LOS ANGELES & SAN FRANCISCO
Daily Journal
www.dailyjournal.com
FRIDAY, JANUARY 18, 2019

PERSPECTIVE

Questions of arbitrability after *Henry Schein*

By Cary D. Sullivan and Maura C. Pennington

The U.S. Supreme Court recently resolved a circuit split on "wholly groundless" motions to compel arbitration. The court unanimously held in *Henry Schein, Inc. v. Archer & White Sales, Inc.*, 2019 DJDAR 147, that the Federal Arbitration Act contains no "wholly groundless" exception to the threshold question of arbitrability.

Drawing heavily on late Justice Antonin Scalia's opinion in *Rent-A-Center, West, Inc. v. Jackson*, 561 U.S. 63 (U.S. 2010), Associate Justice Brett Kavanaugh's first Supreme Court opinion interpreted the FAA strictly, eliminating an exception observed in the 9th Circuit and elsewhere. As a result, when drafting arbitration provisions, parties should carefully consider whether to delegate the issue of arbitrability, and to do so in a clear and unmistakable way if they choose to do so.

"Gateway" Questions of Arbitrability

In *Rent-A-Center*, the Supreme Court affirmed the principle that "parties can agree to arbitrate 'gateway' questions of 'arbitrability,'" including whether the parties have agreed to arbitrate the issue presented in the first instance. According to the court, an "agreement to arbitrate a gateway issue is simply an additional, antecedent agreement the party seeking arbitration asks the federal court to enforce."

Prior to that, in 1986, the Supreme Court decided in *AT&T Technologies, Inc. v. Communications Workers of America*, 475 U.S. 643, 649-50 (U.S. 1986), that, in the face of convincing evidence the parties had agreed to arbitrate disputes, "a court is not to rule on the potential merits of the underlying claims" — no matter how "frivolous."

Yet lower courts developed their own view. Indeed, some courts looked to the threshold question of arbitrability to determine whether the basis of the claim was "wholly groundless," which "necessarily requires the courts to examine, and to a limited extent, construe the underlying agreement." *Dream Theater, Inc. v. Dream Theater*, 124 Cal. App. 4th 547, 553 (Cal. Ct. App. 2004). This created what became known as the "wholly groundless" exception to the FAA.

The Supreme Court made clear in *Henry Schein* that there is no such exception.

Enforcing the FAA as Written

In *Henry Schein*, a dental equipment distributor sued an equipment manufacturer's successor-in-interest for alleged federal and state antitrust violations, seeking both money damages and injunctive relief. The arbitration provision at issue included a carve-out for actions seeking injunctive relief. But the arbitration provision also incorporated the rules of the American Arbitration Association, which provide that arbitrators may decide threshold questions of arbitrability.

The Supreme Court stated in its ruling, "arbitration is a matter of contract, and courts must enforce arbitration contracts according to their terms…. We must interpret the [Federal Arbitration] Act as written, and the Act in turn requires that we interpret the contract as written." More to the point, where an arbitration provision delegates the question of arbitrability to the arbitrator, courts may not "override the contract." This is true, the Supreme Court stated, "even if the court thinks the argument that the arbitration agreement applies to a particular dispute is wholly groundless."

Justice Kavanaugh resolved this split: 'The [Federal Arbitration] 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.'

The court was unpersuaded by the distributor's arguments in favor of the "wholly groundless" exception. The court rejected the notion that Section 10 of the FAA, which "provides for back-end judicial review of an arbitrator's decision," also permits front-end judicial review. The court also rejected the argument that it would be a waste of time and money to arbitrate a "wholly groundless" claim, noting that the exception would lead to collateral litigation and thus create a "time-consumig sideshow."

The court also considered the deterrent effect of the "wholly groundless" exception to frivolous motions to compel arbitration. Ultimately, the court concluded that potential fee-shifting and cost-shifting sanctions imposed by an arbitrator could provide the same deterrent effect.

Resolving the Circuit Split

The underlying *Henry Schein* case came from the 5th Circuit, where district courts in Texas read into the law a "narrow escape valve" allowing judges to deny a motion to compel arbitration in the event the arbitration claim was "wholly groundless." *Archer and White Sales, Inc. v. Henry Schein, Inc.*, 878 F.3d 488, 495 (5th Cir. 2017). The 10th Circuit rejected this approach in *Belnap v. Iasis Healthcare*, 844 F.3d 1272 (10th Cir. 2017).

While the court in Belnap claimed that the 9th Circuit joined the 1st, 2nd, 4th, 8th and D.C. Circuits in this rejection, in fact, district courts in California still recognized the "wholly groundless" exception. *See, e.g., Zenelaj v. Handybook, Inc.*, 82 F.Supp.3d 968 (N.D. Cal. 2015)

Justice Kavanaugh resolved this split: "The [Federal Arbitration] 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."

Conclusion

The Supreme Court has been trending in a pro-arbitration direction for some time. *See, e.g., Epic Systems Corp. v. Lewis*, 138 S. Ct. 1612 (U.S. 2018); *AT&T Mobility LLC v. Concepcion*, 131 S. Ct. 1740 (U.S. 2011). After *Henry Schein*, and with Justice Kavanaugh's inclusion on the bench, it seems the trend will continue. But the reduction of collateral court litigation thanks to *Henry Schein* depends on the degree to which parties delegate the issue of arbitrability in a 'clear and unmistakable' way.

Cary D. Sullivan *is a partner in Jones Day's Business and Tort Litigation practice.*

Maura C. Pennington *is an associate in the Firm's New Lawyers Group. Both are based in the Firm's Irvine, California office.*

The views and opinions expressed are those of the authors and do not necessarily reflect the views of the Firm, its clients, or any of their respective affiliates. This article is for general information purposes and is not intended to be and should not be taken as legal advice.


SULLIVAN


PENNINGTON