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JANUARY 15, 2019

Supreme Court Rejects the "Wholly Groundless" Exception to Arbitrators Determining Arbitrability

On January 8, 2019, the U.S. Supreme Court addressed the question of who should decide whether a dispute belongs in arbitration or in court, unanimously holding in *Henry Schein, Inc. v. Archer & White Sales, Inc*. that when a contract clearly and unmistakably delegates the issue of arbitrability to an arbitrator, the arbitrator—rather than the court—must resolve the threshold question of arbitrability, even if the argument that the dispute is subject to arbitration appears wholly groundless. In doing so, the Court rejected the "wholly groundless" exception applied by the Fourth, Fifth, Sixth, and Federal Circuits as inconsistent with the Federal Arbitration Act.

Those courts relied on the "wholly groundless" exception to block frivolous attempts to transfer disputes from the court system to arbitration. As explained by the Federal Circuit in *Qualcomm Inc. v. Nokia Corp.*, 466 F.3d 1366, 1371 (Fed. Cir. 2006):

> If … the court concludes that the parties to the agreement did clearly and unmistakably intend to delegate the power to decide arbitrability to an arbitrator, then the court should perform a second, more limited inquiry to determine whether the assertion of arbitrability is "wholly groundless." … If the court finds that the assertion of arbitrability is not "wholly groundless," then it should stay the trial of the action pending a ruling on arbitrability by an arbitrator. If the district court finds that the assertion of arbitrability is "wholly groundless," then it may … deny the moving party's request for a stay.

In striking down the "wholly groundless" exception, the Supreme Court reaffirmed the strong federal policy in favor of arbitration and the rule that the court must enforce an arbitration agreement as written—even if the court thinks that the claim of arbitrability is without merit.

But while *Schein* resolved a circuit split over the validity of the "wholly groundless" exception, the Court declined to reach a related issue with far-reaching implications: whether merely incorporating a set of arbitral rules that contain a provision empowering a tribunal to determine its own jurisdiction "clearly and unmistakably" evinces the parties' intent to delegate the threshold issue of arbitrability to an arbitrator

in the first place. The *Schein* opinion left that contentious issue[1] to the Fifth Circuit on remand, potentially setting up a return trip to the High Court.

The "Wholly Groundless" Exception

Parties to a contract may agree to have an arbitrator, rather than a court, decide the threshold jurisdictional issue of whether a dispute is arbitrable—i.e., whether the merits of a dispute should be decided in arbitration or in court. Under the Federal Arbitration Act, courts must enforce the parties' contract as written—including such clauses delegating the "gateway" questions of arbitrability to an arbitrator.

As far back as the 1950s, however, some courts concluded that there is no obligation to order arbitration where "it is clear that the claim of arbitrability is wholly groundless."[2] The "wholly groundless" exception later gained traction in *Qualcomm*, when the Federal Circuit became the first court of appeals to adopt and apply that principle to exclude frivolous attempts to compel arbitration. The Fourth, Fifth, and Sixth Circuits quickly followed suit, while the Tenth and Eleventh Circuits declined to adopt the exception, setting up the circuit split.

Schein v. Archer & White

In *Schein*, the relevant contract between the parties provided that "[a]ny dispute arising under or related to this Agreement (*except for actions seeking injunctive relief* …), shall be resolved by binding arbitration in accordance with the arbitration rules of the American Arbitration Association." When Archer & White sued Schein alleging violations of federal and state antitrust law, seeking both money damages and injunctive relief, Schein invoked the Federal Arbitration Act and asked the district court to refer the parties' antitrust dispute to arbitration. Archer & White objected, arguing that the dispute was not subject to arbitration because its complaint sought—at least in part—injunctive relief. Schein, meanwhile, took the position that by incorporating the AAA's rules, the arbitrator, not the court, had to decide whether the arbitration agreement applied to the parties' particular dispute. In response, Archer & White argued that in cases where the defendant's argument for arbitration is wholly groundless, the court may resolve the threshold question of arbitrability and further asserted that Schein's arbitration argument was wholly groundless because Archer & White sought injunctive relief in its complaint.

Relying on Fifth Circuit precedent, the district court sided with Archer & White, recognizing the "wholly groundless" exception, finding Schein's argument for arbitration was indeed wholly groundless, and denying Schein's motion to compel. The Fifth Circuit affirmed.

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1 As explained in leading arbitration scholar George Bermann's amicus brief, "A majority of courts that have addressed the issue of whether the presence of competence-competence language in the arbitral rules adopted by the parties constitutes a proper delegation to the arbitrator have concluded . . . 'that the express adoption of [the AAA Rules] presents clear and unmistakable evidence that the parties agreed to arbitrate arbitrability.' However, none of these decisions provides any reasoning whatsoever as to how or why incorporation of such arbitral rules meets the clear and unmistakable evidence test." Notably, the ALI Restatement of the U.S. Law of International Commercial and Investor-State Arbitration, for which Bermann serves as chief reporter, has taken the opposite position of the judicial majority.

2 *McCarroll v. Los Angeles County District Council of Carpenters*, 315 P.2d 322, 333 (Cal. 1957); *see also, e.g.*, *American Stores Co. v. Johnston*, 171 F. Supp. 275, 277 (S.D.N.Y. 1959) ("When it appears that a claim of arbitrability is frivolous or patently baseless it would be an abuse of the arbitration process and would defeat the contractual intent of the parties to compel arbitration.").

After granting cert to address the circuit split over the "wholly groundless" exception, the Supreme Court reversed, relying on both the text of the Federal Arbitration Act and the Court's prior precedent. The Court first reasoned that under the express language of the Federal Arbitration Act, arbitration is a matter of contract, meaning that parties may contractually agree to have an arbitrator decide not only the merits of a particular dispute but also "gateway" questions of arbitrability. Moreover, the Federal Arbitration Act does not contain an express "wholly groundless" exception. In addition, the Court looked to prior precedent (*AT&T Technologies Inc. v. Communications Workers*, 475 U.S. 643, 649–650 (1986)), where it held that a court does not have authority to rule on the potential merits of an underlying claim that is assigned by contract to an arbitrator, even if it appears frivolous. Analogously, the Court reasoned, a court should not weigh in on the merits of "gateway" arbitrability questions, even if apparently frivolous.

The Supreme Court also dismissed Archer & White's policy arguments—that abrogating the "wholly groundless" exception and sending the arbitrability question to an arbitrator would waste time and money and that the exception is necessary to deter frivolous motions to compel arbitration. According to the Court, allowing for continued application of the exception would not save time or money because the exception would inevitably spark collateral litigation over whether an unmeritorious argument for arbitration is *wholly* groundless, as opposed to just groundless. Further, the exception is not a necessary deterrent because arbitrators are fully capable of efficiently disposing of frivolous claims by quickly ruling that a claim is not arbitrable.

Schein Redux?

While resolving the circuit split regarding the "wholly groundless" exception, the *Schein* Court declined to resolve the underlying question of whether parties "clearly and unmistakably" demonstrate their intent to delegate the arbitrability of a dispute to an arbitrator by incorporating arbitral rules that allow an arbitral panel to determine its own competence to hear a dispute. If such "clear and unmistakable" intent is lacking in the first place, then the general rule that the question of arbitrability is for judicial determination still applies. The Supreme Court in *Schein* "express[ed] no view about whether the contract at issue in this case in fact delegated the arbitrability question to an arbitrator [by incorporating AAA rules]." The Court did, however, flag that issue on remand for the Fifth Circuit, potentially setting up another showdown before the Supreme Court in the not-so-distant future.

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