in another 5-4 decision in *Epic Sys. Corp. v. Lewis*, 138 S. Ct. 1612 (2018) in favor of individualized arbitration over collective actions.

The Supreme Court's recent unanimous decision in *Henry Schein, Inc. v. Archer & White Sales, Inc.*, No. 17-1272, 2019 U.S. LEXIS 566 (Jan. 8, 2019), continues the trend of federal courts deferring to arbitration. The Supreme Court resolved a circuit split regarding whether a court can decide the threshold question of arbitrability where the contract provides for arbitration and delegates the question of arbitrability to the arbitrator if the party alleges that the dispute falls outside the agreement and, therefore, the demand for arbitration is "wholly groundless." The Supreme Court held that if the agreement provides for the arbitrator to determine arbitrability, then the question of arbitrability must be decided by the arbitrator and not by the courts even if the dispute clearly falls outside the scope of the agreement.

Generally speaking, the Act allows parties to agree by contract that an arbitrator, rather than a court, will resolve threshold arbitrability questions as well as underlying merits disputes. *Rent-A-Center, West, Inc. v. Jackson*, 561 U. S. 63, 68–70 (2010); *First Options of Chicago, Inc. v. Kaplan*, 514 U. S. 938, 943–944 (1995). However, in some circuits, federal courts would "short-circuit" the process and decide the arbitrability question themselves if the argument that the arbitration agreement applies to the particular dispute is "wholly groundless." *Schein*, 2019 U.S. LEXIS 566, at *4. The Supreme Court put a stop to that practice, noting that 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." *Id*. Therefore, when 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 appears that the underlying dispute is not governed by the agreement or its arbitration clause.[2]

It is worth noting that the agreement in question in *Schein* did not actually say that the question of arbitrability was delegated to the arbitrator. Instead, it incorporated the arbitration rules of the American Arbitration Association ("AAA"). The AAA rules, which are incorporated in many contracts, provide that questions of arbitrability are to be decided by the arbitrator.[3] *Schein*, at *6-7. The rules of other arbitration providers similarly delegate the question of arbitrability to the arbitrator.[4]

The Supreme Court's decision in *Schein* closes a loophole in the federal courts' policy of deferring to arbitration. As a result, courts will no longer be able to determine whether a dispute is arbitrable if the parties' agreement contains an arbitration clause delegating the determination of arbitrability to the arbitrator or incorporating rules that delegate the determination of arbitrability to the arbitrator.

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[1] *See* 9 U.S.C.S. § 2 ("A written provision in any maritime transaction or a contract evidencing a transaction involving commerce to settle by arbitration a controversy thereafter arising out of such contract or transaction, or the refusal to perform the whole or any part thereof, or an agreement in writing to submit to arbitration an existing controversy arising out of such a contract, transaction, or refusal, shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract.").

[2] Section 1 of the Act exempts from arbitration "contracts of employment of seamen, railroad employees, or any other class of workers engaged in foreign or interstate commerce." On January 15, 2019, the Supreme Court affirmed, in an 8-0 decision, the applicability of that exemption to independent contractors as well as employees engaged in these trades. In such cases, the question of arbitrability is one that remains with the courts. *See New Prime Inc. v. Oliveira*, Case No. 17-340 (Jan 15, 2019).

[3] *See* AAA Commercial Arbitration Rule 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 or to the arbitrability of any claim or counterclaim." *available at* https://www.adr.org/sites/default/files/Commercial%20Rules.pdf.

[4] *See e.g.*, JAMS Commercial Arbitration Rule 11(b) ("Jurisdictional and arbitrability disputes, including disputes over the formation, existence, validity, interpretation or scope of the agreement under which Arbitration is sought, and who are proper Parties to the Arbitration, shall be submitted to and ruled on by the Arbitrator. The Arbitrator has the authority to determine jurisdiction and arbitrability issues as a preliminary matter.").

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