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Arbitrability in the US, UK, and Continental Europe

Justice Kavanaugh's first opinion on the Court reminds us what to be mindful of in the New Year – Reading the contract

Newly minted Justice Brett M. Kavanaugh issued his first opinion from the bench of the United States Supreme Court on Tuesday, January 8, 2019. *HENRY SCHEIN, INC., ET AL. v. ARCHER & WHITE SALES, INC*, 586 U. S. ____ (2019) is a case on the gateway question of arbitrability under the Federal Arbitration Act.

We want to take a moment to consider the competence-competence of arbitral panels and compare the US approach with that of the UK. In short, competence-competence enables arbitral panels to rule on their own jurisdiction and thereby declaring themselves competent to hear a case (known as the *positive effect*). On a more disputed note, this concept may also serve to restrict access to ordinary courts of law and grants primacy (or at least priority) to arbitral panels for the ruling on arbitrability (known as the *negative effect* of competence-competence, sometimes referred to as the "chronological priority" for the tribunal).

The case at hand arose from a lawsuit in the 5th Circuit. Respondent Archer & White Sales, Inc., sued Petitioner Henry Schein, Inc., alleging violations of federal and state antitrust law and seeking money damages and injunctive relief. The contract between the parties provided for arbitration and included a common carve-out for injunctive relief. Invoking the Federal Arbitration Act, Schein asked the District Court to refer the matter to arbitration, but Archer & White argued that the dispute was not subject to arbitration because its complaint partly sought injunctive relief. Petitioner Schein contended that since the rules governing the contract delegates questions of arbitrability to an arbitrator, not the District Court but an arbitral panel should decide whether the arbitration agreement applied. Respondent countered that Petitioner's argument for arbitration was "wholly groundless" and the court should resolve the gateway arbitrability question. The District Court agreed with Respondent Archer & White and denied Schein's motion to compel arbitration. The Fifth Circuit affirmed.

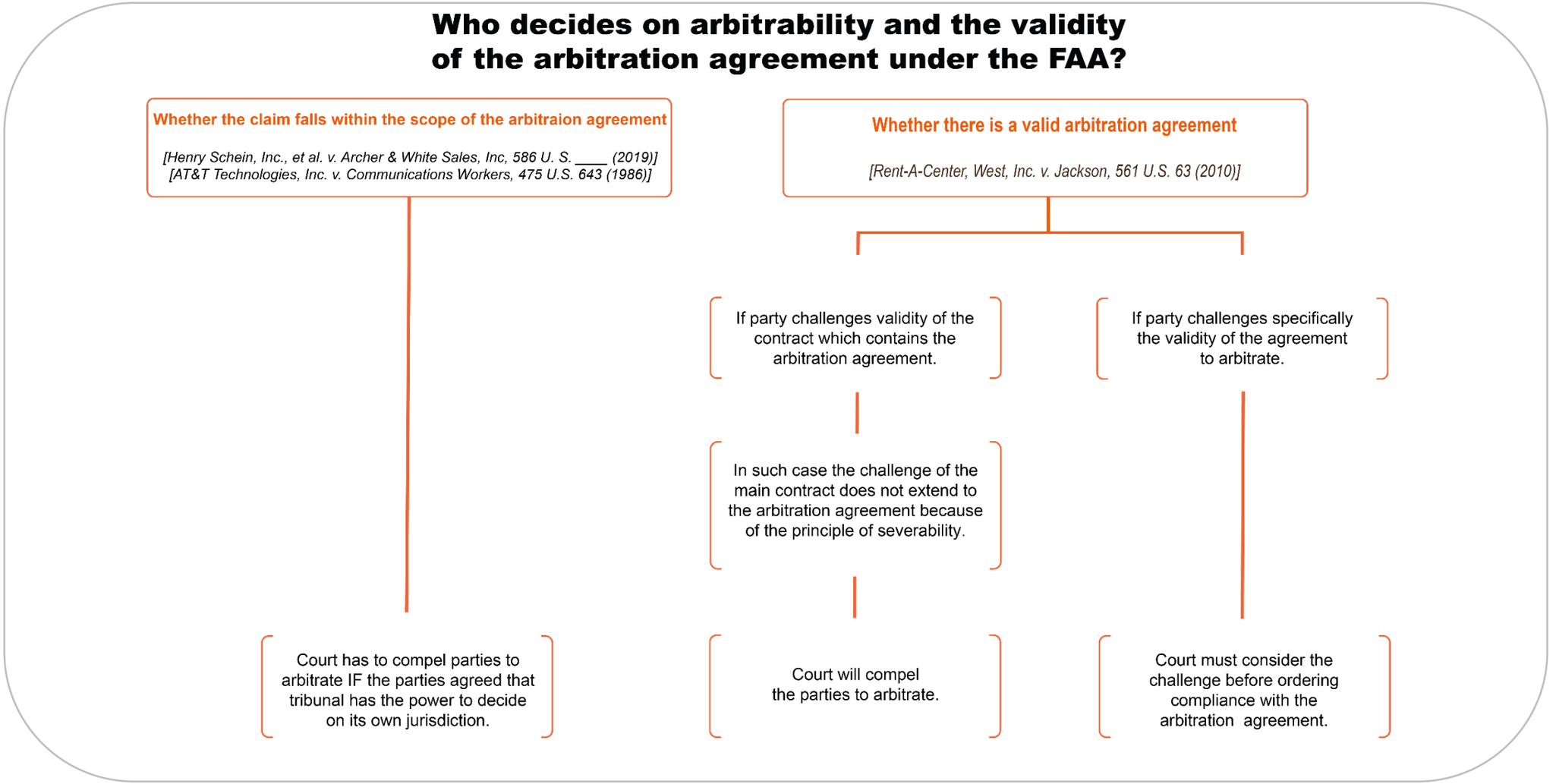
On petition by Schein, SCOTUS vacated and remanded, with the Court holding the "wholly groundless" exception to arbitrability inconsistent with the Federal Arbitration Act and the Court's precedent. The Court reiterates that under the FFA, arbitration is a matter of contract, so courts are generally bound to enforce arbitration contracts according to their terms. Thus, in a setting such as this a court may not override the contract, even if the court thinks that the arbitrability claim is wholly groundless, when the parties' contract delegates the arbitrability question to an arbitrator, see *AT&T Technologies, Inc. v. Communications Workers*, 475 U. S. 643, 649– 650 (1986). Note that the Court left it to the Fifth Circuit Court of Appeals to decide on remand whether the applicable clause actually delegated the arbitrability question to an arbitrator.

The Court's decision is unsurprising, further manifesting the primacy of arbitration in the United States. The parties may not "create" their own exceptions to the Federal Arbitration Act such as the "wholly groundless" exception. Arbitrability, or the question of whether arbitration is proper, lies with the arbitrators and as such is built firmly on the competence-competence of the arbitrator as long as this *was contracted for*. This is the central question of fact, here left to the Court of Appeals to decide on remand. Contracting parties must express their intent to delegate questions of arbitrability to an arbitrator "clearly and unmistakably," see *AT&T Technologies, Inc. v. Communications Workers*, 475 U.S. 643, 649; *First Options of Chicago v. Kaplan*, 514 U.S. 938 (1995). Otherwise the determination is left to the courts. This may from time to time be a high burden to meet and clear language in the governing contract is key for foregoing disputes on this issue. That said, US courts tend towards finding in favor of such intent.

This issue is altogether distinct from the more profound question of whether an arbitration clause and the contained delegation is itself valid. This issue is discussed at length in late Justice Scalia's opinion in *Rent-A-Center, West, Inc. v. Jackson*, 561 U.S. 63 (2010). The applicable law is § 2 of the FAA. According to *Rent-A-Center*, there are two types of validity challenges under § 2: "One type challenges specifically the validity of the agreement to arbitrate," and "[t]he other challenges the contract as a whole, either on a ground that directly affects the entire agreement (e.g., the agreement was fraudulently induced), or on the ground that the illegality of one of the contract's provisions renders the whole contract invalid." *Id*. at 70. This distinction outlines the following rule: "If a party challenges the validity under § 2 of the precise agreement to arbitrate at issue, the federal court must consider the challenge before ordering compliance with that agreement under § 4." Therefore, federal courts "must consider" challenges to delegation provisions "before ordering compliance with [such provisions]." *Id*. at 71 (for a recent example, see *Minnieland Private Day Sch., Inc. v. Applied Underwriters Captive Risk Assurance Co.*, 867 F.3d 449 (2017)).

That is because of the principle of severability, "only the first type of challenge is relevant to a court's determination whether the arbitration agreement at issue is enforceable." *Rent-A-Center* at 71. FAA § 2 states that a "written provision" "to settle by arbitration a controversy" is "valid, irrevocable, and enforceable" *without mention* of the validity of the contract in which it is contained. Thus, a party's challenge to another provision of the contract, or to the contract as a whole, does

not prevent a court from enforcing a specific agreement to arbitrate. In case the party challenges the entire contract or a different provision, the dispute does not settle on the validity of the delegation to arbitration alone. Consequently, such a challenge of validity would be subject to arbitration. Accordingly, unless a party challenged the delegation provision specifically, the court will treat it as valid under § 2, and "must enforce it under §§ 3 and 4, leaving any challenge to the validity of the Agreement as a whole for the arbitrator." *Id.* at 72.



Under English Law

In the UK, arbitration is regulated by the Arbitration Act of 1996. The Act expressly provides for the positive effect of competence-competence in Section 30(1).

> *Unless otherwise agreed by the parties, the arbitral tribunal may rule on its own substantive jurisdiction, that is, as to (a) whether there is a valid arbitration agreement; (b) whether the tribunal is properly constituted; and (c) what matters have been submitted to arbitration in accordance with the arbitration agreement.*

However, the case law in the UK is perhaps less clear on the issue and any indication of the negative effect of competence-competence had been rare until recently. In general, the English approach seemed to confer concurrent power on tribunals and courts to determine challenges to the arbitration agreements, see *Arbitration Act 1996*, § 32(4) and courts seemed less likely to delegate willingly.

A path towards a more arbitration friendly precedent has been laid since the decisions in *XL Insurance Ltd. v. Owens Corning* [2000] 2 Lloyd's Rep. 500, and *Fiona Trust & Holding Corp v. Yuri Privalov* [2007] EWCA Civ 20 (later *Premium Nafta Prods. Ltd. v. Fili Shipping Co. Ltd.* [2007] UKHL 40 in the House of Lords). In *Premium Nafta*, the House of Lords held that "the [Arbitration] Act contemplates that it will, in general, be right for the arbitrators to be the first tribunal to consider whether they have jurisdiction to determine the dispute," at 37. In *XL Insurance*, Justice Toulson found that the agreement to arbitrate was prima facie valid and deferred the final decision regarding the validity of the arbitration agreement to the tribunal stating that "under the arbitration clause and the provisions of the Act, it will be for the arbitral tribunal to rule on the validity of the arbitration agreement, if Owens Corning challenges its jurisdiction on that ground," at 509.

Under UNCITRAL Model Law

UNCITRAL Model Law explicitly deals with the relationship between the arbitration agreement and the resort to courts. In particular, Article 8 (1) provides as follows:

> *A court before which an action is brought in a matter which is the subject of an arbitration agreement shall, if a party so requests (…) refer the parties to arbitration unless it finds that the agreement is null and void, inoperative or incapable of being performed.*

It stems from this provision that the court can always decide on the issue of the arbitration agreements' validity (and arbitrability of the subject in dispute). It does not seem that the Model Law prevents the court from deciding on these matters, even if the parties' agreement clearly provides that the issue of the validity of the arbitration agreement itself is to be resolved by the arbitral tribunal.

This is different from the SCOTUS analysis in the cases cited above, based on which it is possible for the parties to agree, in a clear and unmistakable manner, that the arbitral tribunal is the one to decide the issue of arbitrability. When it comes to the validity of the agreement, this is more nuanced and depends on several further factors as we have seen in Justice Scalia's opinion in *Rent-A-Center*.

Conclusion

In the future and in light of ever-increasing globalization, one should expect the courts to continue to look to arbitral panels and increase willingness to delegate issues of arbitrability. A reminder to us all that careful drafting and reading of contracts is key in evaluating and preparing for risks connected to litigation in and out of court.

For more on SCOTUS future treatment of arbitration issues, we may look to decisions in this term's other arbitration cases (Lamps Plus v. Varela, Docket No. 17-988, and New Prime Inc v. Oliveira, Docket No. 17-340).

https://www.supremecourt.gov/opinions/18pdf/17-1272_7l48.pdf

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