June 24, 2020

Supreme Court to Determine the Effect of a Carve-Out Provision on an Agreement to Arbitrate Questions of Arbitrability

On June 15, 2020, the Supreme Court granted certiorari in ***Henry Schein* v. *Archer & White Sales***[1] to decide whether, under the Federal Arbitration Act, a provision in an arbitration agreement exempting certain claims from the scope of the agreement—a "carve out" provision, for short—negates a provision clearly delegating questions of arbitrability to the arbitrator. This is the second time the Supreme Court has granted certiorari in this case to interpret the arbitration agreement at issue. Paul, Weiss represents Henry Schein, the petitioner, in the Supreme Court.

Legal Framework

Section 2 of the Federal Arbitration Act, the Act's primary substantive provision, provides that "[a] written provision in . . . a contract evidencing a transaction involving commerce to settle by arbitration a controversy thereafter arising out of such contract . . . shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract."[2] The Supreme Court has previously held that Section 2 places arbitration agreements "upon the same footing as other contracts,"[3] and the requirement that courts enforce arbitration agreements according to their terms applies to disputes over "gateway" issues of arbitrability, such as whether a particular claim falls within the scope of an arbitration agreement.[4]

Although courts presumptively resolve such gateway disputes, parties may supersede that general rule by clearly and unmistakably agreeing to "arbitrate arbitrability."[5] One way for parties to accomplish that result is by including a so-called "delegation provision" in their arbitration agreement. A delegation provision is "simply an additional, antecedent agreement the party seeking arbitration asks the federal court to enforce."[6] The Supreme Court has explained 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."[7]

A contract need not contain an express delegation provision in order to satisfy the requirement that parties "clearly and unmistakably" delegate arbitrability questions to an arbitrator. As every court of appeals to consider the question has held, an agreement incorporating arbitration rules that themselves assign questions of arbitrability to the arbitrator, such as the rules of the American Arbitration Association (AAA), clearly and unmistakably indicates that the parties intend for an arbitrator, not the court, to resolve questions of arbitrability.[8]

Background and Procedural History

Henry Schein is a distributor of dental equipment; respondent Archer & White Sales distributes, sells and services dental equipment. In 2012, Archer filed suit against Henry Schein and other defendants in the United States District Court for the Eastern District of Texas, alleging antitrust violations involving a conspiracy to boycott respondent and to restrict respondent's sales territories under certain distribution agreements.

Henry Schein moved to compel arbitration based on Archer's distribution agreements with manufacturing companies, which prescribed that "[a]ny dispute arising under or related to this Agreement (except for actions seeking injunctive relief and disputes relating to trademarks, trade secrets or other intellectual property of [the manufacturing company]) shall be resolved by binding arbitration in accordance with the arbitration rules of the American Arbitration Association." The district court denied the motion, ruling that any reading of the arbitration clause indicating that the parties had agreed to arbitrate the question of arbitrability was "wholly groundless."[9] The Fifth Circuit Court of Appeals affirmed, explaining that, "[i]f an assertion of arbitrability [is] wholly groundless, the court need not submit the issue of arbitrability to the arbitrator."[10] Last year, the Supreme Court unanimously vacated the Fifth Circuit's decision, holding that the "wholly groundless" exception to the enforceability of agreements to arbitrate questions of arbitrability is inconsistent with the Arbitration Act. The Court remanded the case to the Fifth Circuit to decide whether the parties had in fact delegated the question of arbitrability—*i.e.*, whether the claims fell within the scope of the arbitration clause—to the arbitrator.

On remand, the Fifth Circuit once again affirmed the district court's denial of the motion to compel arbitration. The Fifth Circuit acknowledged that the arbitration agreement's incorporation of the AAA rules "presents clear and unmistakable evidence that the parties agreed to arbitrate arbitrability." But the court reasoned that the carve-out in the agreement for claims for injunctive relief meant that the AAA rules—including the rule authorizing an arbitrator to resolve questions of arbitrability—did not apply to actions in which the complaint requested injunctive relief, including this action.[11]

Following the Fifth Circuit's decision, the district court lifted the stay of proceedings pending appeal and scheduled a trial. Represented by Paul, Weiss, Henry Schein successfully sought a stay from the Supreme Court of the lower-court proceedings pending the filing of a petition for certiorari. After obtaining the stay, Henry Schein filed its petition. Archer & White filed a cross-petition for certiorari, seeking review of two separate questions. On June 15, 2020, the Supreme Court granted Henry Schein's petition and denied Archer & White's cross-petition.

Issue Presented

The question presented at the Supreme Court is "whether a provision in an arbitration agreement that exempts certain claims from arbitration negates an otherwise clear and unmistakable delegation of

questions of arbitrability to an arbitrator." There is currently a conflict of authority among federal and state appellate courts on this question. In the decision under review, the Fifth Circuit joined the Second Circuit and the Delaware Supreme Court to hold that the presence of a carve-out provision requires the court to determine whether the claims sought to be arbitrated fall inside or outside of the carve-out before delegating questions of arbitrability to the arbitrator.[12]

By comparison, the Ninth Circuit and the Kentucky Supreme Court[13] have determined that, if an arbitration agreement unmistakably delegates questions of arbitrability to an arbitrator, the presence of a carve-out provision does not undermine the delegation.

Henry Schein argued in its petition that the Fifth Circuit's decision conflated the question of who decides arbitrability with the question of whether the dispute is arbitrable—questions that are analytically distinct. Henry Schein explained that the court of appeals' approach threatens to render even the clearest and most unmistakable delegation ineffective, because no matter how plain the contractual language, a court confronted with a carve-out provision would need to determine whether the dispute was arbitrable before determining whether to send the question of arbitrability to the arbitrator. Such an approach, Henry Schein argued, violates the usual presumption that questions concerning the scope of arbitrable issues should be resolved in favor of arbitration.

A decision is expected by June 2021.

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This memorandum is not intended to provide legal advice, and no legal or business decision should be based on its content. Questions concerning issues addressed in this memorandum should be directed to:

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1 No. 19-963.

2 9 U.S.C. § 2.

3 *Volt Info. Scis., Inc.* v. *Bd. of Trustees of Leland Stanford Junior Univ.*, 489 U.S. 468, 474 (1989) (citation omitted).

4 *Rent-A-Center, W., Inc.* v. *Jackson*, 561 U.S. 63, 68–70 (2010).

5 *First Options of Chi., Inc.* v. *Kaplan*, 514 U.S. 938, 944 (1995).

6 *Henry Schein, Inc.* v. *Archer & White Sales, Inc.*, 139 S. Ct. 524, 529 (2019) (citation omitted).

7 *Id.* at 530.

8 *See, e.g.*, *Belnap* v. *Iasis Healthcare*, 844 F.3d 1272, 1283–84 (10th Cir. 2017) (collecting cases); AAA Commercial Rule R-7.

9 *Archer & White Sales, Inc.* v. *Henry Schein, Inc.*, 2016 WL 7157421, at *9 (E.D. Tex. Dec. 7, 2016).

10 *Archer & White Sales, Inc.* v. *Henry Schein, Inc.*, 878 F.3d 488, 495 (5th Cir. 2017) (internal quotation marks omitted).

11 *Archer & White Sales, Inc.* v. *Henry Schein, Inc.*, 935 F.3d 274, 279, 283–84 (5th Cir. 2019).

12 *See James & Jackson, LLC* v. *Willie Gary, LLC*, 906 A.2d 76, 81 (Del. 2006); *NASDAQ OMX Group, Inc.* v. *UBS Secs., LLC*, 770 F.3d 1010, 1031–32 (2d Cir. 2014).

13 *See Oracle Am., Inc.* v. *Myriad Grp. A.G.*, 724 F.3d 1069, 1076–77 (9th Cir. 2013); *Ally Align Health, Inc.* v. *Signature Advantage, LLC*, 574 S.W.3d 753, 756–58 (Ky. 2019).