U.S. SUPREME COURT REJECTS “WHOLLY GROUNDLESS” TEST AND REMINDS PARTIES OF THE POWER OF THE ARBITRATION AGREEMENT

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International Arbitration Alert

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In a decision issued on January 8, 2019, the U.S. Supreme Court (the "Court") resolved a split of opinion among courts of appeals over whether the "wholly groundless" test has any application to the determination of who, as between a court and an arbitrator, is to decide the threshold issue of arbitrability, i.e., whether an agreement to arbitrate applies to a particular dispute. The Court unanimously decided that it does not. [1] The "wholly groundless" test, as previously recognized by some federal courts, allowed the court to decide the arbitrability issue, notwithstanding the delegation of that decision-making authority to an arbitrator, if the court found the assertion of arbitrability to be wholly groundless. While the Court's decision in *Henry Schein* is notable for its resolution of what had become a growing divide among the federal appellate courts over the use of the "wholly groundless" test, or exception, it is also notable for its narrowness. The Court did not decide whether, pursuant to the particular arbitration agreement between the parties, questions of arbitrability were, in fact, delegated to an arbitrator. Rather, the Court remanded the case to the Fifth Circuit for consideration of that issue among, potentially, others.

Writing for the unanimous Court, Justice Kavanaugh framed the limited issue as "whether the 'wholly groundless' exception is consistent with the Federal Arbitration Act." In concluding that it is not, the Court's opinion is grounded on the text of the Federal Arbitration Act and on Court precedent recognizing the power of the arbitration agreement. As the Court observed, under the Federal Arbitration Act, arbitration is a matter of contract, and courts are required to interpret the contract as written. [2] "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." [3] Accordingly, "if a valid agreement exists, and if the agreement delegates the arbitrability issue to an arbitrator, a court may not decide the arbitrability issue." [4]

The Court addressed and rejected each of the four arguments raised by Respondents and did so primarily on the ground that to accept their arguments would require the Court to improperly rewrite the Federal Arbitration Act. "When the parties' contract assigns a matter to arbitration, a court may not resolve the merits of the dispute even if the court thinks that a party's claim on the merits is frivolous." [5] In summing up its rejection of the "wholly groundless" exception, the Court explained that the exception "confuses the question of who decides arbitrability with the separate question of who prevails on arbitrability. When the parties' contract delegates the arbitrability question to an arbitrator, the courts must respect the parties' decision as embodied in the contract." [6]

Again, however, the Court "express[ed] no view" as to whether the contract between the parties before it provided "clear and unmistakable" evidence of the delegation of threshold arbitrability questions to an arbitrator. [7] In that

regard, the dispute between the parties arose out of a contract to distribute dental equipment, with the "Disputes" provision of the contract providing:

> 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 [Petitioner]), 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. [8]

A dispute arose between the parties, and Respondents (Plaintiffs in the trial court) filed suit in federal court alleging violations of state and federal antitrust laws and seeking injunctive relief in addition to money damages. According to Respondents, their claim for injunctive relief brought the dispute within the contractual exception from arbitration. The Petitioners (Defendants in the trial court) disagreed and sought to have the dispute referred to arbitration. The question then arose as to who — as between the court and an arbitrator — should decide the question of arbitrability.

Rule 7(a) of the Commercial Arbitration Rules of the AAA provides that:

> 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.

On the basis of the AAA rules, as expressly incorporated by the parties into the contract, Petitioners argued that the parties' arbitration agreement extended to questions of arbitrability. Whether Petitioners will prevail remains to be seen, as the Court left for the Fifth Circuit to determine whether the parties' incorporation of the AAA arbitration rules into their contract provides "clear and unmistakable" evidence of an agreement between the parties that questions of arbitrability are to be decided by an arbitrator. [9] The answer, however, most likely will be "yes," as the Fifth Circuit already has held that the incorporation of arbitral institution rules such as those of the AAA and Judicial Arbitration and Mediation Services (JAMS) evinces a "clear an unmistakable" intent to delegate questions of arbitrability to the arbitrator. [10]

The message to practitioners should be clear: Be specific in your contracting. As a practical matter, in a typical contract negotiation when arbitration is designated as the dispute resolution mechanism, the parties often give little thought to the gateway issue of arbitrability and similarly give relatively limited thought to the full impact of incorporating institutional rules into their arbitration agreements. If, in fact, it is the intent of the parties that threshold issues of arbitrability are to be decided by an arbitrator, and not by a court, the parties are well served to be explicit about their intent in their arbitration agreements. And if the opposite is the case, the parties should consider incorporating an "anti-delegation" clause that specifically gives a court the authority to determine the scope and applicability of their arbitration agreement.

NOTES

[1] Henry Schein, Inc. v. Archer & White Sales, Inc., __ U.S. __ (slip op., January 8, 2019).

[2] *Id.*, slip op. at 4–5.

[3] *Id.*, slip op. at 6 (first citing First Options of Chi., Inc. v. Kaplan, 514 U.S. 938, 944 (1995); then citing Rent-A-Center, West, Inc. v. Jackson, 561 U.S. 63, 69 (2010)).

[4] *Id.*

[5] *Id.*, slip op. at 6–7 (citing AT&T Tech., Inc. v. Commc'n Workers, 475 U.S. 643, 649-50 (1986)).

[6] *Id.*, slip op. at 8.

[7] *Id.*

[8] *Id.*, slip op. at 2.

[9] *Id.*, slip op. at 8.

[10] *See* Cooper v. WestEnd Capital Mgmt., L.L.C., 832 F.3d. 534, 546 (5th Cir. 2016) (JAMS rules); Petrofac, Inc. v. DynMcDermott Petroleum Operations Co., 687 F.3d 671, 675 (5th Cir. 2012) (AAA rules). *See also* Simply Wireless, Inc. v. T-Mobile USA, Inc., 877 F.3d 522, 528 (4th Cir. 2017); Belnap v. Iasis Healthcare, 844 F.3d 1272, 1284 (10th Cir. 2017).

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